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Cultural Impacts in Private Equity Deals

A case study of Dometic

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ABSTRACT

The thesis chronicles Dometic's different ownerships from 2001 up to a stock exchange listing in 2015, and analyzes the specific context that played a significant role in the contrasting approaches of private equity firms EQT and BC Partners. Through a case study I investigate the impacts of Swedish national values and characteristics as well as the private equity firms' values and principles on performance, leverage, and conduct of business. I find several cultural aspects that can have great implications in private equity deals, such as the level of transparency, communication with the unions, commitment to a local market, and choice of a CEO. Given that both private equity firms possess relatively the same experience and resources, I hypothesize that the divergent results can come down to the impacts of culture. Although this is a particular caste study and thus cannot test general theories, the study sheds light on the importance and implications of culture in private equity.

Keywords: Private equity, culture, trade unions, Sweden, case study

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1. Introduction

Not everything that can be counted counts. Not everything that counts can be counted.

- William Bruce Cameron

The above sign hung on a wall in Albert Einstein's office at Princeton University and fittingly expresses the role of soft topics in finance, such as human behavior, culture, and values. Quantitative aspects traditionally dominated the field, but with the arrival of behavioral economics and finance the discipline opened up to new research possibilities and insights, recognizing the importance of human factors. For instance, Ahern et al. (2015) list some of the impressive array of financial outcomes that are affected by cultural values, such as foreign direct investment, equity investment, and venture capital flows. This thesis deals specifically with the private equity (PE) industry, since it is strongly underpinned by human abilities. Cumming et al. (2007) argued that there is a need to understand the human capital expertise that successful PE firms require and Bain & Company stated in 2002 that the most important item on the private equity owner's agenda is finding the right leadership team to drive the business. Further research has subsequently explored the role of human capital in value creation in PE deals. Acharya et al. (2013) provide evidence that the superior performance of large, mature PE houses is at least partly due to differences in human capital factors.

Although the area of human factors has been studied, there is a scarce literature about culture per se in private equity. As a result, this thesis contributes to understanding the impacts of culture in the private equity environment. Given that the very notion of culture is fairly broad and the channels through which it can enter the economic discourse are so ubiquitous (Guiso et al., 2006), culture in this thesis is narrowed down to the national values of transparency, trust, and the role of unions, as well as to the individual PE firm values and principles. Since culture is invariably context-dependent, the best way to study the impacts is through a single case study.

In 2001, Electrolux decided to spin off its leisure products division and a new company, called Dometic, was thus formed. Dometic, which caters mainly to the mobile living industry (recreational vehicles, boats, trucks), would undergo three ownerships of PE firms (EQT and BC Partners), near bankruptcy, and an eventual listing on a stock exchange. Dometic serves as a great case because it allows to look at the cultural contrasts of the PE firms, study the specific context, and understand the impacts of culture. Furthermore, as the case spans a period of heightened interest in PE, representing both the boom in early 2000s and the financial crash of

2008, and of the subsequent criticism and increasing research into value creation and benefit to society, the conduct of the PE firms will be linked to the underlying theory and empirical findings to see whether previous research holds true in a particular case study.

I find several cultural impacts that manifested throughout Dometic's history with PE firms. First, transparency stood out as a clear trait of EQT and the Swedish business environment. Whereas EQT shared relatively rich amount of data, BC Partners was very secretive. Interestingly, in line with empirical findings about LBO firm transparency, EQT achieved a better operating performance at Dometic than BC Partners did. Second, trade unions, which play a characteristic and important role in Sweden, were involved in board communication under EQT's ownership, but not under BC Partners'. Third, reputational considerations can have great implications for sticking to an investment in a local market, as PE firms need to consider the relations with lenders for future financing and with industry managers for future deals. Last but not least, the choice of a CEO was rather inconsistent with BC Partners' values.

Even though findings from the case cannot be used to test general theories, they provide unique insights. EQT seems to have a stronger culture than BC Partners, and seems to have better understood the cultural intricacies in Sweden. Perhaps as result, EQT achieved better operating performance, used less leverage, invested in R&D, and collaborated with the unions.

1.1 Scope

The main purpose of the thesis is to understand the impact of culture during the time Dometic was in PE ownership, analyze the company's financial performance, and discuss the possible implications. The aim is to use a real case, with first-hand insights from important stakeholders, in order to see whether cultural context and actual behavior of the firms conform to empirical findings. The secondary purpose is to provide the Department of Finance at the Stockholm School of Economics with a foundation to develop a case study suitable for learning purposes. Accordingly, the scope of the thesis reflects this purpose as it considers a broad theoretical background and a detailed description of the case.

1.2 Outline

Section 2 provides theoretical framework and reviews empirical findings. Section 3 explains the applied methodology and its limitations. Section 4 establishes the case background. Section 5 presents and analyzes the case. Section 6 discusses the case findings and implications. Section 7 concludes.

2. Theoretical and Empirical Foundation

In this section, I briefly present theories, empirical findings in previous literature and industry participant views about private equity, the role of culture, and the specific context applicable for the case study.

2.1 Private equity

2.1.1 Introduction to private equity

In the broadest terms, private equity is a form of investment into companies that are not publicly listed. These companies can be either early-stage (start-ups) or mature. The former is usually classified as venture capital, whereas the latter as private equity. In this thesis, private equity is defined as equity investments in mature companies, and exclude venture capital. Further, since buying large, mature companies almost invariably encompasses using small portion of equity and huge portion of debt, private equity is often referred to as leveraged buyout (LBO), and the two terms will be used interchangeably throughout this thesis.

In 2016, total capital raised globally in the industry was \$589 billion, marking a forth consecutive year of more than \$500 billon raised annually, according to Bain & Company. Data from Preqin further underlie the importance of private equity, with asset under management in 2015 standing at \$2.4 trillion and dry powder[1] reaching a high of \$755 billion. The aggregate value of buyout transactions in 2015 reached \$411 billion. In light of the enormous amounts, private equity has risen to prominence in the past two decades, experiencing booms and busts, and attracting increasing research and criticism along the way.

In his seminal work on the then-emerging new area of finance, Jensen (1989) argued that the new organizational innovation (private equity) would eclipse the public corporate organization form as it clearly benefits shareholders and the economy through the PE firm's use of active ownership, well-aligned incentives, and more efficient capital structure. PE firms typically apply three sets of changes to the firms in which they invest (portfolio companies): financial, governance, and operational engineering (Kaplan, Strömberg, 2009). Gompers et al. (2016) further describe these value-enhancing actions. Financial and governance engineering aims to harness the classical agency problem discussed by Jensen (1986). By providing strong equity incentives to the management of a portfolio company, where management is often required to make substantial investment in the company along the PE firm, there is both a

[1] Available, non-deployed capital that was committed to a fund.

tremendous upside and downside. In addition, since the company is private, the equity is illiquid and management thus cannot sell its equity stakes or exercise its options until the value is vindicated by an exit transaction (Kaplan, Strömberg, 2009). Leslie and Oyer (2008) document that executive incentives at PE-backed companies are much stronger than at comparable publicly traded companies.[2] The other component of financial engineering is leverage, which, apart from amplifying the returns, puts pressure on the management not to waste money in light of the high interest and principal payments. Financial leverage, often criticized and traditionally quoted as the driver of value in the industry, has been a hallmark of private equity and will be discussed throughout the thesis. Last but not least, governance engineering entails controlling the boards of portfolio companies more closely and actively than boards of public companies. For example, Acharya et al. (2013) provide evidence that portfolio company boards meet more frequently, the owners are more engaged in governance, and early and frequent replacements of ineffective management are common. The active ownership from PE firms might be partly due to their focus on continual measuring of key performance metrics, which is one of the fortes of private equity.

While the three engineering actions are not mutually exclusive, some firms do prefer to focus on one of these drivers of value. Traditionally, leverage was deemed the major driver (see Jensen, 1989), but in the past two decades the trend has moved towards operational engineering, which is the industry and operating expertise that PE firms apply to add value to their investments (Kaplan, Strömberg, 2009). The operational-value infrastructure differs across firms. Some rely solely on external advisors as they lack internal operating capabilities, some hire industry generalists and functional specialists at the partner level, and some go as far as to create whole in-house operating teams (2012 Private Equity Report, BCG). Empirical work has shown that most of the value created in PE come from operational improvements. Butler (2001) shows that two-thirds of value in a sample of LBOs were attributed to operational improvements, Cohn and Towery (2013) present consistent evidence of improvements in operating profitability for a sample of U.S. buyouts in the 1990s and 2000s, and Acharya et al. (2013) provide evidence that higher abnormal performance in the portfolio companies is associated with a stronger operating improvement in all operating measures relative to quoted peers.

[2] The highest paid executive at a PE-owned firm owns approximately twice as large a share of the firm, earns about 12% less in base pay, and receives a substantially larger share of his cash compensation through variable pay.

In summary, the literature largely confirms that PE firms create or unlock value in their portfolio companies through strong incentives, active ownership, and operational improvements. Yet, previous research has been scarce when it comes to cultural impacts on performance and leverage.

2.1.2 Private equity in Sweden

Private equity represents a significant part of the Swedish financial industry and the whole economy. In 2007, Sweden had the world's third highest PE investments as a percentage of GDP (EVCA homepage, March 2007). According to SVCA[3] (2015), in 2013, PE-backed companies generated a total revenue of SEK 318 billion, which was 8.4% of the Swedish GDP. There were 190 983 employees in the PE portfolio companies, representing 4.1% of the Swedish workforce. Importantly, these companies outperformed public comparables in terms of job creation, which is contrary to the popular narrative about PE's reckless job destruction (see for example CNNMoney, 2007; The Economist, 2012). Furthermore, Olsson and Tåg (2012) find that unemployment risk declines and labor income rises for employees in the wake of a private equity buyout in Sweden, and Bergström et al. (2007), who study buyout performance in Sweden, find that employment and wage levels in the buyout companies have developed in line with the peer groups. Therefore, there is no indication that PE investments lead to job destruction in Sweden. Perhaps unsurprisingly, in light of these results, the stance of unions in Sweden towards PE firms is generally very positive. We will relate to these findings in the case study in sections V and VI.

The SVCA analysis further finds that the PE-backed companies outperformed the whole Swedish economy and other peers in terms of revenue growth, having a CAGR of 16% versus 3% and 12%, respectively, in the studied period 2005–2014. Regarding operating impact of the Swedish buyout segment, Bergström et al. (2007) look at EBITDA margin, ROIC[4] and sales growth for the buyout companies and find significantly positive development for all three operating statistics. Both findings are line with Bernstein et al. (2010), who find that industries where PE funds have been active in the past five years (up to 2007) grow more rapidly than other sectors, whether measured by total production, value added, total wages, or employment. In light of these results it seems that the PE segment is a major driver of employment and value growth in Sweden, which shall ultimately translate into a value added for the society. The

[3] SVCA is the Swedish branch of Invest Europe (formerly EVCA), a European private equity and venture capital association

[4] EBITDA = earnings before interest, taxes, depreciation and amortization; ROIC = return on invested capital

general perception of PE among the Swedish community is quite indicative. Mats Odell, minister for financial markets from 2006 to 2010, expressed this view: "*There is an exaggerated fear that private equity contains big systemic risks. It is not private equity or hedge funds that caused this crisis, but they are the big problem in some countries... Sweden is not a superpower that can impose its views on others. But we try to be based on facts. And if you look at the facts, it is very hard to say that private equity and hedge funds caused this crisis. That is not to say we should not regulate them, but we should not kill the industry*" (The Economist, 2009).

2.2 Cultural aspects

2.2.1 The value of culture

Guiso, Sapienza and Zingales (2006) define culture as *those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation*. In this thesis, cultural aspects pertain to both the macro level, i.e. national values, beliefs and characteristics, and the micro level, i.e. firm values and principles. The reason is that the firm-specific values can be ultimately influenced by national values, and both levels can have a huge value in the private equity industry.

On a macro level, the business environment in a country and its development can be largely determined by cultural values, such as trust, respect, and understanding. The role of trust in an economic development has been studied for example by Knack and Keefer (1997), who find that a country's level of trust is indeed correlated with its rate of growth, by Knack and Zak (2001), who show that low trust environments reduce the rate of investment, and by Bottazzi et al. (2016), who find that venture capitalists are more likely to invest in start-ups of countries they trust more. Since financing is an exchange of money today for a promise to return it, with an interest, in the future, the main prerequisite for the transaction to happen is not only the trust between the financier and financee, but also the enforceability of contracts. Therefore, trust is important both on the level of individuals in the country and on the level of institutions. In *Why Nations Fail* (2012), Daron Acemoglu and James Robinson show that man-made political and economical institutions, which are either inclusive or extractive, underlie economic success and can explain the huge differences in prosperity between nations around the world (e.g. North and South Korea). The level of financial development (and hence the rise of private equity) and economic prosperity is greatly affected by social capital (see for example Guiso, Sapienza, and Zingales, 2004), of which trust is a key part.[5]

The area of culture on a micro level has also attracted increasing research. Social capital is ultimately made up of human factors, and these factors transcend into business conduct. The link between corporate culture and firm behavior and performance was studied for example by Deal and Kennedy (1982), and Cameron and Quinn (1999) argue that almost every successful company has a distinctive, readily identifiable corporate culture. Studying the value of corporate culture, Guiso et al. (2015) find that high levels of perceived integrity are positively correlated with good outcomes, in terms of higher productivity, profitability, better industrial relations, and higher level of attractiveness to prospective job applicants. Sørensen (2002) also shows that strong-culture firms have more reliable or consistent performance in relatively stable environments, though the benefits disappear in volatile environments. Corporate culture represents the organization's beliefs, values, and principles, which should inform the behavior of all its employees. Since it underlies everything the company does, it can have wide-ranging impacts. For instance, Bouwman (2013) documents that in mergers and acquisitions corporate culture can significantly influence individual and group behavior, and thus affect post-merger performance. She finds that cultural incompatibility between acquirers and targets is an important reason for merger failures. Furthermore, Ahern et al. (2015) find strong evidence that three key dimensions of national culture (trust, hierarchy, and individualism) affect merger volume and synergy gains. When it comes to individual characteristics, Malmendier and Tate (2005) also find that overconfident CEOs have higher investment cash-flow sensitivities and are more likely to engage in value-destroying mergers.

All of the above-mentioned factors can shape the firm-specific culture, which eventually leads to different processes, strategies, and outcomes. Acharya et al. (2013) present evidence that the combinations of value creation strategies and partner backgrounds correlate with deal-level abnormal performance in private equity deals. The authors show that operating partners (ex-consultants, ex-industry-managers) outperform for organic strategies, whereas finance partners (ex-bankers, ex-accountants) outperform for inorganic strategies, such as M&A. Interestingly, Gompers et al. (2016) explore whether PE firms follow particular strategies and find that firms whose founders have a financial background tend to focus more on financial engineering, whereas those with a background in private equity or operations tend to focus more on operational engineering. In conclusion, culture, both country- and firm-specific, has a

[5] *The highest form a civilization can reach is a seamless web of deserving trust* – Charlie Munger

profound impact on the interactions between market participants and the way they conduct business. Since private equity is a human capital-intensive industry, culture can be one of the key determinants of performance.

2.2.2 The Swedish way

When it comes to social capital, Sweden is one of the most developed countries in the world. According to Reputation Institute, which measures annually the reputation of 55 countries based on levels of trust, esteem, admiration and respect through on an online panel of more than 48,000 people representing the G8 countries, Sweden came up first in 2016. In a different survey, Guiso et al. (2006) also show that Sweden ranks very high on trust, second behind Japan. Strong elements of trust, cooperation and mutual understanding between employers and workers characterize the Swedish industrial relations system (Fahlbeck, 1999). Trust and transparency are indeed key pillars of the Swedish financial and political system. In fact, government information, including emails and letters to and from senior officials and ministers, is routinely made public. Characteristically, the focus on transparency aims to ground arguments in facts (The Economist, 2009), which also directly speaks to the nature of trade unions in Sweden, discussed in the next part.

On a company level, the Swedish corporate culture can strike outsiders as characteristic and different. First, the working atmosphere is rather relaxed and informal, with everyone addressing each other on a first-name basis. Second, and related to this informality, is the omnipresent and sacred “fika” break. Employees usually take around two or three coffee breaks during the work, which allows for an informal chat with colleagues and time off for energy boost. Practically everyone in Sweden takes summer breaks, where people do not fret about falling behind at work as is often the case in the US (Business Insider). Whereas in more formal cultures, such as US or UK, employees tend to be encouraged to stay in the office by being offered various perks (e.g. free breakfast and dinner), in Sweden the view is that people who are well rested are more productive. The “lagom” mentality perfectly underlies this. Another peculiar Swedish word, lagom means “just right” in the sense of focusing on doing exactly what’s needed and doing it well, rather than doing unnecessary things (Sweden.se). Finally, there is a shorter chain of organizational command. Swedish companies are less hierarchical and employees can usually take their comments directly to the boss. The implications of such an open culture, or rather the lack of, is best illustrated with the case of Nokia. Vuori and Huy (2016) find that the smartphone giant’s downfall had to do with the culture of temperamental leaders and fear of telling the truth[6], rather than the oft-quoted technical inferiority to Apple, complacency, and failure to see the disruptive iPhone coming.

2.2.3 Trade unions in Sweden

Sweden is characterized by a rather unusual role of trade unions in the business community and society at large. According to statistics from the OECD, in 2013, Sweden had the third highest union density (67%) among the member countries, surpassed only by Finland (69%) and Iceland (85%). Relevant to our case study, the UK's rate was only 25%. In the late 1990s, the Swedish density rate was well above 80%, but ever since has been declining. Still, the high rate of unionization in the country is quite outstanding and there are close to 3 million members (Swedish National Mediation Office, 2015). An important historical step was the Saltsjöbaden Agreement, a labor market treaty signed between the Swedish Trade Union Confederation and the Swedish Employers Association in 1938, which became a model for subsequent labor agreements and a norm that the two sides shall conclude agreements without interference by government (Wikipedia). Partly due to the powerful negotiation base and partly due the historical role of the unions, employers do not resist the trade unions. Rather, they view them as an integral part of a company and decide to work together.

The mutual beneficial cooperation between employers and unions rests on several foundations. First, unions have traditionally pursued a highly ideological agenda, where the goal was a transfer of the means of production to society. Consequently, unions have helped Sweden transform into a welfare state based on political and economic democracy and equality (Fahlbeck, 1999). All along the unions have forged good relations with the employer counterparts, adhering to the typical Swedish transparency. Second, pragmatism seems to be the mantra among the unions. The unions are liberal, open, and deeply rooted in facts and rationality. Such a stance is nicely expressed by Alexandar Zuza, an economist at IF Metall[7]: "*…nobody is helped by having people employed in companies that aren't viable. If you are not viable, you shouldn't survive… We are not protective of jobs at any cost. We have more of an*

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[6] Top managers were afraid of external competitors and shareholders, which lead them to exert pressure on middle managers. The middle managers, in turn, were afraid of top managers, who wouldn't hear to any negative news and regularly shouted at employees. Threats of firing or demotions were commonplace. Afraid to disappoint the top management, the middle managers often remained silent or provided optimistic, filtered information. As a result, top managers developed an overly optimistic perception of Nokia's technological capabilities and neglected long-term investments in developing innovation.

[7] One of the largest unions in Sweden, representing around 310 000 workers. Created through the merger of the metalworkers' and industrial workers' unions in 2006, it has members mostly in the metal, building component, textile and clothing industries.

idea of continuous development, always trying to move up the food chain" (The Economist, 2009). Upon interviewing Mr. Zuza myself, I was indeed struck by his pragmatism and positive outlook for the society: "*If it's a good owner, it's not much of a difference for us whether it's Swedish or foreign…regarding automatization in the car industry and the possible job destruction, I'm not worried, we will find a way to move ahead, as we did with cars after horse carriages.*" (17.3.2017). Last but not least, the unions see themselves as organizations with a mission, as the vanguards of a better society (Fahlbeck, 1999). They realize that they can help create and shape the society by leading their constituents towards a shared goal. As a result, disputes have been rare and a mutual respect between the unions and employers has been instilled.

The role of Swedish trade unions on company boards is also quite characteristic. Employees are represented on the boards of almost all companies with more than 25 employees. Usually, there are two or three employee members and they account for around one third of board members in most companies (worker-participation.eu). The board of directors usually makes the key strategic decisions and the company management then implements them. Since the unions have such a widespread access to boards, they have a say and can decide on important aspects. Following their pragmatic approach, the unions endorse PE firms if they see clear improvements, based on facts. The stance towards private equity investment in their representative companies is thus generally positive among the unions as they have seen no massive layoffs, but mostly production efficiency improvements (Alexandar Zuza, 17.3.2017), which is in line with Kaplan and Strömberg (2009). Mr. Odell added that the striking thing in Sweden during the financial crisis of 2008 was that trade union leaders would often say, in public, that their workers did better in firms run by private equity (The Economist, 2009).

3. Methodology

3.1 Empirical methodology

Despite a standard operating model, PE deals are inherently unique and complex. Moreover, the practitioners in the industry tend not to think in the framework of generally assumed theories: "*Ah yes, the Modigliani-Miller theorem. I learned about that in business school. We don't think that way at our firm. Our philosophy is to lever our deals as much as we can, to give the highest returns to our limited partners*" (Axelson et al., 2009). Further, few PE investors use discounted cash flow or net present value techniques to evaluate investments, and few use the capital asset pricing model to determine a cost of capital (Gompers et al., 2016). Therefore, case studies can be particularly well suited to study what private equity firms actually do in a real context, as opposed to what they are thought to do according to a theory. Dubois and Gadde (2002) argues that the fact that learning from a particular case is conditioned by the environmental context should be considered a strength rather than a weakness and that the interaction between a phenomenon and its context is best understood through in-depth case studies. Since the object of this thesis revolves around cultural values and impacts, I choose a qualitative case study for my methodology as it can best reflect the peculiarities associated with human decisions. Miller (1977) supports this choice: "*Given the complexities of the real-world setting, actual decision procedures are inevitably heuristic, judgmental, imitative and groping…On this score, has there ever been any doubt that the Harvard cases give a far more accurate picture of the way things really look and get done out on the firing line than any maximizing "model of the firm" that any economist ever drew?*"

The role of case studies as a scientific method has been challenged for example by Yin (2003). Weick (1979) stated that many pseudo observers seem bent on describing everything, and as a result describe nothing. The suggested solution to this problem is to invest in theory to keep some intellectual control over the burgeoning set of case descriptions (Dubois, Gadde, 2002). Therefore, the case study of this thesis will be linked to the underlying literature and ultimately aim to give rise to discussion about the possible implications. Siggelkow (2007) sums up the aim of this method: "*The main object of case studies should be to provoke thought and new ideas, rather than to poke holes in existing theories*."

3.2 Data collection

The name "private equity" already suggests that the field is quite secretive and information is mostly private. As a result, gathering data about PE firms and discovering some behind-the-curtain information is notoriously hard. For instance, Cohn et al. (2014) noted that the lack of public data for most private firms has remained an impediment to financial studies of LBO firms post-buyout. The authors bypassed the impediment by relying on confidential federal corporate tax return data in the US, where all corporations must file tax returns. However, I could not access such data for Sweden. Hence, public resources are the primary source of information in this thesis. In order to study the impacts of different ownerships on Dometic's performance, I used data from the S&P Capital IQ database, which covered Dometic's history starting 2001, and the Serrano database. Yet, figures for the period 2005–2007 are not fully available in either database. The only data available for all years is for Dometic's two subsidiaries, whose performance is presented in Appendix C. The lack of data will be discussed later as it might relate to cultural differences. Subsequently, I compared the data from the databases with data from Dometic's reports and Preqin, and found them fairly accurate. Two reservations must be pointed out, though. First, annual reports are not available for all the years. Second, the figures do not match exactly because of restatements, reclassifications and other accounting adjustments. The discrepancies are mostly insignificant and will be pointed out where applicable. Gathering all the data and putting it into a coherent whole proved to be a challenging puzzle, but it also served as a great lesson in investment analysis.

In order to get insider views, I contacted several persons who were involved in the case, but managed to get in touch with only two of them. Still, they provide unique insights and serve as a background check. The first one was Alexandar Zuza from IF Metall. As an economist at the trade union representing the workers at Dometic, Mr. Zuza experienced the ownership of both PE firms and had a lot to say in regard to the different approaches of the firms. The second one was Albert Gustafsson, a Partner at EQT in Stockholm. Given that Dometic was under his directorship, he provided first-hand information and interesting views.

There are limitations to the data collection. First, many stakeholders did not respond to the interview requests. Having more persons interviewed would undoubtedly contribute to a better accuracy. Second, even the interviewees could not share everything, which is apparent given the nature of private equity. Third, the data collected from public sources are limited and sometimes inconsistent. In spite of these limitations, the available data coupled with the interviews should suffice to form a clear picture of the case and to analyze the impacts of culture.

4. Case Background

The following section purports to provide the context in which Dometic underwent the major and contrasting ownership changes.

4.1 Dometic

4.1.1 History

Dometic's history dates back to the early 1920s, when two young Swedish engineering students at the Royal Institute of Technology in Stockholm designed what came to be known as the absorption refrigerator. While the concept of refrigerator itself had already been known prior to 1922, it was the way in which the cooling effect was produced that was revolutionary. In 1922 Baltzar von Platen and Carl Munters designed a cooling cabinet without the need for a then-standard compressor or ice (see Appendix D). The difference between the compressor refrigerator and absorption refrigerator was that the latter required only heat and no moving parts in order to provide the cooling effect. All that was required to produce the cooling was a source of heat, such as propane tank. The cooling cabinet became a worldwide success. Albert Einstein, in his famous patent office in Bern, called the invention a "stroke of genius" and the cabinet was granted a patent in 1923 (Dometic website).

Manufacturing rights were soon acquired by a Swedish company called Artic, but only until 1925, when Electrolux bought Artic. Electrolux, a rapidly growing Swedish appliance producer of vacuum cleaners, enjoyed a huge success with the new cooling cabinet, selling millions of units after the World War II when the product gradually became a mainstay in people's homes. Importantly, the United States saw a great post-war boom in the traveler and leisure industry. Mobile living, mainly through recreational vehicles (RV), precipitated a strong demand for the absorption refrigerators as there is usually no electrical current to come by on the road and the absorption technology thus becomes particularly useful. Capitalizing on the strong demand, Electrolux set its foot in the US market and by 1969 created a subsidiary called Dometic Sales Corporation, which would use the absorption technology to specialize on the mobile living industry.

Despite its success with the absorption technology, Dometic was still a small company and, in the early 1970s, losing money. A real breakthrough came by 1973, when Sven Stork took charge of the Electrolux's division. He expanded the product portfolio into the hotel minibar market and started growing the Dometic division through acquisitions, new product development, and geographic expansion. Importantly, his team decided to concentrate more closely on the RV market in general. Rather than mere selling of refrigerators, Dometic now aimed at the whole RV interior through new products such as air-conditioning, awnings, systems for cooking, lighting, sanitation, and water purification (see Appendix D). Mr. Stork explained the move: "*we decided to make the RV into something that you could really live in*." Dometic was no longer only about refrigerators, it was about RV interior systems and the formidable channel power gained by selling all its products through the same dealers and installers (Zook, 2011). Before long, Electrolux acquired Siegas Metallwarenfabrik in Germany in 1973, Duo-Therm Corporation (RV air conditioners) in the US in 1985, Origoverken (cookers and ovens for pleasure craft) in Sweden in 1986, A&E Systems (RV awnings) in the US in 1988, and Seitz (RV windows) in Germany in 2000. However, starting in 1997, Electrolux began to focus strategically on its core retail business, which was an increasingly prevailing business strategy of large corporations in the early 2000s. As a result, divisional buyouts, where big corporations sell off their divisions, accounted for 41% of global LBO transactions between 2000 – 2004, and were by far the largest source of deals in this period, jumping from 27% in the period 1995 – 1999 (Kaplan, Strömberg, 2009). Characteristically, in 2001, Electrolux decided to sell the assets of Dometic in a divisional buyout. The field of divisional buyouts and spin-offs has been a point of academic interest for a long time, recently investigated for example by Moschieri and Mair (2008), Semandi and Canella (2011), and Rubera and Tellis (2014). By and large, the result is that divisional buyouts tend to perform extremely well in the years after the divesture. What's more, they often represent a perfect target for financial buyers.

4.2 EQT

4.2.1 History

The idea to start EQT as a leading Nordic private equity firm was conceived by a group of five founders in a restaurant in Stockholm's Old Town in 1993. Inspired by and having close ties to the Wallenberg family, the founders wanted to build on the investment philosophy of the family and on the Nordic values of ownership and company development. The board of Investor AB, a Swedish investment company controlled by the Wallenberg family, green-lighted the concept and mandated Conni Jonsson to put a team together and start the firm. Thus, in 1994, EQT Partners was established in Stockholm. The owners in the new venture, together with Investor, were the Swedish bank SEB and AEA Investors, a pioneer of private equity in the US and one of the oldest PE firms, founded in 1968.

Legally, EQT Partners serves as the investment advisor to all of the firm's funds[8]. The first fund, EQT I, was launched in 1995 with a focus on Nordic buyouts and a committed capital of SEK 3.2bn. In 1998, EQT opened its first office outside of Stockholm, in Copenhagen, and SEB sold its shares in the venture to Investor and AEA Investors. The same year, EQT II was launched with a total committed capital of SEK 6.2bn; the fund still focused purely on Nordic buyouts. One year later offices in Helsinki and Munich were opened and EQT would gradually set up offices across the world, in Zurich, Frankfurt, Hong Kong, Oslo, Shanghai, New York, Warsaw, London, Singapore, and Madrid. In 2001, the partners from EQT acquired 33% of Investors' shares and in 2007 increased their ownership in EQT Partners to 69% with the rest being held by Investor.

EQT III was the first fund investing outside of the Nordic region. The fund still covered predominantly Northern Europe, but now had also portfolio companies in Germany. Notable investments included Carl Zeiss in Germany, Com Hem in Sweden, and, importantly, Dometic. Total committed capital reached €2bn; the fund was launched in 2001 and terminated in 2015. Given that a standard fund's life is 10 years, which can be extended by additional 3 years (Kaplan, Strömberg, 2009), EQT III was fairly unusual. Funds raised up until December 2011 were managed off-shore from Guernsey, but the firm then decided to move the domicile on-shore to the Netherlands, Luxembourg, and the UK. In 2014, Conni Jonsson became chairman of the board of directors and Thomas von Koch was appointed a new managing partner. As of 2016, EQT had a total of 8 realized funds, including the main one, EQT IV, and smaller ones (EQT Danmark, EQT Finland, EQT Exp Capital I, EQT EQT Credit I).

By 2017 the firm has 14 active funds with a total committed capital of around €28bn. Since its inception, EQT invested in over 170 companies and exited 84 (EQT, 7.5.2017). From the initial five founders, the firm grew to 480 employees in 14 countries across Europe, Asia, and North America. The portfolio companies under EQT generate €19bn in sales and employ 110,000 people. EQT has become one of the largest and most prominent PE firms in the world.

[8] PE firms are organized as partnerships or limited liability company. They raise equity capital through PE funds, and these funds are in turn organized as limited partnerships, where the general partners (PE firm) manage the fund and the limited partners provide most of the capital. Most of the funds are 'closed-end' vehicles, where the investors cannot withdraw their committed capital until the fund is terminated. For a detailed overview of private equity, see Kaplan and Strömberg (2009).

In terms of total funds raised in the last 10 years, EQT is the top PE firm in the Nordic region, followed by Nordic Capital and Altor (Preqin, 20.4.2017).

4.2.2 Investment approach and strategy

From the very beginning EQT resolved to have a long-term and responsible approach to ownership with an active engagement in its portfolio companies, consistent with the Wallenberg family values. Entrepreneurship and industrial approach were the core tenets behind EQT's philosophy and the driver behind a sustainable development in the firm's portfolio companies. By providing the companies with its operational expertise, ownership skills, and financial shrewdness, EQT strives to make the acquired companies grow and prosper in the future. The long-term prosperity of the acquired company is indeed vital for a PE firm, for the better the company is positioned in terms of operational performance and growth prospects, the higher the exit multiple a PE firm will be able to sell it for. Given that PE firms have a pre-set time frame and rely heavily on favorable exit options, developing the companies into sustainable businesses is a major driver of returns. Accordingly, EQT invests only in good companies where it can consistently apply its industrial approach, access to specialist expertise, and a growth strategy, and thus build and bring a strong company to future owners. As EQT claims that almost all of its returns are attributed to operational improvements, it seems that out of the three sets identified by Kaplan and Strömberg (2009), EQT focuses primarily on operational engineering. Here a major competitive advantage of the firm is its "Industrial Network" consisting of more than 250 independent advisors, who possess relevant industry experience and skills, and help EQT achieve operational excellence and tackle strategic issues. In a way, EQT works as a car repairman and seller. First he finds good cars, then repairs them, putting in new engine, making it drive smoother, faster, and better, and later sell them to a new owner for a way higher price that what he bought it for. Importantly, the car needs be good and drivable, not lemons. Finding these overlooked good cars and jumpstarting them is the art of private equity.

There are three investment strategies within EQT: Private Capital, Real Assets, and Credit. EQT thus does not limit its investment reach to one single specialized area, but rather looks at sectors and companies where it can draw from its extensive industrial network and implement structural changes. Every strategy is focused on control or co-control investments (except for the credit funds, as they invest in debt), whereby EQT takes the owner role through its "Corporate Governance Model." As soon as a new company is acquired, EQT appoints its own board of directors with a chairman, who tends to be an advisor from its industrial network, together with sector specialists and the EQT partner responsible for the portfolio company. The model clearly stipulates the parties' roles and responsibilities. A key pillar of the model is the so-called Troika, consisting of the owner (EQT partner), board (chairman), and management (CEO). Throughout the investment all parties meet regularly and work together, ensuring that the owner is updated with the company's progress, which is paramount for a PE firm in order to accurately measure the key performance indicators, as discussed earlier. EQT's owner-centered approach to investing comes down to developing a strong, sustainable company ready to flourish even after EQT's ownership.

4.2.3 Culture and values

When establishing the firm, the name EQT stood for EQUITY, referring to the quality of being just, impartial, and fair, rather than to the classical financial term. Indeed, these qualities served as the basis for EQT's culture and investment approach. The heritage of the Wallenberg family clearly made its way into EQT's shared values of engaged and responsible ownership. It is interesting to compare EQT's advertised values with those studied by Guiso, Sapienza, and Zingales (2015), where the authors find that the most advertised value is innovation (mentioned by 80% of S&P 500 companies), followed by integrity and respect (70%). Indeed, all these values are also advertised on EQT's webpage, with entrepreneurial (*Innovation*), and respectful (*Integrity* and *Respect*), along with other five values: ambitious, high performing, industrial, informal, and transparent. Interestingly enough, upon interviewing Albert Gustafsson (3.4.2017), the values of integrity and respect also came to the front. He stressed out the importance of trust and reputation in the industry, saying that the vision for EQT is to be the most reputable firm in the world, not necessarily the most profitable one. Many economists, for example Knack and Kneefer (1997), have studied the role of trust in the economy, but private equity is particularly dependent on mutual trustworthiness and integrity. One of the major benefits of being trusted, which is EQT's mantra, is that such PE firm can readily secure financing from banks and lenders. Furthermore, echoing the typical Swedish value of transparency, Mr. Gustafsson said that EQT strives to be as transparent as possible, sharing everything they can, and putting emphasis on employees as they play key role in the PE industry. With its focus on reputation, transparency, and responsible investing, EQT fittingly represents the "Swedish way."

4.3 BC Partners

4.3.1 History

The roots of BC Partners go back to the late 1980s when Barings, a then-renowned and one of the oldest merchant banks in the world, formed Baring Capital Investors to provide advise on management buyouts, at the time an emerging bonanza in the finance industry. Otto van der Wyck, who was also a co-founder of another huge PE house, CVC Capital Partners, started the firm in 1986 as Baring Capital Investors, with a head office in London. Nonetheless, after the collapse of Barings in 1995 following enormous losses from speculative investments made by Nick Leeson in Singapore, the principals of the firm initiated a spinout and BC Partners as a stand-alone PE firm was thus formed (Wikipedia).

From the beginning BC Partners specialized in buyouts, primarily in larger businesses in Europe and occasionally in North America. The firm has invested in high-profile investments, including Sanitec (largest LBO in Finland), Brenntag (second largest LBO in Germany), Intelsat ($16.6bn acquisition), Office Depot, and Com Hem. In 2005, the firm started its eight fund, which raised over €5.5bn, making it one of the largest European buyout fund at that time (BC Partners, 2005). The current fund, BC Partners IX, was raised in 2012 with a committed capital of €6.5bn. Since inception the firm has exited 93 investments with a total enterprise value of €115bn (BC Partners, 15.4.2017). Apart from the London headquarters, the company has set up offices in New York, Paris, and Hamburg, and employs around 50 professionals. Such a low number of professionals might come as a surprise, but PE firms have traditionally employed only few professionals relative to the size of the portfolio companies (Jensen, 1989; Kaplan and Strömberg, 2009). Overall, when analyzing the two private equity firms, I found BC Partners to be more secretive in terms of its website, history, information sharing, and advertised values. Therefore, there is less public information to form as accurate and comprehensive view of the firm as of EQT.

4.3.2 Investment approach and strategy

Since the beginning the firm has specialized in buyouts, mostly large cap companies. When analyzing potential investments, BC Partners looks for defensive growth characteristics, i.e. companies supposedly immune to market shocks and generally stable over the business cycles. The cornerstone of the firm is asset selection, in which it seeks to conduct rigorous due diligence and assess potential investment risks. Next step of the investment strategy is execution, where the firm boasts of winning attractive assets at entry, working with the management as an active shareholder, and maximizing returns at exit. The firm places a particular focus on earnings growth in its portfolio companies as a way to create value for its investors. Throughout its funds, the majority of value has been created from four factors: market growth, return on capital employed, increased operational efficiency, and synergies from mergers and acquisitions (BC Partners, 15.4.2017).

4.3.3 Culture and values

BC Partners does not advertise its values per se, as opposed to EQT. Instead, it lists its founding principles. Nevertheless, they can still be grouped into some of the 9 categories defined by Guiso, Sapienza, and Zingales (2015). The first one advertised on firm's website is a partnership approach, with senior executives wholly owning the firm. The approach ensures equal voting and majority consent. The partnership approach falls into the category of *Teamwork*. Second founding principle is intellectual honesty (*Integrity*), encompassing thorough and open discussion, assessment of merits, and balance of risk and reward. The remaining values are continuous learning (*Innovation*), ownership and responsibility (*Integrity*), and focus.

The firm also aims to pursue responsible investing in terms of environmental, social and governance factors. Apart from its own ESG policy, the firm has committed to the Principles for Responsible Investment, the United Nations-led framework for managers to incorporate the ESG issues in their decision making. Lastly, BC Partners devotes a section on its website to transparency, stressing out its aim to be open and timely in communication with all stakeholders. These values will be tested in section V.

5. The case: Dometic

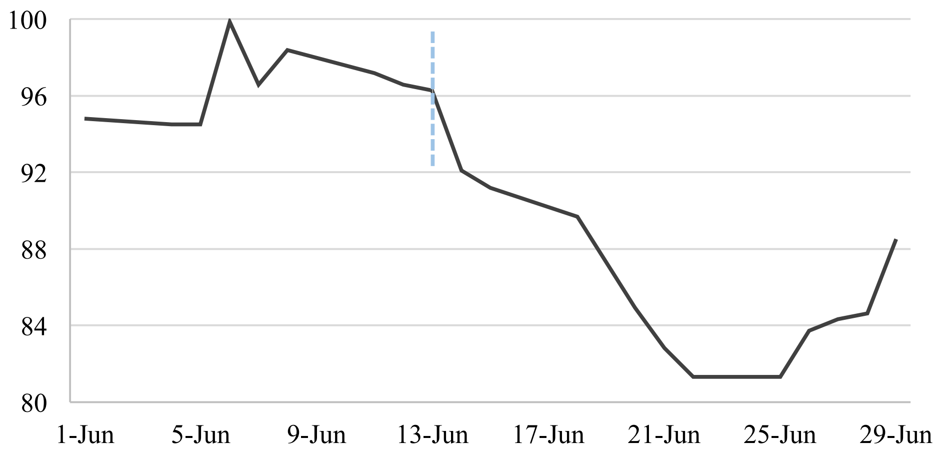
The following section provides a detailed timeline of Dometic's ownership and an analysis of its performance. The case purports to shed light on the different approaches of the PE firms and subsequently open an area for discussion.

5.1 Divisional buyout: EQT buys Dometic

For years Dometic operated independently within Electrolux, its parent company and a large home appliance manufacturer, under the name "Leisure Appliances," and had a particularly strong position in the US market. The division increasingly diverged from Electrolux businesses and there was a limited scope for smooth integration and efficiency with the other business units. Michael Treschow, Electrolux's President and CEO at the time, commented on Dometic: "*The leisure appliances operation is successful and enjoys a strong market position, but offers only limited synergies with other Group operations since the majority of sales are to manufactures of recreational vehicles*" (Electrolux, 2001). Dometic was fit to stand on its own, which would clarify and strengthen its position with customers and suppliers. As a result, Electrolux decided to divest its Leisure Appliances product line in two stages and sell it to EQT. The deal was finalized on June 13, 2001. The immediate market reaction to the divesture was negative, however. Electrolux's share price dropped by 4% following the announcement[9], and would continue falling in the next days. In fact, the share price would only recover its lost ground by August 2001. One of the reasons behind the negative reaction could have been that Electrolux sold the division cheap. Though a pure speculation, this may have been because of the intrinsic connection between Electrolux's largest shareholder, Investor AB (Wallenberg family), and EQT (originated from the Wallenberg family).

[9] There were around 360 million Electrolux shares outstanding, the drop of 4% from 96 to 92 meant a SEK 1.4 billion drop in market capitalization.

Figure 1
Electrolux share price in SEK, June 2001

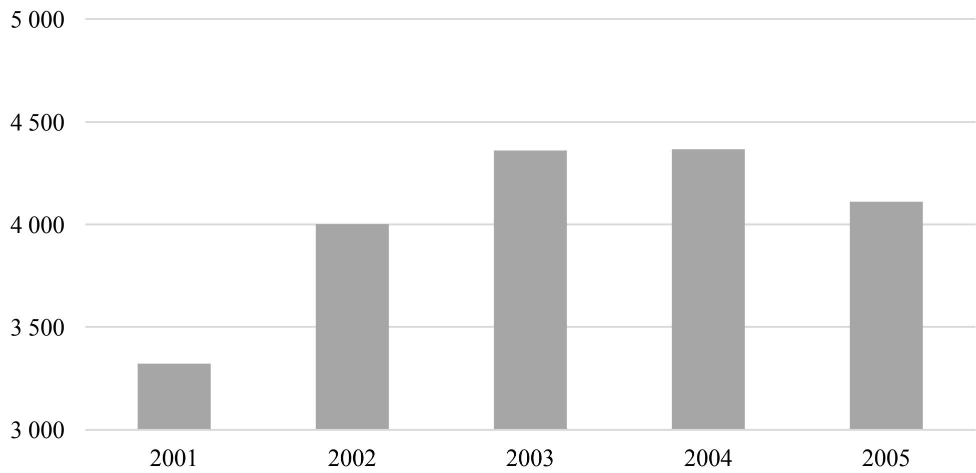


Source: Yahoo Finance

The brand name of Dometic was used for the new stand-alone company, the Dometic Group. Moreover, Electrolux and Dometic also signed an agreement which gave Electrolux the option to sell its remaining recreational product operations in Germany, Slovakia, and Austria. Electrolux exercised this option and the operations in Germany and Slovakia were acquired in January 2002, which was the second stage of the divesture. Upon the acquisitions Dometic became a complete legal group. EQT used its third fund, EQT III, to draw down the committed capital and buy Dometic. The purchase price was not disclosed. However, Electrolux reported a capital gain of SEK 3.2 billion from the sale (Electrolux, 2001). At year end 2001, Dometic generated sales of SEK 5.6 billion and achieved operating profit (EBIT) of SEK 541 million[10] (Dometic, 2003). Based on the prevailing average EBIT multiplies of 11x (Lawson, Chan, 2003), the implied enterprise value of Dometic would be around SEK 6 billion. The company had 3,321 employees; John Waters, President of Dometic, commented upon the acquisition: "*the new ownership will not change our current business relations, nor will it affect our management and personnel*" (RV Business, 2001). Contrary to popular belief about PE investment, EQT did not undertake any significant layoffs during its holding period:

[10] The figure for 2001 is pro forma. The figures for the years prior to the acquisition of EQT might not be entirely conducive: "in the case of the pro forma financial statements for 1999 and 2000, there is no meaningful financial information regarding profit/loss items after EBITA since Electrolux did not report such information for the Leisure product line" (Dometic, 2003).

Figure 2
Number of Dometic employees under EQT III



*EQT exited Dometic in April 2005

During EQT's ownership Dometic underwent extensive programs of development and investments. First of all, EQT initiated a complete rebranding of the previous brand of Electrolux to the Dometic brand, and consolidated global market positions so that Dometic becomes a strong, single, and independent brand. Second, Dometic started a program for continued growth by developing new products in-house and by acquiring companies with supplementary products. In 2002, Dometic purchased SeaLand, a leading US manufacturer of sanitation systems for pleasure boats. Through SeaLand the company strengthened its presence in the North American market and expanded into a new niche market: the marine industry. All of the acquisitions were grounded on Dometic's knowledge of the recreation industry and customer needs, which was underlined by another acquisition in January 2003. Miko Leuchten, Germany's leading manufacturer of lighting systems for recreation vehicles, was acquired, and Dometic thus continued solidifying its strong position in the RV industry across the global markets. Further expanding into the marine industry, Dometic also acquired Taylor Made Environmental, a leading manufacturer of air-conditioning systems for large pleasure boats, in August 2003, and American Polar Bay, a manufacturer of air conditioning systems for the marine industry, in October 2004. Finally, Dometic entered the Chinese market by establishing a production site for its miniBars (small refrigerators for hotels) in China.

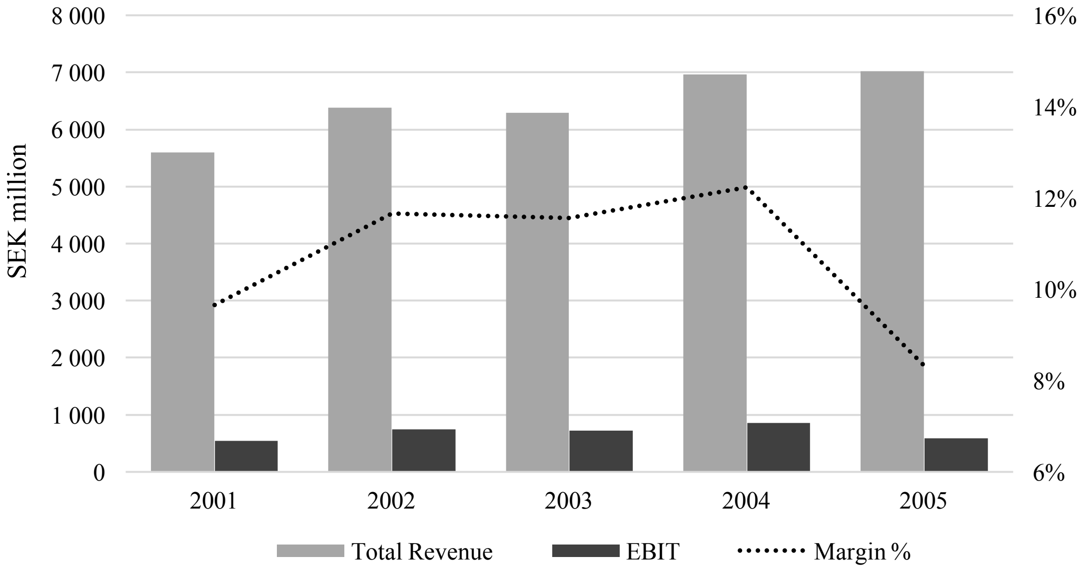
In 2003, EQT contemplated a potential listing of Dometic on the Stockholm Stock Exchange. In fact, both EQT and Dometic devoted substantial efforts to preparing the IPO, but EQT eventually decided to withdraw the proposal on the back of weak demand from institutional investors. Sven Stork, Dometic CEO, had this to say to the withdrawal: "*At the end* *of the subscription period, Dometic's owners, Board and management decided that the current market did not support a valuation that reflected the financial position attained by the company, and its future growth potential. Against this background, the owners and Board decided to withdraw the offering…Naturally, we see the withdrawn IPO as a disappointment, not least in view of the work and costs incurred*" (Dometic, 2003). The prevailing market conditions in Sweden were particularly tough during that time, especially for new issues, as there had been an 18-month listing drought on the Stockholm Stock Exchange and several companies that were to be listed had been hit by scandals. According to Financial Times, EQT planned to sell 15.7 million shares of Dometic in the range of SEK 190 – 240, and the float was to be 51% of the company (RV Business, 2003). EQT sought to use the proceeds to pay down debt and provide funding for further acquisitions. Assuming the numbers are correct, the IPO would value the 51% stake at SEK 3.4 billion (middle range of 215 x 15.7m shares), giving Dometic a total valuation of around SEK 6.6 billion. Taking the suggested upper value of 240 per share, which could have very well been achieved given that the IPO was reportedly fully subscribed, the valuation would be around SEK 7.5 billion. With the benefit of hindsight, it is noteworthy to later compare this value with the exit value by EQT in 2005, and see whether the market had the value of Dometic indeed wrong.

Dometic, not least because it was an unfit division within a large multinational company, was a prime example of a company where a new owner could implement operational improvements, consolidate its businesses, make strategic acquisitions, and expand it across markets thanks to shared network and synergies. Albert Gustafsson echoed this, saying that EQT had looked at Dometic for a long time and deemed it an excellent company (3.4.2017). Importantly, EQT lived up to its values of active ownership and transparency. "The Swedish way" of investing came up during an interview with Alexandar Zuza, who represented the workers of Dometic. He stressed out the cooperation and transparency from EQT's side during the whole investment period, praising the firm's ethics and operational expertise (17.3.2017).

Under EQT's ownership Dometic thrived and became a global group, selling in almost 100 countries, with a new product offering and market segments. Towards the end of 2004, Dometic was now a leading manufacturer of leisure products, such as refrigerators, awnings, air conditioners and stoves for caravans, campers and boats, and also catered to hotels, offices and hospitals through its specially adapted refrigerators. The company achieved the targets set by its owner and was ready for a next phase. Hakan Johansson, partner at EQT, added: "*Dometic has blossomed into a global group and is a good example of a company where EQT identified a business with great potential and then joined with the company to realise this potential.*

Dometic's development potential continues to be great, but we have carried out the development plan we had on acquisition and the fund has a limited investment period. That's why it's time for a new owner" (EQT Press Release, 2005).

Figure 3
Dometic performance under EQT III



*EQT exited Dometic in April 2005

5.2 *Secondary buyout: BC Partners acquires Dometic*

In April 2005, EQT sold its 100% stake in Dometic in a secondary buyout to BC Partners. The price was SEK 256 per share and the total transaction value SEK 10.1 billion (€1.1bn), including debt. Interestingly, secondary buyouts comprised 26% of total transaction value in the 2005-2007 period, and were the second most common type of buyout, after public-to-private (Kaplan and Strömberg, 2009). Lars Johansson, CEO of Dometic at the time, commented on the acquisition: "*Dometic has developed strongly under EQT's ownership and we are today the world's leading supplier to the growing mobile leisure markets. We look forward to working with BC Partners to capitalize on our attractive future growth opportunities*" (BC Partners, 2005). BC Partners took over an excellent company in a good shape and with bright prospects, commanding 75% of world market share for RV interior systems (Zook, 2011). Simon Palley, who led the investment at BC Partners and later became chairman of Dometic, added: "*Dometic is an exciting company with excellent future prospects. The Dometic management and the existing organization will continue to be key in further developing Dometic's leading products and positions. We hope to be a valuable partner in this next phase*" (BC Partners, 2005). The transaction value of SEK 10.1 billion represented a premium of 35% to the upper valuation of the pulled IPO in 2004.[11] Hence, EQT seems to have correctly judged the market sentiment and the undervaluation of Dometic, as it received more than SEK 2.6 billion more only one year later.

Regarding the performance of Dometic during BC Partner's ownership, it is difficult to properly asses it since the last available data from S&P Capital IQ is year-end 2004, and then it begins at year-end 2008. Though data from the Serrano database show certain figures for the 2005-2008 period, the company legal structure is very complicated and the figures do not add up. Moreover, the only available annual report during the period is for the year 2007, which contains limited information. The unavailability of data for the given years may already point out certain weaknesses of the owner's approach to transparency and unwillingness to reveal Dometic's true position and performance.

In light of this impediment, the end data of 2004 and start data of 2008 will be used to see what happened during the ownership. EQT left the company with a total debt of SEK 3,79 billion and equity of SEK 2,53 billion, a capital structure of 60/40 debt to equity. Given that such a structure is fairly balanced for a typical PE-owned business, there was a lot of room for the next owner to leverage up. And lever it up BC Partners did. At year-end 2008, the position of Dometic was as follows: total debt skyrocketed to SEK 12.3 billion, leaving Dometic with a fragile capital structure of 149/-49, which meant a negative equity of SEK 4.1 billion. Even more worrisome was the yearly interest expense, which jumped from SEK 184 million in 2004 to SEK 800 million in 2008, leaving a paltry interest coverage ratio[12] of 0.9x. Net Debt/EBITDA rose to 11.5x from 2.6x under EQT's ownership. Profitability also took a hit, with margins deteriorating across the board in the given period and net income falling from SEK 324 million in 2004 to negative SEK 5.2 billion.

In regard to management style and investment approach, BC Partners acted very differently than EQT, according to Alexandar Zuza. First, the management did not cooperate and the unions were not properly represented. BC Partners essentially bypassed the Swedish board representation system by moving the "real" board to London, and as such, the Swedish board could not make important decisions (see Appendix E). In Mr. Zuza's words, the management "*behaved bad…not the Swedish* way" (17.3.2017). BC Partners did not listen to what IF Metall had to say and did not return calls. Such a low cooperation with the unions might be due to the

[11] Calculated as the difference between the price of 10.1 billion and the implied valuation of 7.5 billion, divided by 7.5 billion.
[12] EBIT (earnings before interest and taxes) divided by interest expense

different role of trade unions in the UK, where the union density is only 25% (see section II). Second, the owner put in a new CEO. In March 2008, Lars Johansson decided to retire and Fredrik Möller, who came from Atlas Copco, was appointed as the new CEO of Dometic. Mr. Möller was known for his aggressive behavior and later acted arrogant towards the unions. Worse, in September 2009, news emerged that he was suspected of serious crimes, having spent eleven days in prison and potentially facing a six-year imprisonment. Last but not least, the unions fought hard to keep the factory in Motala, bringing in consultants and proposing plans to save it, but BC Partners did not listen and the factory was eventually shut down, laying off 600 workers.

Under BC Partners' ownership Dometic took on significant leverage, which exposed it hugely to potential shocks in the economy. The ownership style was characterized by lack of communication and cooperation, aggressive conduct of business, and lesser interest in stakeholders. Alexandar Zuza summed it up: "*BC Partners had a hands-off approach, whereas EQT pursued a hands-on approach*" (17.3.2017).

5.3 Financial crisis: Lenders take over

With the huge amount of leverage on its shoulders, Dometic was now in a precarious state. Any unexpected decline in its top line could send the company into a financial distress as its cash flows would not be sufficient to pay down its mounting interesting expenses. Sure enough, the financial collapse in the aftermath of Lehman Brothers in 2008 and the subsequent global economic crisis heralded significant troubles for Dometic. The automotive industry was hit particularly bad, with the Big Three (GM, Chrysler, Ford) requiring government bailouts and car sales plummeting (NY Times, 2008). The repercussions for Dometic were severe as its products are tightly linked to the auto industry. Total sales of Dometic declined from SEK 8.4 billion in 2008 to SEK 6.8 billion in 2009. Worse yet, the operating profit (EBIT) in 2008 of SEK 730 million was already below the interest expense of SEK 824 million. The company was on the brink of bankruptcy and had to negotiate restructuring of its debt with lenders. Using so much debt meant that BC Partners had to borrow from a big syndicate of lenders, comprising over 30 banks, both domestic and foreign. Such a large and heterogeneous group of lenders makes for a complicated negotiation during restructuring and can prove to be a real obstacle in turning a troubled company around. Alexandar Zuza raised this topic during the interview, saying that the debt structure brought about by BC Partners was very complex and that banks had difficulties with complex financing, especially foreign banks in Sweden (17.3.2017). With its daunting capital structure and debt composition, Dometic was in an unprecedented and unenviable situation.

Before long negotiations got under way and in September 2009 BC Partners reached an agreement with Mizuho financial group, the major lender, whereby the British PE firm lost control of Dometic. In a debt-for-equity swap[13], the 25 main lenders assumed a 70% ownership, while key executives and employees received 25% and the board 5% of the shares. Through the swap, Dometic's total outstanding debt was halved from SEK 12.3 billion to SEK 5.9 billion. At the same time, the annual interest expense was substantially reduced and Dometic was thus provided with an important breathing space. The negotiations were in the final stages when the news about the imprisonment of CEO Fredrik Möller came up. Subsequently, the lenders froze the negotiation process and required that he receive no compensation until proven innocent. In the end, the management made huge amounts of money on the deal, essentially at the expense of the banks, who took big write-downs of debt. Senior lenders took a 22% write-down for the 70% equity stake.

In restructurings and bankruptcies, banks usually do not want to take control of the companies as they possess no experience, ability, or time to run them. As a result, the entrenched management was in a position to demand sweet golden parachutes. Including bonuses, the total agreement was worth up to SEK 800 million. The CEO alone reportedly made SEK 10.7 million. In December 2010, news came out that he could actually make over SEK 100 million when the company is sold, according to Dagens Industri, a leading Swedish business newspaper. The other top four executives would each get around SEK 50 million. Responding to the newspaper, Fredrik Möller said: "*I have no comment on a possible deal or what this would mean*" (Sverigesradio, 2010).

The financial terms of the deal were not disclosed, but BC Partners reportedly recovered its investment in full (The Independent, 2009). In light of its investment strategy and advertised values, it is curious why BC Partners loaded Dometic with so much debt and then, as soon as troubles occurred, handed the keys to the banks and simply walked away.

5.4 Comeback: EQT tries again

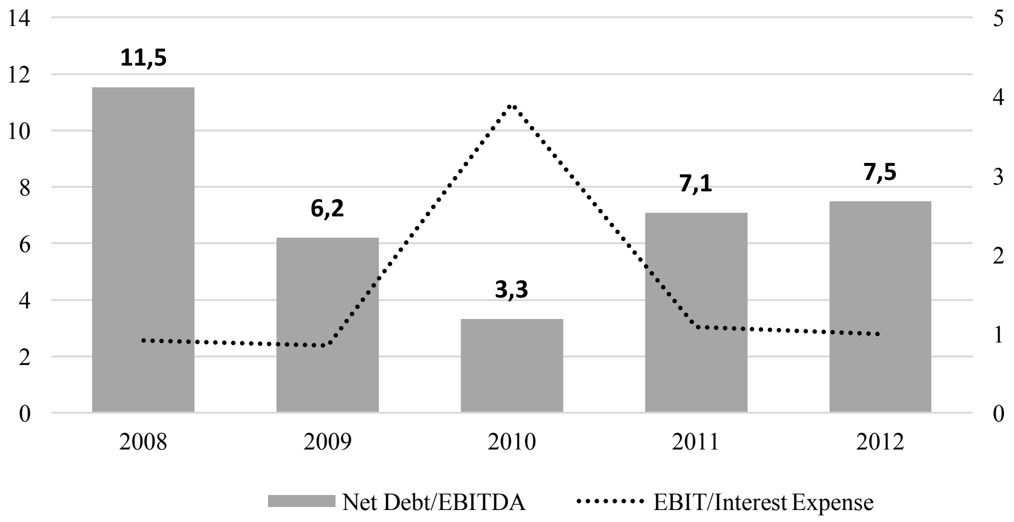
After the agreement and the following exit of BC Partners, banks held control over Dometic and left the incumbent management in place to carry on the business. The company was now

[13] Debt-for-equity swaps usually occur when a company needs to undergo some restructuring. In the swap, debt holders are offered a predetermined amount of stock (equity) in exchange for their debt.

out of deep waters and slowly becoming a new potential target. In December 2010, Permira, a huge European private equity firm, was listed among the potential bidders, but prior to the ending of second round bidding Permira withdrew the bid. Other bidders included Nordic Capital, a prominent private equity firm in the Nordic region, and EQT. In January 2011, Nordic Capital abandoned its bid, and in February EQT announced it had offered to acquire Dometic for SEK 12 billion. Albert Gustafsson revealed during the interview that banks wanted to sell quickly and that EQT, being a local and trusted player, had good connection to them and thus approached them with the offer to buy (3.4.2017). The offer was accepted by shareholders of Dometic at an "Extraordinary General Meeting" on March 25th. The deal was completed in May 2011 and Dometic was thus once again under EQT's ownership, this time with its fifth fund, EQT V.

Given its previous ownership of Dometic, EQT had an in-depth knowledge of its business and market conditions, which made the buyout all the more appealing. Another factor in favor of the deal for EQT was Dometic's ability to generate high margins and the positive long-term demographic trends of the industry. Despite its recent troubles, which were mainly due to overleverage, Dometic still had a fantastic market position in a great industry, according to EQT. Reflecting upon the indebtedness of the company, Albert Gustafsson said: "*a huge difference [in the PE industry] is how you deal with the companies with lot of leverage…when evaluating leverage, it's important to look at leverage relative to profit*" (3.4.2017). As a result of the restructuring, there was yet again a room for leverage. At the time of EQT's entering the investment in 2011, Dometic had a Net Debt/EBITDA ratio of around 3.3x, which was significantly lower than under BC Partners, around 11x. Since using leverage is inadvertently a key factor in private equity investments, EQT probably saw a great investment potential in the company. At the end of 2011, the debt ratio increased to 7x:

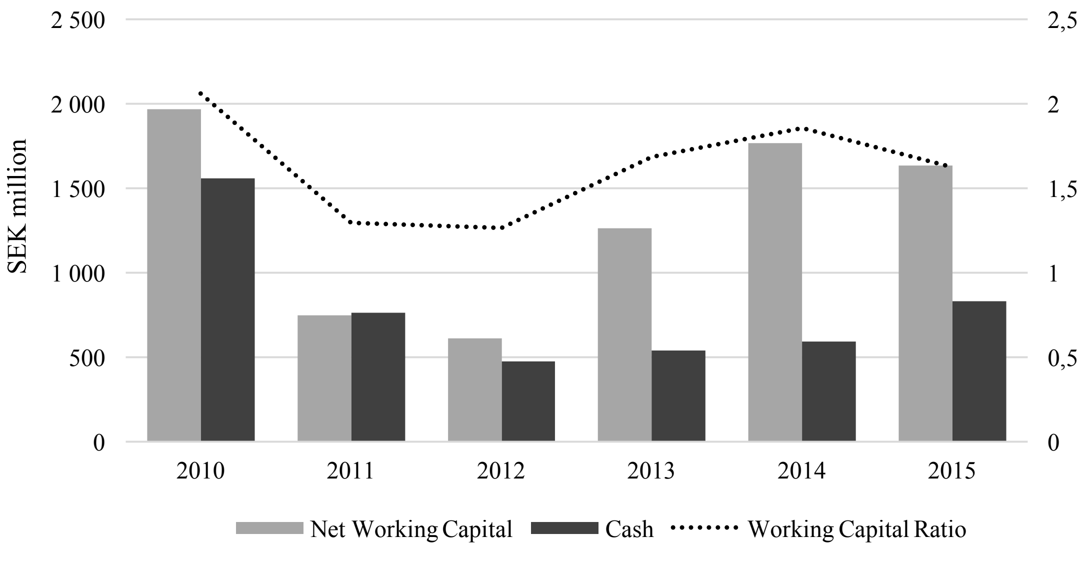
Figure 4
Leverage and interest coverage ratio during three different ownerships



* September 2009 lenders take over; May 2011 EQT enters

Upon acquiring Dometic for the second time, EQT started implementing its value creation agenda. The new business plan for the company focused on the aftermarket by improving dealer and distributor management. Other parts of the plan included centralized purchasing program, working capital reduction, improved financial transparency, geographical expansion, and, in the wake of closing the factory in Motala, moving production to China and Eastern Europe.

Figure 5
Working capital development



Given that Dometic had substantial product development underinvestment, EQT also started putting lot of money into R&D, which was put on hold during the crisis (Albert Gustafsson, 3.4.2017). The alleged sacrifice of long-term cash flows for short-term performance has attracted criticism towards PE investments. However, by studying the patenting activity and its economical benefits of post-buyout companies, Lerner, Sørensen, and Strömberg (2011) find that there is no underinvestment in innovation; in fact, they find that PE-backed companies actually pursue more influential innovations as measured by patent citations. Whether Dometic's neglected R&D investment was an intentional move by BC Partners or an inevitable result of the financial crisis-induced difficulties is hard to gauge. Nevertheless, EQT's increased focus on product development[14] is consistent with the above-mentioned authors' findings, which refute the hypothesis that PE firms sacrifice long-run investments. Further, it is also consistent with EQT's approach of long-term and responsible investing: *"Increased investments in product development have resulted in a stronger portfolio of innovative and high quality products launched during the year and in the pipeline for 2015 launches"* (Dometic, 2014). EQT continued growing Dometic through both organic and acquisition activities. In October 2012, EQT put in an additional investment of SEK 225 million into Dometic and also negotiated a revised financing package with senior lending banks, providing further flexibility: "*Our owners continued to show their commitment through making an additional investment when refinancing the Company*" (Dometic, 2013). Strategic acquisitions included Atwood Mobile Products, a heater and ventilation technology provider in the US, and Prostor RV, an awning division from Belgian Brustor NV. Dometic kept focusing particularly on the strong US market, the largest market for RV in the world, especially at the coastlines.

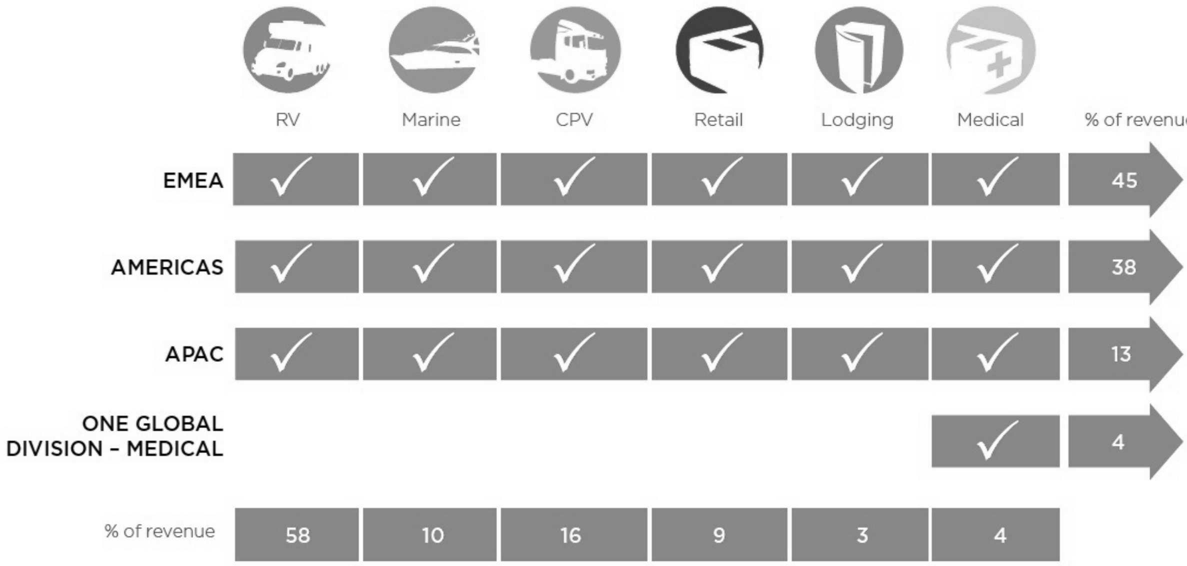
Interestingly, after the acquisition EQT kept the incumbent management in place for a while, plausibly on the back of the golden parachute arrangements. However, they made management changes later in 2012 after all: "*We didn't think the management was able to take it to next level*" (Albert Gustafsson, 3.4.2017). On November 8th, 2012, Roger Johansson was appointed a new President and CEO of Dometic.

[14] Examples of new products launched in 2012 include Waeco Cool Fridge, Gold Series Air Handlers, and European RV Awning.

5.5 IPO: Dometic goes public

Dometic was steadily growing and achieving the owner's targets, helped by favorable market conditions and renewed customer confidence in the aftermath of the financial crisis. The company was still heavily depended on the RV industry, but it was also heading towards a more diversified base. At the end of 2014 Dometic's revenue origin looked as follows:

Figure 6
Dometic sales origination



Source: Dometic annual report 2014

The year 2015 was quite eventful for the company. In March the company divested the Medical division due to limited synergies, and focused instead on its core markets of RV, Marine, and Commercial and Passenger Vehicle (CPV). The company achieved a growth of 30% for the whole year, driven by organic growth (8%), strategic acquisitions, and positive currency developments (Dometic, 2015). Dometic was now a focused, balanced, and stable company, with growth prospects still ahead. *"In just a few years, through hard work and with the backing of our principal shareholder EQT and experienced Board, we have become a significantly stronger and more financially stable company. The key pillars in Dometic's continued success are to strengthen our product portfolio, focus on operational improvement, grow the Aftermarket business and capitalize on the recovery in the EMEA RV market*" (Roger Johansson, Press Release, 2015). In light of the stability and the high growth number[15], it was

[15] High growth number by the exit can significantly increase the company value as valuations are based on the future earnings potential. PE firms usually leave something on the table for the next owner in the form of either high growth potential or additional room for operational improvements

a perfect time for the owners to exit the investment. On November 2nd, 2015, Dometic announced its intention to launch an IPO and list its shares on the Nasdaq Stockholm Stock Exchange. The price range of the offering was SEK 43-52 a share, with up to 108 900 014 shares available to the public (35.5% of total shares outstanding), corresponding to a market capitalization[16] of SEK 13,2–15 billion, according to the prospectus (Dometic, 2015). Harry Klagsbrun, Partner at EQT, commented on the offer: "*EQT has supported Dometic's management team for a number of years and I am delighted with the Company's strong development and its prospects for continued growth and value creation. I am excited to see the Company broaden its investor base and welcome new shareholders to take part in Dometic's development going forward*" (EQT Press Release, 2015).

On November 25th, 2015, 12 years after the first IPO proposal, EQT listed Dometic on the Nasdaq stock exchange in Stockholm under the ticker "DOM." The offering price was set at SEK 48 per share with a total number of shares of 97 756 603, corresponding to 33% of the total shares outstanding, which gave Dometic a market capitalization of SEK 14.2 billion. With a total debt of SEK 4.8 billion, cash of SEK 833 million, and EBITDA of SEK 1.7 billion, the EV/EBITDA[17] multiple was around 10.5x. Dometic claimed the IPO attracted huge interest and was oversubscribed several times (Dometic, 2015). Harry Klagsbrun added: "*The strong interest from both Swedish and international investors is a seal of approval from the market and a validation of the management team's hard work over the last few years*" (Press Release, 2015). Through the issuance the company received gross proceeds (before costs) of SEK 4.6 billion, which were to be used for reducing its indebtedness and providing financial flexibility. Being a listed company could bring Dometic a broader shareholder base, increased awareness of the brand and the products, and access to capital markets. EQT remained the company's largest shareholder, owning 57% of the total shares. EQT's stake was thus worth around SEK 8.1 billion. Throughout 2016 EQT divested its entire stake in Dometic in three blocks: May – 29 583 333 shares (10%) at SEK 52.5 per share; August – 59 166 667 (20%) at 61; November – 80 911 428 (27.35%) at 62.5. By the end of November 2016 EQT no longer held any shares in Dometic and the company was now fully in public hands.

As of 2016, Dometic is a worldwide leader in a very specific niche market, with 75% of net sales coming from markets in which Dometic is the market leader or second placed (Dometic, 2015). Even though Dometic's key focus has remained on the original RV market, its portfolio

[16] Market capitalization = number of shares outstanding multiplied by price per share.
[17] EV (enterprise value) = market cap + debt - cash

has expanded and now manufactures and sells a diverse range of products within Climate, Hygiene & Sanitation, and Food & Beverage. These products are for use in RV, pleasure boats, work boats, trucks, and premium cars. The group also manufactures small refrigerators and safes to the hotel industry. As of 2016, the company has 22 manufacturing sites in nine countries and roughly 85% of the products sold in 2016 were manufactured in-house (Dometic, 2016). Its products are sold in almost 100 countries around the world and are distributed through two sales channels: Original Equipment Manufactures (OEM) and Aftermarket.[18] The Aftermarket accounts for 40% of group revenues, and more than half of operating earnings. (Dometic, 2016). Dometic is organized into three regions: Americas, EMEA, and APAC. Total number of employees in 2016 was around 6,500 and sales reached almost SEK 12,4 billion. The headquarters are in Stockholm, Sweden.

[18] OEM customers are manufacturers of RVs, pleasure boats, work boats, trucks and premium cars. The Aftermarket comprises upgrade and replacement products, parts and consumables, as well as standalone aftermarket products.

6. Discussion

6.1 The value of culture in private equity

The value of culture cannot be expressed in any precise figure. This does not mean, however, that it is futile to study its impacts and try to gauge its worth. Guiso et al. (2015) study the value of corporate culture in public companies and find results that can be transmitted to private equity. The authors find that proclaimed values of companies have no significant correlation with short and long term performance. The possible reason is that it is easy to advertise favorable values, and hence every firm does it. When it comes to advertised values, EQT and BC Partners proclaim very similar values to those identified by Guiso et al. (2015) in public companies:

Figure 7
Advertised values/principles

EQT	BC Partners
Ambitious	Partnership approach
High performing	Intellectual honesty
Respectful	Continuous learning
Industrial	Ownership and responsibility
Entrepreneurial	Focus
Informal	
Transparent	

Although proclaimed values appear to be irrelevant, the authors find significant impact on performance when the values are measured through a perception by employees. In the case of private equity, the perception of PE firms by stakeholders might be the key to ascertain the value of culture. Some firms are renowned for their strong and consistent values whereas others are shunned and infamous. As the value creation in private equity moved towards operational improvements and active ownership, PE firms cannot act recklessly and a good perception stemming from the firm's culture thus becomes increasingly important. In fact, the 2012 BCG Private Equity Report stated that the strength and quality of culture will be the key determinant of a PE firm's competitive advantage in the years ahead. PE firms can also stand out by creating a performance culture in their portfolio companies, where management and employees focus on increasing the equity of the business. Accordingly, all actions are directed towards that goal.

From the case study of Dometic, EQT seems to put more emphasis on living up to its values than BC Partners does. This is particularly evident through the contrasts of transparency and communication. For instance, I found annual reports of Dometic for almost every year under the ownerships of EQT. Under BC Partners, meanwhile, there is only annual report for the year 2007, which, furthermore, contains only figures for sales and number of employees. The missing data in the databases also point to a lesser transparency. Further, the interview with Mr. Zuza revealed that EQT shared more information with the unions that BC Partners did. The implication of better transparency was studied by Cohn et al. (2014), who find that LBO firms with available public financial statements for at least their first two years post-LBO have substantial improvements in operating performance. The authors argue that LBO firms with available public financial statements are systematically better performers than those without. The case of Dometic seems consistent with these findings. Although some PE firms are notoriously secretive and still achieve great performance, the level of transparency in a portfolio company of private equity firm can be indicative of its performance.

Communication with the unions is another striking difference from the case study of Dometic. The high rate of unionization in Sweden can be very foreign to an outside investor. Coming from the UK, where the rate is substantially lower, BC Partners probably did not find working with the unions as important as did EQT. Given that active ownership entails close cooperation with the board, and the unions in Sweden are represented on the board, a failed communication can result in disputes and ultimately hinder the PE firm's agenda.

Importantly, I find the decision to appoint Fredrik Möller as a CEO inconsistent with BC Partners' values. Regardless of his accusation, he was already known for aggressive and brash behavior prior to his appointment. From its advertised values, it is hard to guess that they would choose such a candidate for the role. This relates to Malmendier and Tate (2005), who find that CEO personal characteristics lead to distortions in corporate investment policies. In the case of Dometic, it led at the minimum to a worse communication with the unions and a near halt of negotiations with the lenders in the wake of Dometic's financial difficulties.

6.2 Staying close

One of the key ingredients for a successful long term performance of a PE firm is its ability to raise subsequent funds and secure financing. Generally, a current fund with high performance is likely to attract more investors for the next fund raising. Nevertheless, the current high performance often does not translate into higher future performance (Lerner et al., 2007). Bearing this in mind, limited partners (LPs) probably consider other factors other than the performance history in their reinvestment decisions.[19] The same holds for lenders. For instance, Landier et al. (2009) find that banks far away from a borrowing firm rely more on impersonal means of information collection and, in turn, hard information, whereas industries where the distance between banks and firms is short rely more on soft information. Consequently, trust, reputation, and personal relations, i.e. soft information, can play a major role in the viability of a PE firm.

The case of Dometic illustrates implications of both the close proximity and soft information in the private equity context. EQT forges good relations with the local banks in Stockholm, which is important for its ability to secure future financing. The local banks, on the other hand, have a good knowledge of EQT in light of their mutual history and are willing to provide the financing. The value of such a relationship is illustrated by Ivashina and Kovner (2011), who find that bank relationships are an important factor in explaining cross-sectional variation in the loan interest rate and covenant structure in private equity deals. Specifically, PE firms receive favorable loan terms[20] because the repeated interactions reduce inefficiencies from information asymmetry, and also because banks price loans to cross-sell other fee business. Hence, the implication might be that EQT is more likely to stick to a local portfolio company under a financial distress than a foreign PE firm, such as BC Partners in the case of Dometic. This seems to be consistent with Hotchkiss et al. (2014), who find that reputational concerns with lenders and other stakeholders might provide incentives for the PE firm to ensure that distress is resolved efficiently, and also that PE investors frequently remain in control of their firm following the restructuring. Simply walking away at the first sight of a trouble could severely affect the local PE firm's reputation with the banks, since they would possibly face large write-downs of their capital. Coming from London, BC Partners had probably fewer reasons to put more money in Dometic, especially since they made their money back on the investment. Interestingly, this leads to another implication of close proximity, which has to do with the agency problem discussed by Jensen (1986). Sticking to an investment primarily because of reputational considerations, even though it would be more beneficial for the LPs to have the fund exit it, can jeopardize the performance. Landier et al. (2009) find that market reactions to in-state divestures are positive and significantly higher than out-of-state divestures,

[19] Lerner et al. (2007) show that market cycles have a much more significant impact on reinvestment decisions than individual fund performance.

[20] A one standard deviation increase in both bank relationship strength and cross-selling potential is associated with a 17 basis point (5%) decrease in spread and a 0.4 point (7%) increase in the maximum debt to EBITDA covenant.

which suggests that the willingness to divest within a state is a positive signal about the manager's objective of shareholder interests. Private equity might be prone to the same phenomenon. Lerner et al. (2007) document that the returns among LPs dramatically differ, with endowments' annual returns nearly 14% greater than average. One of the reasons is that LPs who get higher returns invest less in proximate funds, where the interests between general and limited partners may not be perfectly aligned. The decision of BC Partners not to put in more money seems to be in line with these findings, as they did not have to worry about the reputational repercussion in Stockholm.

The assertion of Albert Gustafsson about EQT striving to be the most reputable rather than the most profitable PE firm underlies the significance of soft information. After all, reputation can form the backbone of profitability. If a PE firm happens to have one bad-performing fund, but otherwise boasts a stellar reputation when it comes to trust, reliability, and integrity, investors will likely stay with the firm in the next round of fund raising. Accordingly, this might contribute to the divergent returns achieved by the different classes of LPs. Lerner et al. (2007) find that corporate pension funds and advisors (underperformers) are more likely to reinvest if the current fund had a high performance, whereas endowments (overachievers) proactively use the information they gain as inside investors to improve their investment decisions. The overachievers seem to not view the current fund performance as the decisive factor. Rather, they use subtle information, such as culture and the proximity bias, to complement their decision making. Furthermore, EQT's emphasis on reputation seems to be backed by Demiroglu and James (2010), who find that high reputation PE groups pay narrower loan spreads, have fewer and less restrictive financial loan covenants, and their deals are less likely to experience financial distress. Finally, good reputation with industry managements, not only with the lenders, can also play a significant role in PE long-term success. In auctions, PE firms with great, untainted reputation are more likely to be picked by the management. This could well have been the case with EQT in 2011, when the management and banks decided to sell to EQT.

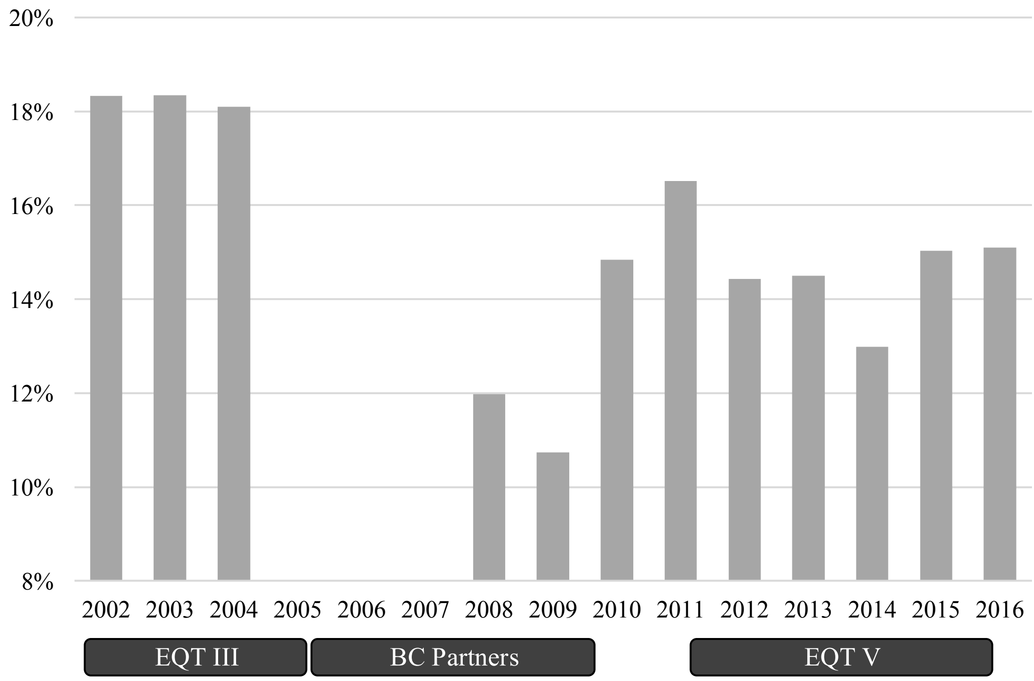
6.3 Price and performance

The performance of Dometic under the different ownerships is quite contrasting. What was the same, interestingly, is almost the exact holding period of 4 years under each PE fund, and also the fact that secondary buyouts paid higher purchase multiples (Price/EBITDA). Holding period is an important ingredient of private equity success. PE firms strike a balance with the time horizon being long enough to implement restructuring measures and short enough for management to have the energy to bring the plans to reality (Bergström et al., 2007). The case of Dometic supports the evidence from Kaplan and Strömberg (2009), who find that quick flips (exits within 24 months after acquisition) have not become more common, as some critics tend to point out, but in fact the holding periods have increased.

The purchase price of Dometic from Electrolux in 2001 is unknown. Yet, the subsequent acquisition prices were public and can be linked to Arcot et al. (2015), who find that price multiples are higher for secondary buyouts, in this case BC Partners and EQT V. BC Partners acquired Dometic in 2005 for an EBITDA multiple of around 8x. Given that EQT pulled out the planned IPO in 2003, which valued Dometic at SEK 7.5 billion and thus implied a multiple of 6.5x, BC Partners very likely paid a higher multiple. When EQT bought Dometic again in 2011 for SEK 12 billion, the purchase multiple was over 10x. Hence, secondary buyouts do seem to pay higher multiples, which can be expected given that multiple expansion is one of the return-generating factors for LBO; the other being leverage, growth, and margin enhancement (Lawson, Chan, 2003).

The difference in performance can be seen through EBITDA margins (EBITDA/Sales). The empirical evidence on operating performance under PE ownership is mostly positive (Kaplan, Strömberg, 2009). For instance, Acharya et al. (2013) find operating outperformance, as measured by EBITDA, and significant value creation in the PE portfolio companies relative to quoted peers. In the case of Dometic, EQT managed to generate high EBITDA margins of over 18% during its first ownership. Subsequent to BC Partners' entry, however, the margins went down and never reached those levels again. Therefore, it looks that secondary buyouts did not reach the same level of operating performance as the primary buyout of EQT III, which is in contrast to Bergström et al. (2007), who find that Swedish primary buyouts do not show larger operating improvements than secondary buyouts.

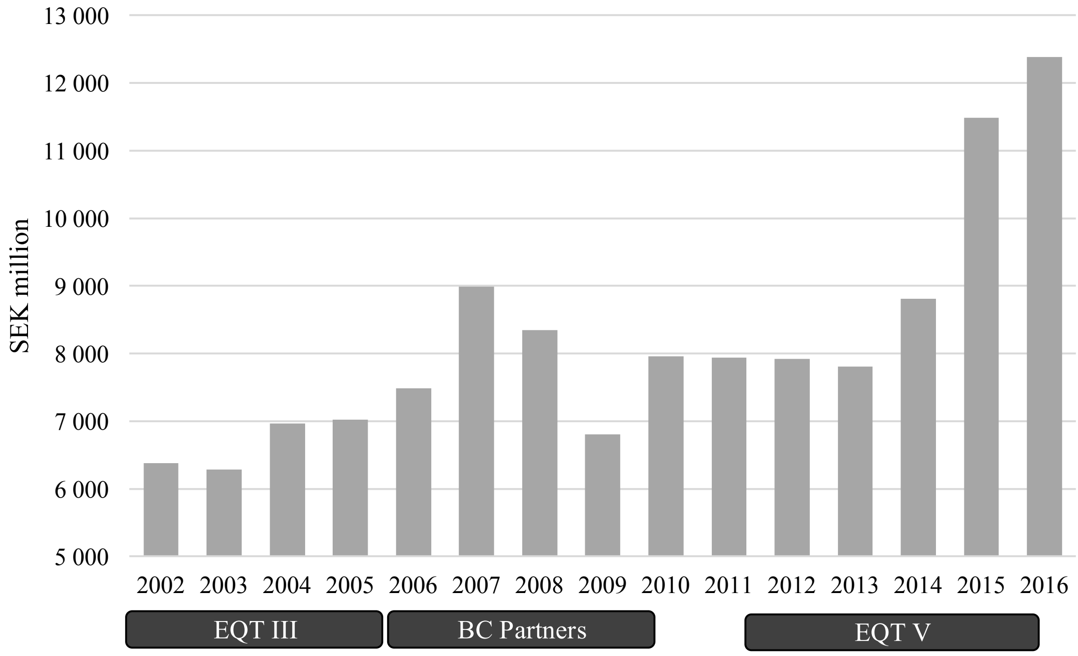
Figure 8
Dometic EBITDA margins



*Data for 2005-2007 unavailable

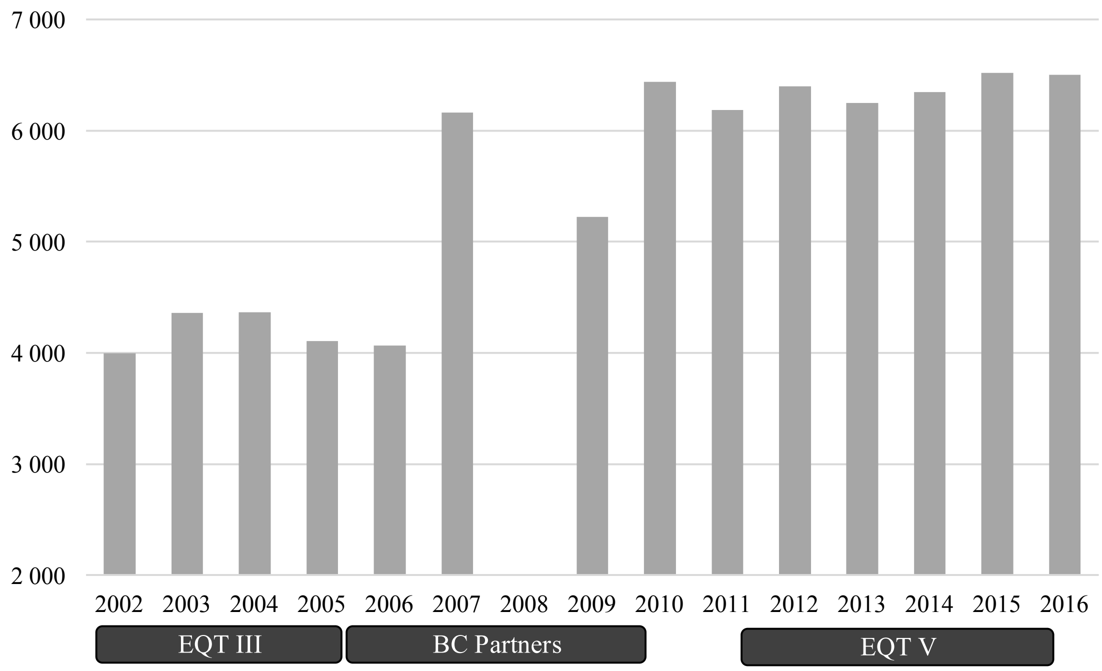
The compound annual growth rate of Dometic sales from 2001 till 2016 is 5.4%. In the studied period 2005-2014 of the SVCA analysis, Swedish economy grew at 3% and PE-backed companies at 16%. Dometic achieved sales growth of only 2.5% in the given period, indicating a slight underperformance relative to the economy and significant underperformance relative to other PE-backed companies. EQT, especially towards the end of their second investment, did better than BC Partners in regard to sales growth. However, BC Partners owned Dometic during the unfortunate turn of events in 2008 and the subsequent global economic slump. A different owner would probably not have been able to avert the financial repercussion either. Under such conditions, though, leverage can be the defining factor for a survival, which I discuss in the next section.

Figure 9
Dometic total revenues



Interestingly, under EQT III Dometic started to develop new products in-house, which corresponds to the findings of Lerner et al. (2011) about PE firms pursuing more influential innovations and thus investing for the future. This can be perhaps linked to the EQT's value of entrepreneurship. Moreover, Albert Gustafsson said that Dometic suffered from underinvestment prior to EQT's acquisition in 2011. Subsequently, EQT started investing into R&D, which supports the hypothesis of Cohn and Towery (2013), who suggest that PE firms may create value in part by solving underinvestment problems in the portfolio companies. Finally, the employment level has been quite steady under both ownerships of EQT. This is in line with Bergström et al. (2007), who find that employment in Swedish buyouts has developed in line with peers.

Figure 10
Number of Dometic employees



*Data for 2008 unavailable

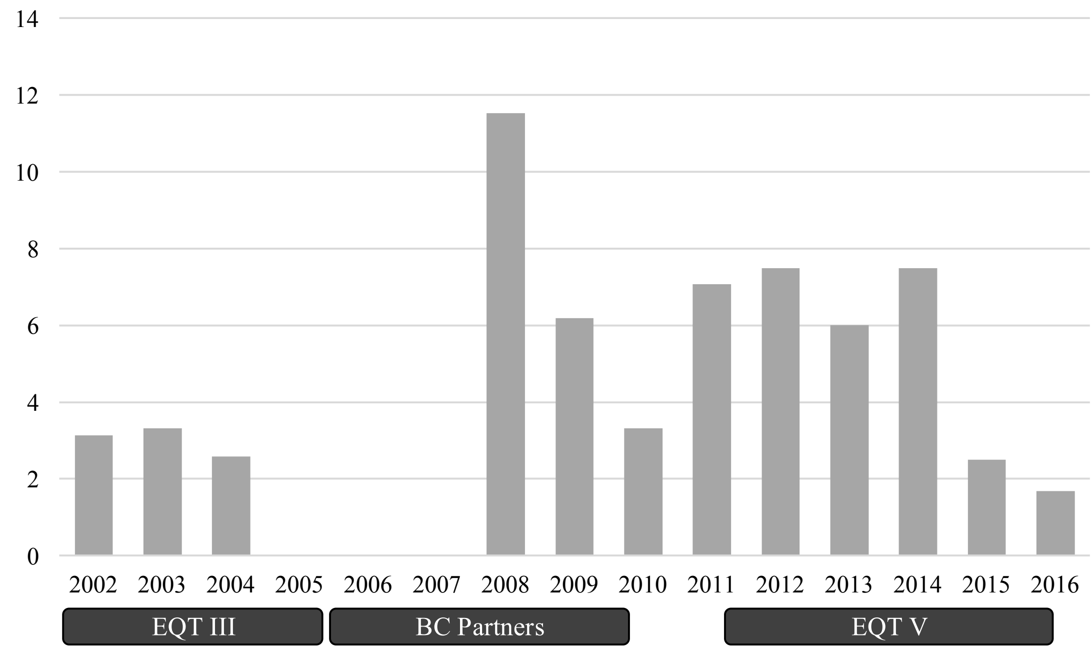
**In 2007 Dometic acquired WAECO, which had 1,800 employees

6.4 Leverage

Leverage is an inherent part of private equity. It serves three main purposes: increased returns to the investors, discipline to the portfolio company, and also discipline to the acquiring leveraged buyout fund. Leverage per se, however, cannot directly create value in the portfolio company, apart from a tax expense deduction (Modigliani and Miller, 1958). The classical trade-off theory states that the optimal amount of debt in a company shall be a balance between the value creation of interest tax shields and the cost of financial distress (Myers, 1977). In other words, a firm should raise additional debt until the benefit of marginal interest tax shield equals the cost of financial distress. Yet, most PE firms do not think in this framework, as stated in section III.

Private equity is quite peculiar when it comes to leverage. First, the industry is highly cyclical, where the availability of financing drives booms and busts (e.g. Kaplan and Stein, 1993; Ljungqvist, Richardson, and Wolfenzon, 2007). This is perfectly illustrated with the case of Dometic:

Figure 11
Dometic Net Debt/EBITDA



*Data for 2005-2007 unavailable

With such a high level of debt in 2008 (and presumably also in the preceding years), it is hard to argue that BC Partners adhered to the trade-off theory. The interest coverage ratio at the end of 2008 stood at 0.9x, which is an ample warning of a looming financial distress. Admittedly, BC Partners could not have foreseen the market turmoil starting 2008, but this, according to theory, should have been incorporated in the expected cost of financial distress. Alas, in theory there is no difference between theory and practice; in practice there is.[21] The economy-wide cost of borrowing in the years up to 2008 were extremely low and likely contributed to the increasing debt loading at Dometic, which is supported by Kaplan and Stein (1993), who find that hot credit markets can lead to excess leverage. Once the market conditions started to improve and lenders took the debt write-down, Dometic was again levered up in 2011. The case of Dometic seems to be consistent with PE firms tailoring the debt level according to the prevailing market environment, instead of looking at leverage with regard to the trade-off theory. One explanation might be that market interest rates determine the principal, i.e. with the

[21] Axelson et al. (2009) discuss this issue and present a model of how PE funds decide to raise capital, which is either on a deal by deal basis (ex post), or for several future projects (ex ante), or a combination of both. With ex post financing, the state of the economy determines whether deals will be financed – in good times, there is overinvestment, in bad times, there is underinvestment.

same cash flows firms can pay interest on a lower principal when the rates are high, and the other way around.

The other peculiarity of leverage in PE pertains to secondary buyouts. If the previous PE owner already did the majority of operational improvements in a portfolio company, there will be less potential for additional improvements for the new PE owner. As a result, secondary buyouts might be forced to take on more debt in order to make the investment worthwhile. If there is less room for implementing restructuring and other measures, financial engineering can take precedence. However, PE firms usually do not bring the company to operational perfection as it would be less attractive for the new PE owner, and the price would reflect that. Still, although data for Dometic during BC Partners' ownership is limited, there was substantially more leverage than under EQT. The first available data of 2008 show Net Debt/EBITDA of 11.5x, whereas when EQT was about to exit Dometic in 2004 the ratio stood at 2.6x. After the debt restructuring of 2009, when the ratio came down to 3.3x, EQT levered Dometic up to an average of 7x during 2011-2014. Given that this was way higher than when Dometic was under EQT III, the case seems to be consistent with secondary buyouts using more leverage.

The arguments above beg the questions why did BC Partners use so much leverage and whether there could be any link between culture and leverage. I find one possible explanation in its strategy of looking for companies with defensive growth characteristics. These types of companies ought to be more immune to market whims and thus possess larger cushion when it comes to interest coverage. Consequently, the company is able to take on more debt. In light of this preference of BC Partners, though, it is striking why they chose Dometic given that it is linked to the highly cyclical auto industry.

7. Conclusion

The case study of Dometic serves as a great testament to how complex the private equity environment and its connection to culture can be. Cultural impacts, both micro, such as firms' values, and macro, such as the Swedish value of transparency, are best understood by studying the specific real-life context. Although this might render any findings unsuitable for a general inference, it illustrates a real case and thus reflects how things are done, as opposed to how they should be done according to theories. The increasing preoccupation with numbers and reliance on data can result in our prioritizing quantity at the expense of quality. Given that human factors are key in the art of private equity, this can eventually become problematic as there are implications beyond the quantifiable, and people may instead prefer to focus on easily observable data points (Bergström et al., 2007). In the case of Dometic, these implications include the value of soft information in bank financing, the communication with unions, the reputational considerations, and the role of transparency.

Some of the findings from the case are in line with empirical studies and literature, whereas other seem to be in contrast. Over the whole period, PE ownerships did not lead to a job destruction, even though there was a factory closure and an economic slump after the financial crisis in 2008. Secondary buyouts (BC Partners and EQT V) used more leverage than the primary buyout of EQT III did. Moreover, the leverage was influenced by market conditions. Specifically, the hot credit markets leading up to the financial crisis likely fueled the debt loading at Dometic by BC Partners, and the subsequent recovery in credit availability allowed EQT to again lever the company in 2011. Price multiplies were also higher for each secondary buyout when acquiring Dometic. As regards the performance, the results are not particularly in line with empirical findings. Dometic sales growth underperformed both the Swedish economy and PE-backed peers. Furthermore, secondary buyouts did not reach the same level of operating performance (EBITDA margins) as did the primary buyout.

The whole case study purports to shed on light on the importance and impacts of culture. I find that EQT seems to have a stronger culture, which relates to both its firm values and national values. One value particularly stands out – transparency. Not only does it permeate everything EQT does, including communication with the unions, it also affected the scope of this thesis as there was way more public information about EQT than about BC Partners. Cohn et al. (2014) find that that LBO firms with available public financial statements are systematically better performers than those without, and the case of Dometic supports this statement. EQT, with both funds, achieved better operating performance and used less leverage than BC Partners.

Why might culture matter? Guiso et al. (2015) state that as it is difficult to design the proper incentive contracts, culture, through shared values, can be the solution for addressing moral hazard and maintaining quality across the organization. Since private equity often receives criticism with regard to outrageous payments, use of leverage, and inconclusive improvements, strong culture can be the antidote. In fact, it may become the key advantage of successful PE firms. The case study of Dometic reveals that culture does indeed have impacts on a variety of factors in the private equity setting, and can serve as a source of further research. For instance, Kaplan and Schoar (2005) study how fund returns affect the ability of PE firms to raise follow-on funds. It could be interesting to see whether culture in a PE firm also affects this fund-raising ability. Further research could also address the effects of culture on incentives and compensation, e.g. do strong-culture PE firms provide better incentives to the portfolio company management.

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Appendix

A. Timeline

Table A1
Dometic Timeline

2001	•Divesture from Electrolux; acquired by **EQT III** on June 13
2002	•Acquisition of SeaLand (US)
2003	•Acquisition of TME (US), and Miko Leuchten (GER) •IPO withdrawal
2004	•Acquisition of TUS (GER), Polar Bay (US), and Oyster (ESP) •Production established in China
2005	•Acquired by **BC Partners** on April 8 for SEK 10.1 billion; **EQT III** exits
2006	•Acquisition of Eskimo Ice (US)
2007	•Acquisition of SMEV (ITA), and WAECO (GER)
2008	•Fredrik Möller appointed as CEO in March •Financial crisis begins in the US after Lehman Brothers collapses in September
2009	•Lenders take over in September; **BC Partners** exits
2010	•Potential bidders examine Dometic
2011	•Acquired by **EQT V** on May 4 for SEK 12 billion •Acquisition of DG Line Group (RUS)
2012	•Roger Johansson appointed as President and CEO in November
2013	•Acquisition of Livos Technologies (US)
2014	•Acquisition of Prostor RV (BEL), and Atwood Mobile Products (US)
2015	•Listing on Nasdaq Stockholm on November 25; **EQT V** exits •Divesture of Medical business

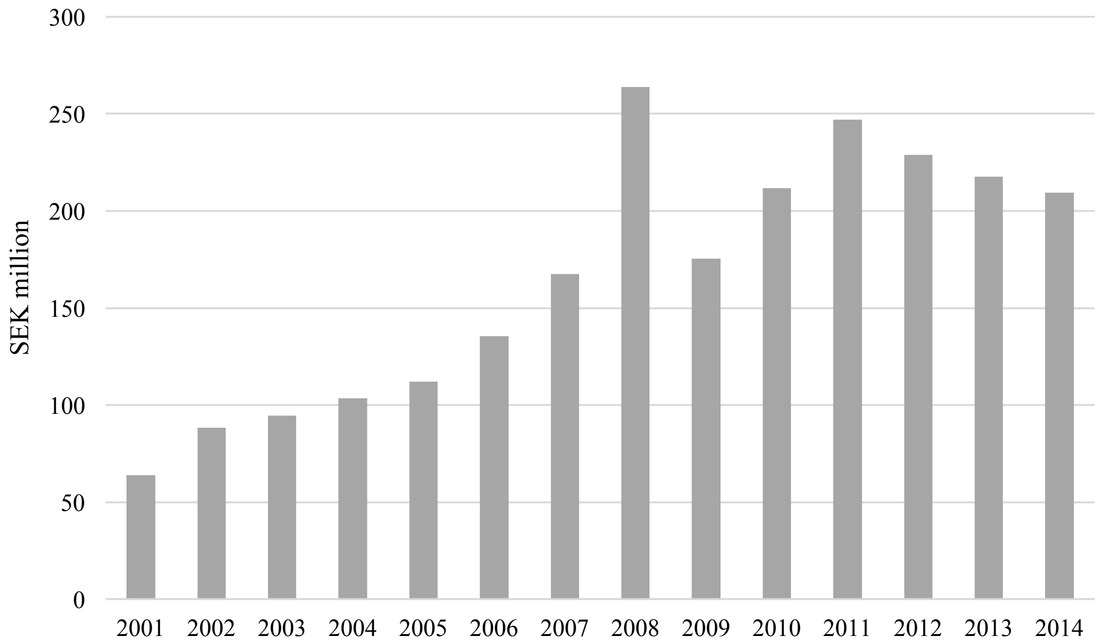
B. Dometic Financials

Table B1
Available key financials, in SEK million

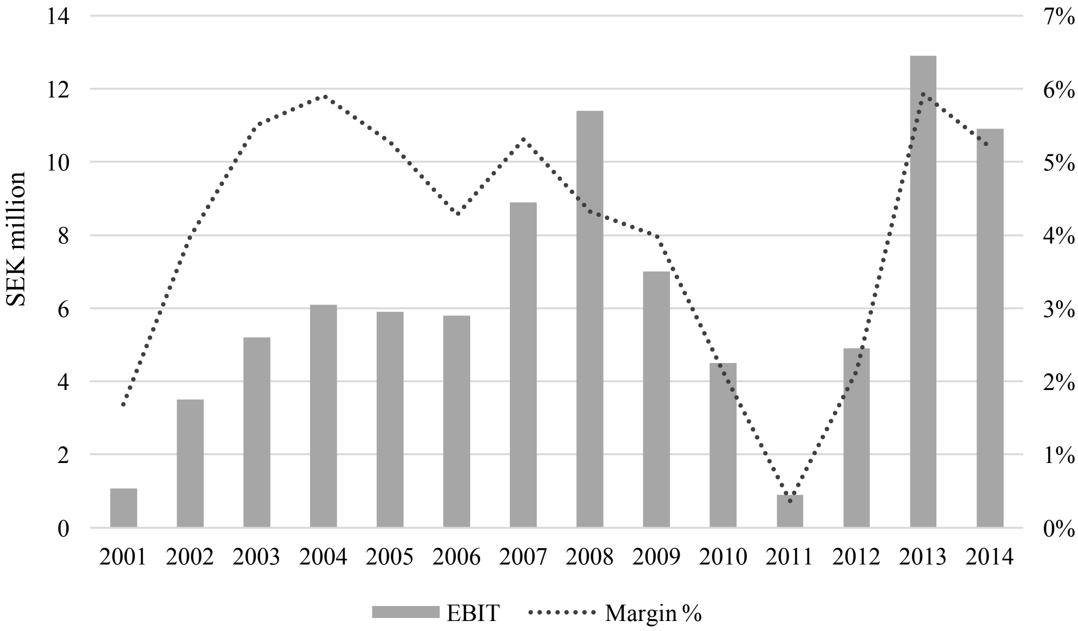
Key Financials																
For the Fiscal Period Ending	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Total Revenue	**5,600**	**6,383**	**6,288**	**6,963**	**7,024**	**7,483**	**8,992**	**8,344**	**6,809**	**7,958**	**7,941**	**7,922**	**7,808**	**8,806**	**11,486**	**12,388**
Growth over prior year	x	*14.0%*	*(1.5%)*	*10.7%*	*0.9%*	*6.5%*	*20.2%*	*(7.2%)*	*(18.4%)*	*16.9%*	*(0.2%)*	*(0.2%)*	*(1.4%)*	*12.8%*	*30.4%*	*7.9%*
EBITDA	x	**1,170**	**1,153**	**1,260**	x	x	x	**999**	**731**	**1,181**	**1,311**	**1,143**	**1,132**	**1,143**	**1,727**	**1,871**
Margin %		*18.3%*	*18.3%*	*18.1%*				*12.0%*	*10.7%*	*14.8%*	*16.5%*	*14.4%*	*14.5%*	*13.0%*	*15.0%*	*15.1%*
EBIT	**541**	**744**	**727**	**852**	**585**	x	x	**730**	**489**	**986**	**1,017**	**940**	**963**	**1,000**	**1,325**	**1,600**
Margin %	*9.7%*	*11.7%*	*11.6%*	*12.2%*	*8.3%*			*8.7%*	*7.2%*	*12.4%*	*12.8%*	*11.9%*	*12.3%*	*11.4%*	*11.5%*	*12.9%*
Net Income	x	**235**	**203**	**324**	**(286)**	x	x	**(5,195)**	**(230)**	**51**	**(359)**	**(91)**	**392**	**(828)**	**1,032**	**1,362**
Margin %		*3.7%*	*3.2%*	*4.7%*	*(4.1%)*			*(62.3%)*	*(3.4%)*	*0.6%*	*(4.5%)*	*(1.1%)*	*5.0%*	*(9.4%)*	*9.0%*	*11.0%*
Debt	x	4,135	4,222	3,791	10,223	x	x	12,321	6,552	6,041	9,141	8,716	7,291	9,488	4,815	4,782
Net Debt	x	3,668	3,822	3,247	9,828	x	x	11,519	5,138	4,483	8,379	8,240	6,752	8,896	3,982	3,183
Net Debt/EBITDA		3.1	3.3	2.6				11.5	6.2	3.3	7.1	7.5	6.0	7.5	2.5	1.7
Interest Expense	x	349	275	262	513	x	x	799	572	252	935	941	839	776	870	124
EBIT/Interest Expense		2.1	2.6	3.3	1.1			0.9	0.9	3.9	1.1	1.0	1.1	1.3	1.5	12.9
Cash	x	467	400	544	395	x	x	802	1,414	1,558	762	476	539	592	833	1,599
Current Assets	x	1,806	1,899	2,157	2,196	x	x	3,359	3,700	3,821	3,287	2,919	3,112	3,832	4,255	5,707
Current Liabilities	x	1,058	1,156	929	1,306	x	x	2,421	1,821	1,854	2,539	2,305	1,847	2,066	2,619	2,632
Net Working Capital		748	743	1,228	890			802	1,879	1,967	748	614	1,265	1,766	1,636	3,075
Working Capital Ratio		1.7	1.6	2.3	1.7			1.4	2.0	2.1	1.3	1.3	1.7	1.9	1.6	2.2
Employees	3,321	4,000	4,361	4,367	4,109	4,068	6,161	x	5,224	6,441	6,187	6,400	6,247	6,349	6,518	6,503

C. Subsidiaries Performance

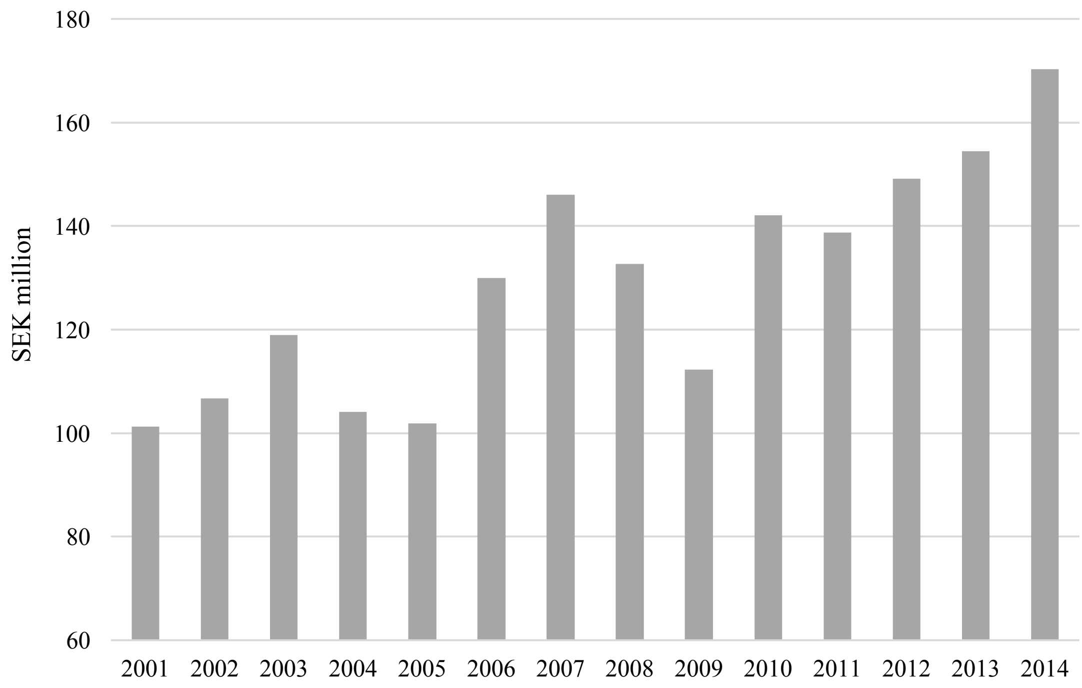
Graph C1
Dometic Scandinavia AB
Total Revenue



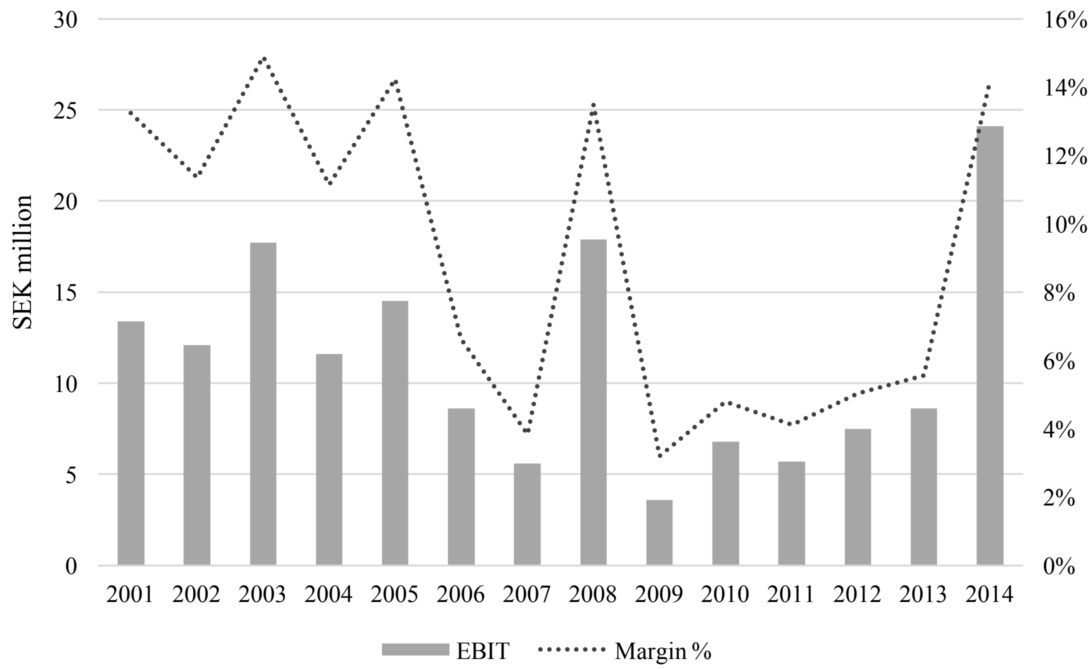
Graph C2
Dometic Scandinavia AB
EBIT Performance



Graph C3
Dometic Seitz AB
Total Revenue

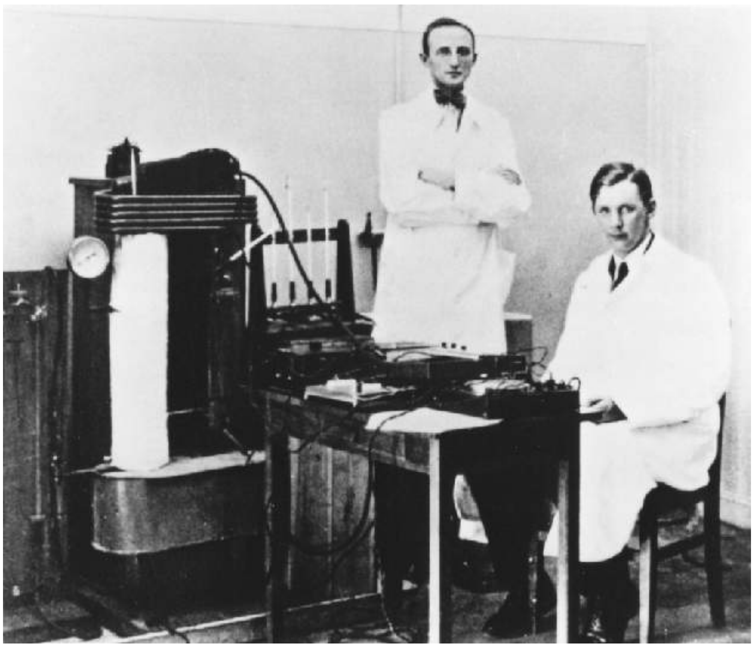


Graph C4
Dometic Seitz AB
EBIT Performance



D. Dometic Products

Picture D1
Baltzar von Platen and Carl Munters, inventors of the absorption technology



Picture D2
The "cooling cabinet" in the early 1930s

Picture D3
Portable fridge

Picture D4
Air conditioner

Picture D5
Hotel Minibar

Picture D6
Awning

Picture D7
Portable toilet

Picture D8
RV refrigerator

E. Trade Unions in Sweden

Text E1
Board-level representation in Sweden

(source: worker-participation.eu)

Employees are represented on the boards of almost all companies with more than 25 employees (Sweden has a single-tier board system.) There are two or three employee members and they account for around one third of board members in most companies. They are chosen by the union and are generally the key figures in a whole range of employer-union relations.

Employee representation at board level is very widespread in Sweden, which has a single-tier board system. Under the 1987 Act on Board Representation for Employees in Private Employment, employees in almost all companies with more than 25 employees have the right to elect two board members and the same number of deputies (three in companies with more than 1,000 employees which operate in several industries, again with three deputies). The employee representatives, however, can never be in the majority.

The employee representatives on the board are chosen by the local union, with which the employer has a collective agreement. This is done either through local agreement between the unions in the company, provided they represent a majority of the employees, or, if agreement cannot be reached, a more formalised approach is adopted. This states that if one union has 80% of the employees in the company, then it is entitled to both the employee seats on the board, otherwise each of the two unions with the largest membership in the company has a seat. In practice in most cases, one of the employee representatives on the board come from the manual confederation LO and the other comes from one of the two non-manual confederations, TCO and Saco. They can be chosen in a number of ways including election at the union meeting in the company, appointment by the union or a membership ballot.

As boards have recently fallen in size, employee representatives make up one-third of board members in around three-quarters of companies covered by the legislation.

On most issues, board members representing employees have the same rights as those representing the shareholders of the company. However, they cannot take part in discussions relating to collective bargaining or industrial action, or other issues where there is a clear conflict of interest between the company and the union. Employee representatives have no power of veto and so cannot stop majority decisions taken against their wishes.

There is also a difference in approach between the legislation on board representatives and involvement according to the MBL Co-determination Act. Employee members on the board, like other board members, are required to act in the best interests of the company, while the negotiating rights provided through the MBL legislation emphasise the differences between the parties' interests. In addition, information rights under the Co-determination Act cannot be replaced by information an employee representative receives as a member of the board.

An employee board representative is covered by the 1974 Act on Trade Union Representatives. As such, he or she normally receives his or her ordinary pay for the work as a board member. Additional remuneration is exceptional.