TIME TO SORT THINGS OUT

VALUE CREATION AND MANAGEMENT CONTROL SYSTEMS IN ESG-FOCUSED PRIVATE EQUITY: A CASE STUDY ON SUMMA EQUITY'S VALUE CREATION JOURNEY IN SORTERA GROUP

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Abstract:

This study elaborates on the research of value creation and management control systems in the private equity field. Through a single case study of the ESG-focused private equity firm Summa Equity and its previous portfolio company, Sortera Group, this study addresses the limited research on how an ESG focus can be implicated in the value creation process in private equity and how it affects how management control systems are designed in supporting such a process. This is done by integrating key value creation levers and management control systems categorisations under an ESG focus to ultimately present interlinkages between different control systems and their involvement in the value creation process. The study contributes to previous literature by showing how ESG can be in the centre in the private equity value creation process thereby demonstrating that ESG not only can be integrated but also be a driving force in this process alongside more traditional private equity value creation tools. In addition, this study contributes to previous literature by presenting a holistic view of how management control systems are designed to support both financial value creation and ESG impact, particularly detailing the reliance on results, behaviour and social controls as well as a somewhat amended design of these.

Keywords:

ESG, Sustainability, Private equity, Value creation, Management control systems

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Table of Contents

1. Introduction

> Over the years I have worked in private equity, I have seen an increasing focus on sustainability. I think this has mainly been driven by the overall sustainability debate in society, which is also increasing rapidly. It has taken a higher position on the agenda for politicians, companies and the overall population. (Investment Director, Bridgepoint)

Since its emergence, the private equity (PE) industry has become a crucial part of the global financial economy. In the first half of 2020, the global PE industry held $4.5 trillion in assets under management and has since year 2000 more than ten folded its size, outpacing the growth of global public markets by a factor of 3 (McKinsey, 2021). Moreover, it is estimated that PE-owned companies in Europe and the United States combined employ roughly 20 million people (Invest Europe, 2021; Morgenson, 2021), which further emphasises the societal importance that the PE industry has accumulated.

The early PE investment model leveraged the organisational inefficiencies of large conglomerates by acquiring them using large portions of debt, splitting them apart and divesting the newly formed entities (Leleux et al., 2015). From the first wave of leveraged buyouts in the 1980s to date, the PE industry has undergone several cycles of change, where additional value generating dimensions have emerged and constantly amended the PE investment model (Leleux et al., 2015). Today's emerging PE firms are, in contrast, said to have a much greater focus on operational improvements in their portfolio companies (PCs) compared to the early pioneers (Leleux et al., 2015). While the industry has historically been guided by the goal of only maximising financial returns for its investors, the growing challenges of human impact on climate, population growth and resource scarcity have directed PE firms in adapting to the changing conditions and contribute to positive environmental, social and governance (ESG) impacts as well (Indahl & Jacobsen, 2019). Given the industry's increasing impact on the global economy along with the rising sustainability awareness in society, there is an evident evolution in the PE industry where focus on investing in companies with a sustainability angle is becoming a more common element in PE firms' investment model (PEI, 2020). Accordingly, the PE industry has seen a growing number of firms who seek to integrate different ESG dimensions into their investments (Bain, 2021; Pedrini & Zacconi, 2020). This has, over time, yielded a new subsector within the PE industry in which PE firms actively screen and select investments based on the level of adherence to ESG criteria often linked to the United Nation's (UN's) 17 different sustainability development goals (SDGs) (PEI, 2020). Understanding that firms are widely interconnected with society and the environment in different aspects, these new types of PE firms aspire to have a deeper positive ESG impact apart from merely creating financial value and view the two outcomes as interlinked (PEI, 2020).

In spite of the significant effort and attention placed on the PE industry by academics, limited attention has been directed towards understanding how value creation processes are conducted in PE firms' portfolio companies and how management control systems are designed in the context of ESG. Researchers within this field have mainly focused on what different financial value creation tools are commonly used by PE firms in practice (see e.g. Gilligan & Wright, 2020; Kaplan & Strömberg, 2009; Rogers et al, 2002), and the types of management control systems that come into play to direct the actions of PCs (see e.g. Bedford & Ditillo, 2021; Sbarba et al., 2020). The increasing adoption of ESG-focused investment practices among PE firms raises the imminent question as to how PE firms implement and manage a multifaceted strategy that comply with both the financial value creation aspect and the aspect of ESG impact. Hence, this study aims to present a more holistic academic understanding of how an ESG focus in PE firms can be implicated in the value creation process and how management control systems are designed to support in this process. In order to address the aforementioned gaps in existing research, this study will seek to answer the following research question:

How can an ESG focus be implicated in the value creation process in private equity and how does it affect how management control systems are designed in supporting such a process?

In order to answer the research question, a single in-depth case study of Sortera Group (Sortera), a previous PC of the Nordic ESG-focused PE firm Summa Equity (Summa) has been carried out. As an investment philosophy, Summa places an equal emphasis on financial value creation and ESG impact, which creates a need to design control systems to ensure the attainment of both ESG and financial strategies. The research question is examined by categorising value creation levers into financial, operational and governance engineering building upon findings discussed in Kaplan & Strömberg (2009). Further, this study applies a management control system categorisation into contractual, results, behaviour and social controls, building upon findings in Bedford and Ditillo (2021). These two dimensions are synthesised into a two-dimensional framework to visualise interlinkages between value creation levers, management control systems, and how they under an ESG focus may facilitate in reaching multi-dimensional value creation in the form of both financial returns and ESG impact.

The rest of the paper is structured in the following way: section 2 provides an overview of the ESG discourse and previous research conducted in the PE value creation and management control systems fields while also elaborating on the existing research gaps. The section ends with a presentation of the theoretical framework that serves as the foundation for the empirical analysis of this paper. Section 3 presents the research design, data collection process and data analysis process. Section 4 presents the empirical findings and the analysis guided by the theoretical framework. The empirical findings and analysis are further discussed in section 5 in relation to previous research within the relevant domain. Finally, section 6 provides the conclusion of the study including a summary of contributions to previous research and points out the limitations of the study as well as suggestions for future research.

2. Theoretical overview

In this section, the literature review will be presented. First of all, the discourse within ESG will be described. The terms ESG and sustainability are used interchangeably in this study. Thereafter, traditional value creation levers in the PE industry in the form of financial, governance and operational engineering will be explained. The paper will then proceed with highlighting previous research on management control systems and PE. Finally, a theoretical framework based on previous literature that will serve as a foundation in this study will be presented.

2.1. ESG

The increasing importance of ESG issues in business has been manifested in many different ways. For example, in October 2014 an EU Directive was presented, making sustainability disclosure mandatory for thousands of companies in the European Union (CSR Europe & GRI, 2017). Moreover, in 2015, all UN member states adopted the 2030 Agenda for Sustainable Development consisting of 17 interlinked SDGs within ESG issues that are aimed to be achieved by 2030 serving as *"a shared blueprint for peace and prosperity for people and the planet, now and into the future"* (United Nations, 2021).

Since sustainability became a topic in the academic discourse, there have been different views on how it should be perceived by companies. The Anglo-Saxon governance model has been dominating over the years and implies that all decisions made by managers should be in the interest of the shareholders (unless any contracts state otherwise) while other stakeholders will need to rely on contractual and/or legal protection (Strömberg, 2018). The argument put forward by Jensen (2001) is that *"since it is logically impossible to maximize in more than one dimension, purposeful behavior requires a single valued objective function"*. This is in clear contrast to the stakeholder theory that states that managers should make decisions in the interest of all stakeholders in a company. The issue with the stakeholder theory according to Jensen (2001) is that it does not specify how the trade-off between different stakeholders should be. Therefore, managers would be unable to make purposeful decisions should they follow what the stakeholder theory advocates. Moreover, the proponents of the Anglo-Saxon governance model argue that the shareholders are the most vulnerable stakeholder, meaning that they should be the ones that managers are accountable to since other stakeholders can protect themselves easier through contracts (Strömberg, 2018). The focus on shareholders has led to companies, not the least PE firms, focusing on maximising financial returns, much in line with Friedman's (1962) argument that a company's sole social responsibility is to utilise its resources and engage in activities that increase its profits.

In the light of this, the question if companies that do good also do well has gained interest among academics (e.g. Habaragoda, 2018; Margolis et al., 2007; Roman et al., 1999). However, the relationship between sustainability and financial performance is still inconclusive (Habaragoda, 2018). While the majority of studies that have examined this relationship have come to the conclusion that there is indeed a positive relationship between sustainability and corporate financial performance (e.g. Habaragoda, 2018; Saeidi et al., 2014; Lev et al., 2010; Margolis & Walsh, 2003) others have found a negative (e.g. Julian & Ofori-Dankwa, 2013; Sundaram & Inkpen, 2004; Klassen & Whybark, 1999) or neutral relationship (e.g. Surroca et al., 2010; Peloza, 2009; Seifert et al., 2004).

The increased focus on sustainability in the society at large has also led to increasing amounts being invested in companies where ESG is a central part (Bain, 2021). Moreover, it has also led to a rise in PE firms focusing on this field where the most notable ones in the Nordics are Alder (established in 2008), Summa (established in 2016) and Trill Impact (established in 2019).

While the ESG investment strategies can be generated from within a PE firm, PEI (2020) elaborates on institutional investors' role in implementing such strategies, as they often provide PE firms with capital. Often being large, scrutinised institutions such as pension funds, banks and endowment funds, an imperative for them is to be assured that the funds are deployed in a responsible manner and contribute to a better society. PEI (2020) further points out that this may translate into increased awareness but also increased pressure on PE firms to amend their investment model. Not only does it become necessary to display a strong financial return track record to raise capital, but also showcase intent and track record in integrating ESG-related practices in PCs.

With the increased emphasis of sustainability in the PE industry, how PE firms think about value is put in the front. Traditionally within the PE industry, the internal rate of return (IRR) that an investment would yield, that is the discount rate that would correspond to an investment having a net present value of 0, has often been one of the metrics used as a proxy to capture value (Albers-Schoenberg, 2019). The other common metric used is multiple of money (MoM), which measures an absolute return on invested capital in comparison to the IRR which focuses on time-adjusted returns (Albers-Schoenberg, 2019). Thus, in this study, the term *financial value creation* refers to increasing the financial returns of the PE firm. In the ESG discourse on the other hand the term *value* often revolves around positive impact on the society from environmental, social and/or governance aspects (Hung, 2021; Gupta, n.d.), which in this study is referred to as *ESG impact*. Furthermore, the term *value creation* is in this study used to refer to situations where there can be a financial value creation and/or ESG impact.

2.2. Traditional value creation in PE

Traditionally, the focus in PE has been on creating financial value. Kaplan and Strömberg (2009) highlight three engineering types that PE firms utilise in order to create financial value in their PCs: financial engineering, governance engineering and operational engineering.

2.2.1. Financial engineering

Financial engineering focuses on the capital structure that PE firms implement in their PCs. An important part in financial engineering is the use of considerable leverage in connection with an acquisition by a PE firm (Døskeland & Strömberg, 2018). PE firms have an advantage over other market participants regarding debt financing as they can leverage the relationships that they have built with banks as they tend to be recurring and high-profile clients for the banks (Ivashina and Kovner, 2011; Demiroglu and James, 2010). Moreover, Demiroglu and James (2010) find that PE firms with a good reputation are able to use more leverage in leveraged buyouts and also obtain better credit terms owing to reduced agency costs of debt as better reputation implies lower risk of lending in the lender's eyes.

Leverage comes with at least two benefits: i) corporate tax reductions related to for example interest payments and ii) incentive effects (Døskeland & Strömberg, 2018). The incentive effects reduce agency costs of free cash flow (Jensen, 1986). By taking on debt, managers are inhibited to spend cash wastefully as cash is needed to service debt. In this way, managers are more cautious with spending and avoid projects that yield returns below their cost of capital (Jensen, 1986) which would be value destroying for the company. Although there are benefits from leverage, there needs to be a trade-off vis a vis the increased costs that higher leverage entails, that is debt-servicing costs and increased risk of costly financial distress (Døskeland & Strömberg, 2018). In other words, higher leverage is advantageous up to a certain point before the increased costs from leverage outweigh the benefits.

2.2.2. Governance engineering

Although financial engineering is an important lever in creating financial value in PE acquisitions, solely relying on leverage as a value creation tool is often insufficient to achieve attractive returns (Hoffman, 2008). Thus, an additional form of engineering for value creation commonly used by PE firms is governance engineering, which refers to the way of control of their PCs (Kaplan & Strömberg, 2003).

Døskeland and Strömberg (2018) mention four primary ways PE firms exercise their governance engineering. First, PE firms view incentive alignments between the firm and the managers of its PCs as a crucial step to establish strive towards mutual objectives. This is ensured by offering management incentive programmes (MIPs), where management and key employees are required or encouraged to invest their own wealth in the PC. Investments in MIPs typically take the form of equity stock options with significant equity upside (Acharya & Kehoe, 2008). Second, PE firms typically have smaller boards consisting of representatives of the PE firm, industry experts and other owners (Kaplan & Strömberg, 2003). Boards of PE-owned firms also tend to be more active relative to e.g. boards of public companies in the form of more frequent meetings and actions taken towards poorly performing management members (Acharya & Kehoe, 2008; Cornelli & Karakas, 2012). Third, Døskeland and Strömberg (2018) argue that routines and procedures through which the board exercises governance over its PCs differs from public and private non-PE-owned firms.

Some salient governance mechanisms observed in PE firms involves Troika[1] meetings, structured improvement processes, the development and use of detailed business plans, and operational key performance indicator (KPI) implementation and monitoring. Finally, professionalising the management of the portfolio company is yet another tool that is common among PE firms which is done through the replacement of existing management teams as well by complementing the teams with senior executives (Acharya & Kehoe, 2008).

Concludingly, the governance engineering lever presented by Kaplan and Strömberg (2009) addresses how PE firms steer their PCs toward intended goals, which is also the role of management control systems. Although overlapping with the governance engineering lever, management control systems span across a broader set of dimensions in the directing and monitoring (see **section 2.3.**), which is why this paper will focus on management control systems to cover aspects from the governance engineering lever presented by Kaplan and Strömberg (2009) in the value creation process.

2.2.3. Operational engineering

Today, there is an increased emphasis on the third form of engineering, namely operational engineering which refers to operating and industry expertise that is applied by PE firms in their PCs (Kaplan & Strömberg, 2009). Kaplan and Strömberg (2009) highlight that PE firms use their industry and operating knowledge to find attractive investments as well as to set up and implement a value creation plan. Among the initiatives that are frequently included in such value creation plans are productivity enhancements, cost-cutting initiatives, strategic changes or repositioning and acquisitions (Døskeland & Strömberg, 2018). In line with this, Acharya et al. (2013) found that PE firms create value through margin improvements.

The majority of investment professionals that work within PE have a financial background from working in for example investment banking where they have cultivated M&A skills (Døskeland & Strömberg, 2018; Acharya et al., 2013). This background is valuable in PE since acquisitions and divestments are common tools that PE firms use to increase value in their PCs (Døskeland & Strömberg, 2018). One common acquisition strategy is the buy-and-build strategy where a PE firm acquires a platform company which it then adds smaller companies to, called add-on acquisitions (add-ons) (Hammer et al., 2017). These add-ons are usually made at lower valuations whereby the larger entity that is created achieves a higher valuation due to its increased size and enhanced market position (Døskeland & Strömberg, 2018). In other words, all else equal, a larger company has a higher valuation multiple than a small one since a larger company is more liquid and less risky owing to its corporate strength (Hoffmann, 2008). In addition, when a smaller company is integrated with a larger company, it will be valued in line with the larger company's valuation multiple, thereby creating a multiple arbitrage. Since the valuation multiple for add-ons are smaller than for the larger entity at acquisition, a multiple expansion is obtained. In line with this, Acharya et al. (2013) find that on average, large PE firms create value in their PCs through multiple

[1] Meetings between the Chairman of the Board, the CEO and the PE Partner

expansion alongside margin improvements. Capturing operational synergies is also a main reason for a buy-and-build strategy (Bansraj et al., 2020). These kinds of synergies might come from increased purchasing power resulting in lower supplier costs (Bhattacharyya & Nain, 2011) or economies of scope where redundant activities are abandoned (Gomes & Livdan, 2004). Another important aspect within the buy-and-build strategy is the post-acquisition integration, as one of the biggest challenges after an acquisition is to create a unified organisation for the employees of both the acquirer and acquiree (Krug et al., 2014). Specifically, Van den Steen (2010) highlights that a culture clash has been found to be a major reason why acquisitions in general fail.

Another potential field for capturing value is within deal sourcing where PE firms can conduct proprietary transactions and thereby avoid that the value adding parts are incorporated in the acquisition price in a competitive bidding auction (Døskeland & Strömberg, 2018). As a proprietary deal is beneficial for a PE firm, many PE firms proactively monitor acquisition targets within their target size and industry in order to achieve proprietary deals or have an advantage over competitors once the acquisition target is put up for sale (Schenkel and Strömberg, 2017; Kaplan and Terachi, 2003).

2.3. Management control systems and PE

Throughout this study, "management control mechanisms" will refer to specific mechanisms designed to steer the management of a company in the intended direction. "Management control systems" will refer to the bundle of management control mechanisms with the same overarching purpose.

2.3.1. Management control systems

Management control in PE firms refers to their ability to direct and monitor the behaviour of their PCs during their holding period (Bedford & Ditillo, 2021). Early studies on management control in PE largely centred around how control was achieved through formal contracts, i.e. legal binding agreements between PE firms and their PCs aimed at detailing rights and obligations (Poppo & Zenger, 2002). Contracts in the PE context typically specify the responsibilities of each party, performance obligations and potential repercussions for contract violations. These are crucial for the relationship between PE firms and their PCs as they lay the foundation of how PE firms operate and intervene in the operations of their PCs. According to Kaplan and Strömberg (2003) there are three main classes of rights related to contracts. *Cash flow rights* refers to the distribution of the PCs' cash flows to its investors and is often contingent on performance metrics specified in the formal contracts. *Control rights* concern number of board seats, voting rights and other types of rights that grant PE firms power over corporate decisions. *Liquidation rights* is the final right which concerns the possibility of triggering a liquidation or default of a PC in order to obtain payments that are owed. While contracts are a crucial part of how PE firms exercise control over PCs, there are far broader controlling aspects involved in steering PCs into intended strategic directions (Nama & Lowe, 2014). Management accounting and control literature make distinctions between different type of control systems, such as results controls, action controls, and personnel/cultural controls (Merchant & Van der Stede, 2017). Bedford and Ditillo (2021) divide the control systems into contractual, results, behaviour and social controls. In their study, the role and characteristics of each control system is investigated in six different PE firms holding both majority and minority stakes in their PCs. The study concludes that not only are the different control systems important for directing the actions of PCs, but also that there are plenty of interrelationship between them. In addition, the combination and extent to which they are used is dependent on the *equity arrangement* (minority/majority ownership) and *perceived cognitive style of management* (entrepreneurial/managerial). First, firms with minority investments are claimed to mainly rely on contractual and social controls, regardless of the cognitive style of management. Second, PE firms with majority investments in firms with entrepreneurial management typically rely on contractual, results and behaviour controls. Finally, PE firms with majority investments in firms with a managerial cognitive style of management typically rely on contractual and results controls. In essence, according to Bedford and Ditillo (2021), the combinations of control systems implemented by a PE firm is determined by whether the PC is majority or minority-owned and whether the PC's management is entrepreneurial or managerial, see **Appendix A**.

Results controls are diagnostic in their nature and relate to the specification and achievement of predetermined performance targets, analysis and monitoring of variances, as well as the use of incentives to reach the predetermined targets (Bedford & Ditillo, 2021). Incentives typically involve managerial equity ownership, stock option programmes, earn-outs and annual bonuses and are typically linked to investment exit multiples achieved by the PE firm (Kaplan & Strömberg, 2009). Bedford and Ditillo (2021) further elaborate on incentive schemes by finding that annual bonuses and earn-out bonuses within a PE context can be based on performance of the firm over a specified period. In line with previous studies within the space, Bedford and Ditillo (2021) further find that monthly or quarterly reporting and strategic target setting with clear time horizons are common results controls procedures undertaken by PE firms.

Behaviour controls in a PE context are on the other hand control mechanisms that specify how tasks should be carried out by placing constraints on managers of PCs (Bedford & Ditillo, 2021). While there is limited research on behaviour controls in a PE context, some guidance is provided by Kaplan and Strömberg (2009), who show that PE firms are active participants on boards and have a significant influence on financial and strategic decisions and are often involved in developing strategic plans (as part of governance engineering). In line with Kaplan and Strömberg (2009), Bedford and Ditillo (2021) found that operational and budget planning was a crucial element in how PE firms establish behaviour controls and served to define the role and extent of involvement of the PE firm included in their study. Included in behaviour controls were also various rules relating to boundaries around strategic and operational activities which stipulated to what extent PCs were allowed to engage in these activities (Bedford & Ditillo, 2021). In an organisational setting, Merchant and Van der Stede (2017) argue that personnel controls can act as behaviour controls and facilitate employees' natural tendencies to motivate or control themselves by educating them on what the organisation wants. Personnel controls are typically implemented through selection, training and job design. In addition, cultural controls which are built on for example shared traditions, norms, beliefs and ideologies together with codes of conduct can act as powerful behaviour control mechanisms (Merchant & Van der Stede, 2017).

Social controls are instead used to foster interaction and socialisation between firms to establish control through mutual trust, social norms and implicit understanding (Hoetker & Mellewigt, 2009; Dekker, 2004). These are established through personal ties between PE firm managers and managers of PCs and can include direct contacts such as site visits but also *"include information exchange through meetings and informal contacts"* (Bedford & Ditillo, 2021). These kinds of interactions facilitate trust between the parties and help tackling unexpected and unforeseen events, which make them particularly important in dynamic environments. Merchant and Van der Stede (2017) elaborate on social controls and find that trust and mutual understanding also can be developed through personnel selection in an organisational setting, which is also common among PE firms (Acharya & Kehoe, 2008). According to the study undertaken by Acharya & Kehoe (2008) the CEOs of PCs are replaced at some point in nearly 70% of all studied transactions. This is a costly and time-consuming process and highlights the importance of establishing mutual trust and rapport both prior to and throughout the investment. Bedford and Ditillo (2021) further develop the notion of social controls and their interplay with contractual controls and show evidence that contractual controls function primarily as a tool for ex-ante determination and specification of strategic objectives, rights, responsibilities, and for developing initial trust rather than being used as a means of ex-post enforcement. Building on social controls, they argue that they play a central role in PE relationships by enabling a collaborative spirit and information exchange which reduces information asymmetry and facilitates a constructive relationship between parties.

Sbarba et al., (2020) further highlight the importance of social controls by establishing how PE firms bundle management control mechanisms into diagnostic, prognostic and motivational frames and how these frames support and promote a shareholder-focused frame and ensure effective alignment of managers of PCs. The diagnostic framing revolves around consensus building around specific problems which are largely catalysed through management control mechanisms such as initial joint planning, partner selection, trust generation (part of the social control system in Bedford and Ditillo (2021)). The prognostic framing refers to identifying actions that can solve the specific problem including control mechanisms such as rules and procedures (behaviour controls), performance monitoring (results controls), joint decision making (social controls), face-to-face meetings (social controls) and trust generation (social controls). Finally, the motivational framing is built on performance-based incentives (results controls) and shareholder mindset (behaviour controls). While various control mechanisms are prevalent in the different frames, social control mechanisms seem to be recurring. For instance, trust and the ability to verify mutual goodwill, commitment to a shared objective, and the selection of a good business partner (i.e. manager of a potential PC) act as particularly important social control mechanisms to ensure consensus around main objectives, further supported by Merchant and Van der Stede (2017) and Bedford and Ditillo (2021).

2.3.2. Management control and ESG

Studies investigating the role of management control systems in the context of sustainability includes Narayanan and Boyce (2019), who examine the extent to which management control systems may be used as enablers in organisational change towards ESG in a multi-national construction company. While the governance and incentive structures are different from that of PE firms, this study sheds important light on the use of management control systems in the sustainability and financial discourse in companies. By drawing upon Simons' levers of control (Simons, 1995), the study finds that although sustainability aspects are integrated into belief systems, boundary systems and diagnostic control systems, it did not necessarily translate to interactive use of sustainability information for pure sustainability purposes. Hence, in the case company used, there was no interest in taking corrective actions to improve genuine sustainability performance; reporting and measuring sustainability outcomes were seen as the end rather than a means to improve sustainability performance. Instead, sustainability topics were being viewed through a financial lens and seen as commercial opportunities as it enhanced reputation and legitimacy, referred to as the *business case for sustainability*. Only in the commercial context was sustainability-related information being used interactively. To summarise, the study finds that while the use of management control systems is not entirely irrelevant to drive organisational change, they do not play a transformative role in enabling change towards *strong-form sustainability*[2] when viewing sustainability as a balance between economic, social and environmental concerns.

While studies have investigated management control systems in the light of sustainability, few have touched the topic in the light of the changing discourse within PE, where adoption of ESG is becoming more prevalent. It has been unclear why integration of ESG factors matter to institutional investors with shorter time horizons from a purely financial standpoint, as this often entails increased costs, with benefits materialising over longer time horizons (Jain & Jamali, 2016; Peters & Mullen, 2009). One recent study conducted by Süsi and Jaakson (2020) investigates how a Baltic PE firm (BaltCap) weaves corporate social responsibility (CSR)[3] into its business logic through corporate governance mechanisms. Furthermore, the study investigates how this PE firm designs and implements different corporate governance mechanisms in its PCs. In line with the ongoing discourse, the study finds that PE firms do see increased firm value from long-term sustainability

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[2] The strong-form sustainability concept does not view natural capitals (e.g. natural resources) through the lens of economic capital. Instead, strong-form sustainability assumes a state where the increase of human capital is possible without affecting natural resources (Davies, 2013).

[3] Although CSR and ESG are two different terms, their purpose is the same, that is adopting policies and practices that are intended to have a positive impact on the world (Gupta, n.d.). CSR focuses on the accountability of a business in a qualitative manner, whereas ESG focuses on the measurability or quantification of the business' efforts (Hung, 2021; Gupta, n.d.). As such, the study by Süsi and Jaakson (2020) is closely related to this study.

supported by CSR, as opposed to earlier studies in this field, which argue that investors with shorter time horizons, such as PE firms, neglect this aspect as the value is not considered to materialise during their holding period (Süsi & Jaakson, 2020).

While corporate governance and management control in general are two distinct concepts (Merchant & van der Stede, 2012), there are multiple similarities when it comes to how PE management control systems and corporate governance mechanisms are designed to steer PCs in the desired direction (see Bedford & Ditillo, 2021; Süsi & Jaakson, 2020). BaltCap used six primary governance mechanisms related to shareholder agreements, board composition/selection of key personnel, incentive programmes to top management, strategic advisory and KPI/ESG reports. Bedford and Ditillo (2021) also find in their study that these types of control mechanisms are commonly implemented by PE firms, but instead bundle them into the four control systems of contractual (e.g. shareholder agreements), results (e.g. KPIs and management incentives), behaviour (e.g. codes of conduct), and social controls (e.g. key personnel selection).

To conclude, Narayanan and Boyce (2019) provide an explanation of how management control systems are designed and used in a sustainability-focused organisation, while Süsi and Jaakson (2020) elaborate on how a CSR focus is implicated in the design of corporate governance mechanisms to achieve both financial and CSR goals. Despite the similarities between the concepts of corporate governance and management control systems as well as between CSR and ESG, there are, to the best of the authors' knowledge, apparent gaps in the research on how ESG-focused PE firms design management control systems to support a value creation process. Hence, the next section will present the framework of this study, which will be used to understand how an ESG focus can be implicated in the value creation process in PE firms and how it affects how management control systems are designed to support such a process in the inter-relationship between PE firms and their PCs.

2.4. Theoretical framework

Current studies are able to answer what actions PE firms undertake to create financial value, how management control systems can be designed in PE firms and how the interplay between different management control systems in PE firms may appear. However, they are to the best of the authors' knowledge unable to explain how ESG can be implicated in the combination of different PE value creation levers and various management control systems. Thus, for the purpose of the research question, the theoretical framework has been designed using the two dimensions of i) value creation levers presented by Kaplan and Strömberg (2009) and ii) four different management control systems presented by Bedford and Ditillo (2021) (see **Figure 1**). As PE firms in general have the overarching mission to create value through different engineering types, and use management control systems as a support, the two dimensions will enable a deep degree of analysis, as they together provide a comprehensive framework for investigating this paper's research question. In addition, the framework has been extended to also include the dimension of

ESG, which, as previous literature has shown (e.g. Süsi and Jaakson (2020)), may be a factor in how PE firms design control systems.

The theoretical framework shown in **Figure 1** is a conceptual depiction that will help in analysing the empirical findings in this study. As mentioned in **section 2.2.2.** the governance engineering lever is deemed as incorporated in management control systems. The management control systems can contribute to value creation on a standalone basis, i.e. by not going through any of the financial or operational engineering levers, or by supporting the financial and/or operational engineering levers. Furthermore, the financial and operational engineering levers can contribute to value creation on a standalone basis, i.e. without being supported by any management control system, or by being supported by any management control systems. The ESG focus, in turn, can be implicated in the management control systems and/or value creation levers.

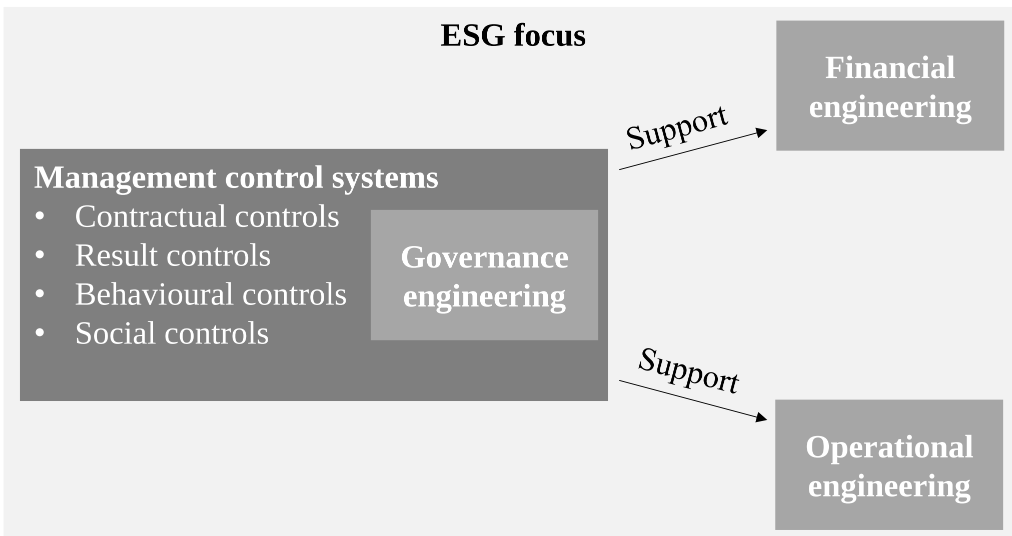

Figure 1: *The theoretical framework of this study, with the value creation levers and four management control systems, which will work as a theoretical lens through which the Summa and Sortera case will be examined*

3. Method

This section covers the reasoning behind the choice of research design used in this study including the research approach and case selection. Following this, this section then describes the data collection process including the reasoning behind the chosen interview technique before ending with explaining the data analysis process.

3.1. Research design

This study is based on a qualitative in-depth single case design. A benefit of using a qualitative research design compared to a quantitative one is that a qualitative design enables to capture a more comprehensive and in-depth understanding of specifics events (Vaivio, 2008). In other words, it is the more appropriate research design for research questions that are framed as *how* rather than *is* (Hellström, 2020). Since findings using a qualitative design may question or contradict existing theories that are deemed general, it is also a well-suited design to stimulate new research (Dyer & Wilkins, 1991). Furthermore, a single case study focusing on Summa's ownership in Sortera, as opposed to multiple cases, was selected in order to obtain a greater depth in the empirical data and analysis (Vaivio, 2008; Dyer & Wilkins, 1991). This would allow to zoom in on the thoughts of the different parties involved in the case. In addition, this setting is also well-suited for studies in new research areas or where existing theory seems scarce (Eisenhardt, 1989). Considering the scarce amount of previous research on sustainability-focused PE cases, the single case design was deemed appropriate in this study. With time constraints in mind, although a multiple case study would potentially be able to broaden the empirical findings (Vaivio, 2008) it would be at the expense of the depth that a single case study provides.

The domain for this study is value creation and management control systems within PE. The choice of a qualitative case design is in line with previous studies in our domain that focus on management control systems (see e.g. Bedford & Ditillo, 2021; Sbarba et al., 2020). However, those studies that have focused on the value creation aspect within our domain have commonly used a quantitative case study design (see e.g. Hammer et al., 2017; Acharya et al. 2013; Demiroglu & James 2010; Kaplan & Strömberg, 2009). Our theoretical framework combines as highlighted in section 2.4 our domain with key value creation lever and management control system concepts in PE that in turn constitute our method theory. As this study thereby aims to combine the dimensions of value creation levers and managements control systems in PE, the qualitative single case study design in line with the studies focusing on management control systems was deemed preferable owing the reasons mentioned above in this section.

3.1.1. Research approach

There are two main research approaches: the inductive and deductive approaches. While the inductive approach focuses on putting the empirical findings in the centre to produce new theoretical insights, the deductive approach implies hypothesising based on previous theory

(Lukka & Modell, 2010). Therefore, which research approach will be deemed as most suitable will depend on which of theory building or testing is deemed as the key driver for a particular study (Eisenhardt & Graebner, 2007). The research approach that has been used in this study is the abductive research approach. This research approach focuses on iterating between theory and empirics where the empirics are continuously analysed and hypotheses are being formed repeatedly (Dubois & Gadde, 2002). As such, no prior hypothesising is conducted. Hence, the chosen approach provides flexibility in revising the theory to be as relevant as possible as new insights continuously emerge from newly collected empirical data during the study process (Dubois & Gadde, 2002). The abductive research approach has been recommended for cases with limited previous research (Dubois & Gadde, 2002) and due to the limited number of previous research in our research area, this approach was deemed suitable for this study.

3.1.2. Case selection

The selection of the particular case in this study is a result of several factors. First of all, there is a scarce set of previous research on the combination of value creation and management control in PE in a sustainability setting, which made it appropriate to further examine this field. Second, the set of PE firms with an ESG focus has been and is currently limited. Hence the access to materials and employees has been a decisive factor of the case selection. Moreover, since value creation is examined in this study, it was important to obtain access to a case where a PE firm had exited its holding in order to capture the value creation process in its entirety.

Owing to the recent emergence of ESG-focused PE firms, Summa was deemed the optimal ESG-focused PE firm for this study as the authors were granted access to both materials and employees and as Summa had recently exited one of its portfolio companies, Sortera. The exit was done after a five-year holding period, meaning that the value creation process in its entirety could be captured and analysed. Moreover, the exit enabled access to materials and employees' thoughts and opinions as no current initiatives bound by confidentiality were ongoing.

3.2. Data collection

The empirical findings in this study consist of confidential material received from Summa, public material in terms of press releases as well as interviews. The confidential and public materials were used to gain an overall view of Summa, Sortera and the waste management industry in the Nordics in which Sortera operates. The obtaining of this background information about the researched companies helped the authors to focus on asking more specific and relevant questions for the research purposes of this study during the interviews. Thus, the interviews conducted as part of this study served as the core for the empirical data gathering and analysis while internal documents contributed to a more comprehensive view of the empirical findings.

In order to obtain a comprehensive and nuanced understanding of the case, several different parties relevant to the case were interviewed. To gain a holistic understanding of the value creation process in Sortera and how management control systems were designed to support this process, eleven people from Summa with varying seniority and one person from Sortera were interviewed. Furthermore, one investment professional from the international PE firm Bridgepoint was interviewed to obtain an outside perspective and a broader understanding of the link between ESG and PE (see **Appendix B** for an overview of the interviewees who participated in this study). Given the current circumstances with the Covid-19 pandemic, the interviews were held via the online communication platform Microsoft Teams. A total of 15 interviews were conducted, consisting of two follow-up interviews with Summa employees. The interviews were held between 4 October 2021 and 2 November 2021 and ranged from 40 to 75 minutes. All interviews were recorded and transcribed after they had taken place.

The technique used for the interviews has been the semi-structured approach. This entailed creating a structured interview guide before the interviews to serve as a basis. Follow-up questions that were not planned beforehand were then asked where deemed necessary in line with the recommendations by Ryan et al. (2002). This enabled the authors to gain a deeper understanding of the interviewees thinking and reasoning while at the same time having a basic structure throughout the interviews. The interview guide was continuously revised and amended throughout the empirical data gathering process in line with the abductive approach (Dubois & Gadde, 2002). Moreover, the interview guide, as well as the follow up questions, were adapted to the role of the interviewee owing to the fact that obtainable insights varied depending on the role in the Summa-Sortera case. **Appendix C** shows one example of an interview guide that has been used as part of this study.

3.3. Data analysis

An abductive research approach involves combining the empirical findings, theoretical framework and the empirical analysis so that they evolve simultaneously (Dubois & Gadde, 2002). Therefore, after each interview had been transcribed, a discussion between the authors took place where the findings were analysed in accordance with the theoretical framework of this study. The overall structure of the theoretical framework with the three different value creation levers and four management control systems remained the same during the process. Each specific concept from the empirical findings was distributed into one or several of the value creation levers or management control systems in the theoretical framework of this study where interlinkages were discussed and analysed. The continuous analysis of empirical findings led to the above-mentioned amendments in the interview guide for subsequent interviews as well as to a revision of concepts in the literature review in order to provide the reader with relevant background information before proceeding to the empirical section. Conducting the empirical analysis in conjunction with the empirical data gathering enabled the authors to identify the number of interviews required as well as which areas relevant for the research question that required a deeper focus in subsequent interviews.

4. Empirics

The following section will present the empirical findings and analysis. The initiatives highlighted in this section are not all the initiatives that were undertaken by Summa during their ownership in Sortera, but rather the ones that were deemed to be the most relevant for the purposes of this study.

4.1. Empirical findings

4.1.1. Overview of Summa

The increased ESG focus in PE has led to more focus on establishing control systems to ensure that ESG practices are implemented and conducted in the post-acquisition period through ESG-related KPIs.

> It is a growing area [sustainability KPIs] and the focus on these will increase as it is demanded by the institutions who supply us with capital. It is not enough to tell them 'we have done x, y, and z', you need to also be able to show it through KPIs. (Investment Director, Bridgepoint)

Looking into the future of the industry, the control mechanisms used to govern the implementation and use of ESG practices in PE-owned companies are expected to increase. One frontrunner in this space is Summa, a PE firm which was built on the foundation of creating positive contributions to the society through ownership and development of companies that solve global challenges. Summa was founded in 2016 with the mission to invest in companies that solve some of the world's toughest challenges by addressing three core investment themes: resource efficiency, changing demographics and tech-enabled businesses, while at the same time providing strong financial returns for its investors. The core of Summa's investment model lies in addressing the current megatrends of for example climate change, growing and aging population and urbanisation through the UN SDGs, which are used as a framework for assessing the importance and impact areas of potential investments as well as the multi-dimensional value creation potential. As Summa's ambition is to create long-term value in its PCs, the focus lies on future proofing the companies and using a time horizon that extends beyond its holding period, which is usually around five years. The longer time horizon allows Summa to focus on value creation aspects which take longer to materialise, such as ESG-related initiatives. The financial goal is thus not to maximise profit margins and earnings which entail a shorter-term focus, but rather to increase the longer-term intrinsic value of its PCs which can translate to a higher valuation as the PC is sold to the next owner. In essence, Summa's philosophical view is that there does not need to be a trade-off between financial returns and ESG impact:

> It is not about choosing the one or the other [ESG or financial returns]. Summa's philosophy is that we can both generate strong returns for our investors while contributing positively to the world through our investments. (Investment Manager 1, Summa Equity)

Besides usual management control systems used by PE firms, such strategies seem to require additional, and more comprehensive management control systems in order to ensure that PCs are pursuing intended activities and achieve the desired outcomes with respect to ESG (see **Appendix D** for KPIs used by Summa to track financial and ESG performance in Sortera).

4.1.2. Entry

On 18 April 2016, it was announced that the Norwegian PE firm Norvestor had sold Sortera to the newly founded Summa making it its second investment since its founding (Coeli, 2016). At entry Sortera was a waste collection and sorting provider focused on the new build and RMI (renovation, maintenance and improvement) market, active in the Stockholm/Uppsala region, Gothenburg and Oslo. The waste management industry in the Nordics was at this time fragmented and crowded by i) large multi-country broad waste service providers, ii) niche providers with narrower waste focus and iii) companies with waste services combined with transport or contractor services. For a breakdown of industry participants in the Swedish and Norwegian markets at entry, see **Appendix E**. Since its inception in 2006, Sortera had grown to become one of the market leaders in Stockholm by focusing on environmental concerns and by offering construction companies increased flexibility. **Appendix F** shows product and service overview of Sortera at entry.

Summa had already from the start a very positive view on and were very interested in the waste management industry in general. It was an industry that the people at Summa at this time had positive experience from. That was particularly true for Reynir Indahl, Founder and Managing Partner at Summa, who had prior experience in the industry from having been involved in Norsk Gjenvinning, Norway's leading waste management company, during his time at the Swedish PE firm Altor Equity Partners. Thanks to Indahl's prior experience in the industry, Summa was invited to meet with the management team of Sortera, which was highly entrepreneurial with both founders being part of the management as CEO and CFO. During those meetings, the Founder and former CEO of Sortera felt that Summa would be a good match:

> I thought that Reynir zeroed in on the right questions and we achieved consensus on goals [strategic and financial] and how we should take the company to the next level and that in turn made me want to choose them. (Founder and former CEO, Sortera)

One of Summa's pre-conditions for acquiring Sortera was the alignment of strategic and financial objectives, which as highlighted in the above quote was fulfilled. After the completion of the acquisition, Summa and Sortera together developed a strategic business plan and a set of business principles, referred to as *The Sortera Way*. These principles were to dictate how Sortera would operate as a company with regards to for example basic code of conduct and its strategic domain, described in following way:

> They had a very standardised approach around how they made their offices, conducted their meetings, talked to customers, treated materials and trucks and which add-ons they pursued and how they did them. […] Some things

> were clearly defined and some of it was more a perception of how they wanted things to be. For example, all offices were super clean and you had to take off your shoes when you went inside. All in all, they had a clear perception of what they did and how they did it. When we came in, The Sortera Way wasn't defined, so we tried to make it more defined and structured. (Investment Director 2, Summa Equity)

4.1.3. Putting ESG on the agenda – introducing ESG KPIs

One of the first initiatives undertaken by Summa in Sortera was to put ESG on the agenda for both management and the Board.

> When we entered, it [Sortera] was a very nice company with a good ESG profile, but they did not know what ESG was really about. There was some focus on the work environment, but no sustainability report and they did not measure anything related to ESG. However, they were operating in a sustainable industry, and I would say that they unconsciously focused on certain sustainability aspects but more related to health and safety as well as compliance and protecting the downside rather than creating value. (Principal, Summa Equity)

As part of this process, Summa held several workshops to ultimately compile a materiality matrix. Interviews with stakeholders of Sortera were conducted, including owners, employees, suppliers, customers and the local environment in which the company was operating in order to obtain input on what the company's material risks and opportunities were. Having performed these workshops and put a materiality matrix in place, Summa together with Sortera then asked themselves: what are the ESG risks and opportunities? Based on that, which KPIs should be used? Summa then inquired Sortera to start issuing a sustainability report which was initially received with some resistance from the company.

> They said: 'we have already an annual report and ISO certification, why should we have another annual report?' But after having pushed them to do it and distributed printed versions in the office, they quickly realised that the reports disappeared and management was wondering: 'where have they gone, we have printed a huge number of copies?' Soon, they realised that the salespeople at Sortera had brought the sustainability reports to client meetings to win new business. This was a major turning point for management who realised that this is not a report we do to make Summa happy and a tick the box exercise but something that creates value for Sortera's business. In the following year, it was the salespeople who knocked on management's door and asked for the sustainability report: 'have we improved from last year and what do we do to achieve our targets?' Management then understood that they had taken step number one and that it was time for the next step, which was not only to measure different ESG KPIs but also continuously improve and stay ahead of the competition. In other words, management started thinking: 'now we have measured this and that, we are on this level but what should we do to become even better?'. (Principal, Summa Equity)

The introduction of the sustainability report became, as highlighted, quickly a central part of Sortera's business being issued once every year documenting for example Sortera's compliance with ESG regulation, investment in recycling technology and sustainability improvements in its value chain. **Appendix G** shows a materiality matrix from Sortera's 2020 annual sustainability report and **Appendix H** examples of KPIs from the same report. Thanks to the increased attention directed by the public and regulatory authorities towards the waste management industry in recent years, Sortera came to be deemed as a company with best-in-class ESG practices. This reputation led to a strong competitive advantage which enabled the company to increase its market share and demand premium rates for its services. Having started early with issuing a sustainability report also gave Sortera a head start that was difficult for its competitors to catch up on.

> Almost everyone has sustainability reports now. But one should keep in mind that it is a learning ladder to get there [where Sortera is]. Sortera is on a level today that many are not until a couple of years because it takes time to get there. It is a bit of trial and error. There is not an obvious solution for all companies and no matter how many consultants you receive help from – the level that Sortera is on today takes time to reach. You need to do some reports and get through the KPIs and find the right KPIs for your follow-up and business and that takes some years. (Founder and former CEO, Sortera)

Later during Summa's ownership, bonuses to the CEO and the rest of the management team were linked to ESG KPIs, which determined the amount being paid out. Besides financial incentives, Summa also saw an increased intrinsic motivation among members in the management team in Sortera as they became more familiar with the ESG KPI system. This facilitated accountability and goal setting, which further assisted Sortera's sustainability improvements.

4.1.4. Upgrading and incentivising the Board and management team

As part of the process of putting sustainability on the agenda in Sortera, Summa also noticed that there was a need for increased competency with regard to ESG in the company. This led to the recruitment of a member with a very clear ESG profile to the Board. In addition, Summa and Sortera jointly recruited a Head of Sustainability and a Chief Cultural Officer (CCO). The responsibility of the Head of Sustainability mainly included setting and developing ESG-related strategic plans and ensuring that undertaken operational initiatives were compliant with Sortera's ESG strategy (**see section 4.1.5.)**. The CCO was, on the other hand, responsible for establishing a culture which supported interactive communication, openness and diversity. Furthermore, a Principal from Summa became the Chairman of the Board in Sortera. Combined, these initiatives were important in shifting the mindset with respect to ESG in the company.

> Some traditional companies regard ESG as an HR function where there is a person responsible for ESG who runs around with a checklist and wants to tick some boxes. Achieving the mindset that this is not a compliance or tick the box exercise, but really something that should be part of the business decisions taken by management and be an integrated part of how one thinks about the strategy and the business was very important from Summa's point of view. (Principal, Summa Equity)

In addition to bringing in key people with ESG competency, the diversity in the Board and management team was also enhanced during Summa's ownership. The company went from having zero women in the Board to two. Furthermore, when Summa entered Sortera there were only men in the management, amounting to a total of five people. At exit, there were three women in the management team. In addition to increasing the diversity in the Board and management, diversity in terms of for example gender, ethnicity and prior experience was also implemented throughout the organisation.

Finally, management incentive programmes (MIPs) aiming to align the interests of both newly added management team members and old ones with the interests of Summa were implemented from start. The mechanisms enabled key management employees to invest their own wealth in Sortera with the ability to earn a significant return upon Summa's exit.

4.1.5. Implementation of ESG-focused operational initiatives

The use of ESG KPIs as well as the recruitment of people with an ESG background proved to be important parts in Summa's value creation plan to implement operational improvements in Sortera. When Summa started its partnership with Sortera, it had a large recycling facility that used diesel as a source of energy. Management and the Board in Sortera were investigating alternatives to upgrade or replace this facility and Summa assisted the company in this process by asking questions that made the people at Sortera think in a broader way.

> You could obviously buy a new diesel machine. However, by asking how much diesel costs we could save by switching to an electric alternative you make them evaluate both alternatives where they then realise that the company can save a lot in diesel costs in the long run […] But it is also about putting ESG on the agenda for management and the Board and also upgrade the ESG competency in the organisation so that you have the right competency in management and the Board that can ask the right questions. […] The discussions become different compared to if that competency is lacking in the room. (Principal, Summa Equity)

In 2017, the decision was then made by the Board to invest in a new electric recycling facility, which became one of Europe's most modern recycling facilities and the largest capital expenditure in the company's history. The benefits from this investment were several. Profitability increased due to i) increased recycling rates which reduced the per unit labour cost and ii) reduced energy costs in the form of diesel via electrification. In addition, there were environmental benefits owing to an increase in material recycling which saved a substantial amount of resources and a reduction of carbon emissions thanks to the shift to a renewable energy source. The investment also had positive social effects by improving the health and safety of the facility-employees and communities close to the facility. This was primarily accomplished by reducing the risk of accidents as well as by reducing the noise, pollution and risk of fire. Furthermore, there were also benefits from a regulatory compliance point of view since the new facility facilitated the Swedish construction industry's compliance with an EU Directive from 2018 concerning packaging and packaging waste. A Principal at Summa highlighted this investment as one of the initiatives with a multiple bottom-line effect where there was a positive financial, environmental, social and governance effect.

As waste collection was a major part of Sortera's business, it owned a large fleet of trucks. Using and analysing the ESG KPIs, where Summa and Sortera saw that emissions were greatest from the fleet of trucks, an initiative was then taken to cap the maximum speed of the trucks to 80km/h which reduced the fuel consumption by 10%. Similar to the electric facility investment, this initiative too had multiple bottom-line effects. Fuel costs decreased by 10% (financial effect), carbon emissions were reduced (environmental effect) and the number and risk of accidents declined (social effect). Furthermore, the fleet of trucks was standardised to one type which was beneficial both from a safety perspective as it took time to understand how new trucks worked and from a resource perspective as only one type of spare parts was needed, instead of multiple for different trucks.

The use of ESG KPIs also had an effect on the culture at Sortera. One of Sortera's traditions was to have a cake in the office every time the company set a new sales record. As Sortera broke one record after another, this tradition started to become an issue as sick leaves increased and health KPIs deteriorated. The company then got rid of the cake tradition and offered free health examinations, sponsored runs, company-wide physical exercises, floorball exercise and spinning classes together with Summa which had a very positive effect on reducing sick leaves.

4.1.6. Expansion through acquisitions

Already before investing in Sortera, Summa saw that there was a large potential for Sortera to grow through add-ons by expanding both geographically and into adjacent niches. Due to a fragmented market within the niches that Summa was investigating, there was a large buy-and-build potential. During Summa's ownership, Sortera completed 10 add-ons across Sweden and Finland. Many of these deals were sourced by Summa themselves by forming relationships with potential targets and thereby avoiding bidding processes. This turned out to be a contributing factor to Summa's financial success with Sortera. Furthermore, a key factor in materialising these add-ons was Sortera's increased focus on ESG.

> People were much more inclined to join due to this [Sortera's ESG focus]. This was one important reason to why the acquired businesses thought that it made sense to join Sortera. (Investment Director 1, Summa Equity)

> Many of the companies that we acquired, they saw that it was difficult when it came to the ESG topics that they were to tackle on a standalone basis, and they saw Sortera as a safe haven that they can roll into and get the assistance that they needed within these topics. (Investment Director 2, Summa Equity)

The acquisitions not only entailed geographical expansion for Sortera, but also expansion of product and service offering where two new complementary business segments, Materials and Industry, were added to the already existing Recycling segment. Having had investment professionals with experience in conducting M&A transactions, Summa was very involved in these M&A processes at Sortera:

> We supported a lot in the M&A processes and during some periods it was almost as Summa was acting CFO in the company. […] We also led the effort in idea generation and supported

in financial due diligence, financing and the legal part. So, we used our [M&A] transaction skills in the whole process. (Investment Manager 3, Summa Equity)

An important element in many of the acquisitions made were synergies, where at least 50% of the acquisitions had clear synergies. One of the synergies was related to procurement where an increased size entailed higher purchasing power leading to lower costs. Another was the sharing of best practices. If for example one of the add-ons within Sortera was skilled in logistics and another in handling customer relations, the routines and procedures from these companies were examined to see if they could be applied in other companies to drive revenue growth and improvement of margins.

Another very important aspect in the buy-and-build strategy was Summa's aim to professionalise an industry with many unprofessional players.

> We were very clear to Sortera […] that they need to be the leading value creating player in this industry. By being the leading player who actually contributes to value creation in an industry with a lot of unprofessional players, Sortera would achieve a competitive advantage. It cost perhaps more in the beginning, but the customers were getting larger and larger needs in the form of for example regulation related to recycling of construction materials. (Investment Manager 3, Summa Equity)

> The waste management industry is an industry with many unprofessional players and by being a professional player with a clear sustainability profile, Sortera was creating a lot of societal value by making sure that the waste that represents a large resource for the society was handled in a correct and responsible way. That created much value for the society at large. We saw what the outcomes were when competitors did not handle the waste in a correct way because this created large societal costs, both by there being a risk of fire in waste facilities which creates pollution and smoke but also costs to remove illegal landfills. (Principal, Summa Equity)

Considering the large number of add-ons made by Sortera, the selection, cultural fit and shared ideological values of add-ons became imperative along with the post-acquisition integration. The evaluation of add-on targets and the integration process were facilitated by *The Sortera Way* and made the add-on processes streamlined, further illustrated by the following quote:

> We wanted to create one integrated group and not a bunch of businesses, and The Sortera Way was a way of getting there. It represented a way of working at Sortera and when you joined the group that was how we did things in terms of reporting, organisational stuff, code of conduct and all these types of things. So, we really had an integration roadmap for each of these add-ons. (Investment Director 1, Summa Equity)

4.1.7. Use of leverage

Throughout Summa's ownership in Sortera, multiple initiatives which required additional financing, on top of the significant use of leverage at entry, were implemented. Among the more capital-heavy initiatives were the add-ons in order to grow the business and expand into adjacent business areas, for which mainly debt and to a small extent roll-over equity from previous management were used. The use of debt in conjunction with the add-ons allowed Summa to amplify its returns from its investment in Sortera. One important aspect that facilitated the possibility to be granted leverage was that Summa had a very good relationship with the banks. An Investment Director at Summa further accentuated that:

> Financing in the Nordics is a relationship business, and it is crucial that you have good relationships and mutual trust in order to get things going [be granted debt]. (Investment Director 3, Summa Equity)

An additional factor that gave tailwind for Summa in securing debt financing in conjunction with the acquisition of Sortera and for add-ons was the fact that Sortera was positioned as a strong ESG player. This made associations with the company attractive from a stakeholders' point of view and also played a role in the relationship with banks, as illustrated by the following quote:

> It was not necessarily the case that we received a discount on the interest rates […] rather that it gave us a tailwind in credit committee meetings [at the bank]. Of course, it is easier to present a case to the credit committee when it has a positive sustainability profile. (Investment Director 3, Summa Equity)

4.1.8. Establishing the governance model

As a standard entry procedure, Summa and Sortera entered various contractual agreements such as a share purchase agreement (SPA) and a shareholder agreement (SHA), which included a standardised set of clauses relating to for instance dispute resolution, lock-in in relation to MIP, non-compete and exit rights. However, these were looked upon as a formality and a legal protection rather than as a means of control and governance:

> Generally, of course you need an SPA in place, but if you come to the stage where you have to point to the SPA to get something to work, you are probably not in a very good place. So, my hope is to never look at that agreement again [after it is signed]. (Investment Director 2, Summa Equity)

When asked about whether any of the contracts were related to ESG impact or financial goals Summa had as part of their initial plan in Sortera, the same Investment Director commented the following:

> We had standardised contracts in place but none were related to strategic plans or SDG goals or even financial goals. The way you collaborate and influence [through other means] takes away the uncertainty and it is so much more powerful than what you have contractually agreed on. [With Sortera] We needed to find a way of working together, get to know each other and learn each other's strengths and weaknesses [to achieve value creation goals]. (Investment Director 2, Summa Equity)

The collaboration translated into viewing the journey as a joint partnership, despite Summa being the majority owner with the ultimate decision power. Mutual exchange of skills and knowledge was encouraged along with transparency and open communication.

I think Summa has succeeded extremely well with finding people who fit together and can collaborate and deliver together with the management, rather than finding 400 Zlatan [Ibrahimović] who think who think they will all be number 1 - because that will not work. Private equity firms can think what they want, but if they do not have motivated management teams and CEOs, the companies [they own] will not deliver. (Founder and former CEO, Sortera)

As part of the ambition to grow Sortera from a local waste manager into a leading Nordic player with solutions that spanned across multiple business segments, Summa implemented a business plan in collaboration with Sortera that would dictate the improvement avenue in the company. The plan included an operational financial model, used to translate ongoing dialogues into numbers as well as presentations and written documents to prescribe strategic initiatives and priorities. In addition, the plan was used to form strategic targets with different time horizons.

We used them [the documents outlining the plan] as a tool going forward and it had very clear drivers of the case – e.g. number of bags and number of pickups. We used them [the documents outlining the plan] to set targets but also in budgeting and when we did new acquisitions. (Investment Director 2, Summa Equity)

The operational model also fed into the budgeting and the strategic evaluation of Sortera. Once a year, Summa had discussions about the overall strategic direction of Sortera, which usually took place during the summer. In the last quarter of every year, Summa had a series of Board meetings where discussions around the budget and forecasting took place, with input from the strategy meetings that had occurred previously during the year. To continuously keep track of Sortera's development also throughout the year, Sortera reported monthly on the progress of the budget which was evaluated by an audit committee. Moreover, a valuation of Sortera was conducted on a quarterly basis to keep track of both the financial value creation and the different ESG goals and reported to Summa's investors.

In total, Summa had three main communication forums. First, Summa conducted Troika meetings, in which the CEO of Sortera, the deal partner at Summa and the Chairman of the Board at Sortera held discussions around the business plan and ongoing strategic initiatives. Second, Summa also held regular Board meetings on a monthly or bi-monthly basis to discuss the progress of Sortera's operations and evaluate the progress on key strategic objectives. This allowed Summa and Sortera to have conversations around potential improvements and take corrective actions if outcomes deviated from key strategic objectives. Finally, key topics regarding live activities such as operational initiatives, financing and organisation were discussed in smaller groups and between members of the Summa and Sortera teams on a bi-weekly basis, where Summa could continuously follow the progress on key objectives. Site visits was also a part of how Summa and Sortera interacted, enabling Summa to obtain a first-hand perception of how Sortera progressed as a company and meet employees from all levels to also strengthen the relationship.

4.1.9. Exit

The journey that Summa had done with Sortera not only improved the revenues (that went from around SEK 282 million in 2015 to SEK 1.4 billion in 2020) and profit margins of the company but also the valuation multiple at exit. There were three key drivers for the multiple expansion. One was the increased size of the company where Sortera became more well-diversified at exit compared to at entry. At exit, the company had three divisions consisting of the previously mentioned segments Recycling, Materials and Industry and had presence across the whole of Sweden as well as presence in Finland. See **Appendix I** for an overview of Sortera's business at exit. The second key driver was the M&A track record that Sortera had built during Summa's ownership where Sortera had successfully integrated 10 add-ons in a short period of time. This demonstrated that Sortera was a platform with successful acquisitions that the new owner could continue to build upon. The third key driver was the clearer focus on ESG.

> Sortera is top 11 in the Sustainable Brand Index. What can be seen among both public and private companies is that buyers are willing to pay a higher multiple for a company with a good ESG profile. (Investment Manager 4, Summa Equity)

Although Sortera was performing very strongly both growth and margin wise, Summa reached a point where it made sense for a new owner to take over the company as Summa had done what they had planned to do with the business.

> The decision to sell Sortera was mutual and was a discussion topic for almost a year. Of course, there were more we could do [implement initiatives], but the timing was right. (Investment Manager 3, Summa Equity)

On 8 March 2021, the Swedish PE firm Nordic Capital acquired Sortera from Summa (Nordic Capital, 2021) and Summa achieved a very high financial return on the investment in Sortera.

> We typically underwrite our base cases on a multiple of 3x and sometimes a bit more. But the outcome of this investment was quite substantially higher and also much higher than the current valuation that we had in our books. (Investment Director 1, Summa Equity)

When reflecting upon the value creation in Sortera during Summa's ownership, a Principal at Summa said:

> One can think of value from several different perspectives. […] From Summa's perspective, Sortera has created value for our investors through a fantastic financial return. From the employees' perspective, Sortera is creating much value to them by providing a safe and attractive workplace that is a fun and motivating job to go to. From an environmental perspective, Sortera is reducing the amount of CO_2 and has a positive CO_2 contribution that contributes to reaching the sustainability goals. Last but not least [….] Sortera is creating societal value by professionalising an industry with many unprofessional players. (Principal, Summa Equity)

4.2. Empirical analysis

In this section we will, based on our empirical findings, address the research question in this paper, that is: how can an ESG focus be implicated in the value creation process in private equity and how does it affect how management control systems are designed in supporting such a process?

Guided by the theoretical framework presented in ***section 2.4.****, this section will start with addressing the first part of the question, i.e. how an ESG focus can be implicated in the value creation process in PE, before moving on to the second part of the question, i.e. how it affects how management control systems are designed, and finally showing interlinkages between management control systems and their involvement in the value creation levers.*

4.2.1. Financial engineering

As highlighted in **section 4.1.**, Summa created value in many different ways in Sortera, not only financially but also from environmental, social and governance perspectives. Throughout its ownership in Sortera, Summa used many traditional PE value creation tools but also added various new sustainability angles to this toolbox in many but not all respects.

From a financial engineering perspective, Summa not only used considerable leverage when acquiring Sortera but also when completing the add-ons. By using substantial leverage at entry, Summa limited the amount of equity that they needed to invest initially and by financing the add-ons entirely with debt, alongside roll-over equity from previous management, Summa did not put in any extra equity post the acquisition of Sortera. This contributed strongly to Summa's success in terms of financial returns, as the equity contribution from Summa at entry was kept low while at the same time the equity proceeds at exit had become large. This was illustrated by Investment Director 1, who mentioned that the returns multiple at exit was very high for Summa. One aspect that facilitated the obtaining of debt financing was Summa's strong relationships with the banks as well as the strong ESG profiles of Summa and Sortera. However, rather than obtaining a discount on interest rates, Summa and Sortera's strong ESG reputation gave tailwind in the credit committee discussions for debt financing at the bank and enabled them to repeatedly raise debt to finance add-ons. Concludingly, the implications of the ESG focus on the value creation process from a financial engineering point of view were relatively limited.

4.2.2. Operational engineering

The case study shows that Summa was engaged in operational engineering in several different areas. Summa was for example active in sourcing proprietary deals. Moreover, Summa was highly involved in the M&A processes throughout its ownership period in Sortera where the investment professionals at Summa utilised their M&A transaction skills.

There were multiple financially oriented aspects in the buy-and-build strategy: i) many of the add-on acquisitions were proprietary deals, ii) all of the add-ons were made by Summa without injecting any additional equity, iii) a multiple expansion would be achieved by making add-ons and iv) operational synergies in the form of for example purchasing power and sharing of best practices were realised. These more financially oriented aspects might, rightly so, raise questions if this way of growing the company was mainly financially motivated with ESG being only a secondary matter. Our findings indicate, however, that this was not the case as Summa's ESG focus was in the centre of this strategy. First of all, the increased ESG focus implemented by Summa in Sortera helped the company in attracting add-on targets owing to its ESG profile, as was stressed by two investment directors at Summa. In addition, Summa's strong ESG focus with creating societal value played an essential role in the buy-and-build strategy through the professionalisation of an industry with many unprofessional players. Thereby, the focus was not only to use a buy-and-build strategy for financial benefits. Instead, by bringing in and integrating additional companies into Sortera, Summa was able to contribute to professionalising the industry which had direct societal benefits. In a longer term, there would also be financial benefits arising from this as it gave Sortera a competitive advantage.

Although the reason for completing the add-ons was not only to achieve a multiple expansion, it still contributed heavily to it. The fact that Sortera became a larger and more diversified company at exit was a key driver to the multiple expansion. In addition to that, a second key driver for the multiple expansion was also the M&A track record that Sortera had built which the next owner could rely on and utilise going forward. Moreover, the ESG focus implemented by Summa in Sortera also played a key role in this multiple expansion. Investment Manager 4 at Summa highlighted that this was the case due to buyers, in both the public and private markets, being more willing to pay a higher multiple for a company with a strong ESG focus.

However, Summa's ESG focus did not only have a central role in the buy-and-build strategy but also in identifying and implementing purely operational improvements in Sortera. Summa's ESG focus led to ESG being put on the agenda at Sortera and the implementation of ESG KPIs as well as the issuance of an annual sustainability report. A direct benefit of this was that it helped the company to win new business as the salespeople used the sustainability reports in client meetings which was highlighted by the Principal at Summa. Furthermore, together with increased ESG competency in the company through additions of personnel with an ESG background, it laid the foundation for new operational initiatives at Sortera. This was in the form of an investment in a new electric recycling facility, standardisation of and speed limits on Sortera's trucks and improvement of the environment at Sortera from a health perspective through removal of the cake tradition. As was accentuated in the case, the investment in a new electric facility and standardisation of and speed limits on Sortera's trucks improved the margins at Sortera. However, these initiatives further had positive effects from environmental, social and governance perspectives thereby demonstrating that there does not necessarily need to be a trade-off between financial and ESG aspects. In the longer term, these initiatives gave Sortera a head start that was difficult to catch up to in terms of sustainability reporting. The initiatives also led to the company being seen as one with best-in-class ESG practices, giving Sortera a competitive advantage that enabled it to increase its market share and obtain premium rates for its services, further showing how ESG contributed to financial benefits.

4.2.3. Contractual controls

As asserted by Investment Director 2 at Summa, the contractual controls were limited in Sortera and the interviewee argued that these contracts in the form of SPAs and SHAs included a standardised set of clauses.

As Summa's investment model is highly centred around ESG practices, one could expect that there would be ESG-linked contractual clauses between Summa and Sortera. However, the nature of the topic was seen as too uncertain to be formalised in a contract and better built through collaboration and social influence. As was noted by Investment Director 2 at Summa, finding the way of working together and learning the team members' strengths and weaknesses was seen as the crucial step in order to implement initiatives that created both ESG impact and financial value. Moreover, contractual clauses were rather seen as formality instead of a central part in Summa's governance model, further evidenced by the joint decision making revolving the exit in Sortera. The contractual clauses included numerous exit rights, which formally allowed Summa to order a full divestment of Sortera including those shares held by minority owners, such as management and Board members. However, in practice and as illustrated by Investment Manager 3 at Summa, the timing of the exit was rather jointly determined through ongoing dialogue with the objective of doing what was best for both Summa and Sortera.

To summarise, this paper has not identified any contractual control mechanisms implemented by Summa that directly relate to financial value creation or ESG impact. The contractual clauses employed by Summa can be seen as a standardised and uniform set of formal rights, which implies that despite the ESG-centric mindset and investment model of Summa, contractual controls were not seen as nor used to support either financial value or ESG impact in Sortera. Instead, social controls were more dominant in resolving contractual matters and in supporting the achievement of value creation objectives (see **section 4.2.6.**).

4.2.4. Results controls

The design of Summa's results controls in Sortera were used to i) control for financial value and ii) control for ESG impact. These two outcomes were in multiple instances interlinked in the sense that some initiatives were perceived as a support for value-add both financially and from an ESG impact standpoint. Some of such results control mechanism related to incentives, which came in the form of MIPs and management bonuses. While there were no explicit links between ESG impact and the MIP, there is support for an indirect link between the two. The primary purpose of the MIP related to aligning incentives to create financial value at exit and there were numerous ways to reach a strong financial outcome. As such, Summa's way was in part to enhance the ESG profile through various initiatives, thereby making the company more attractive from a future buyer's perspective. Besides MIP, there were incentive schemes more directly tied to control for ESG impact. Summa implemented a rigorous set of ESG KPIs which were linked to management bonuses, thereby more directly incentivising key employees to undertake and drive initiatives which would contribute to Sortera's ESG impact.

An explicit usage of KPIs to monitor Sortera's progress from an ESG impact aspect served as an additional layer to how Summa evaluated the different impact areas in Sortera. For instance, Summa and Sortera closely followed various trackers of employee health, carbon emissions and energy consumption in Sortera, and evaluated these on a monthly and quarterly basis. Thus, some KPIs were tracking purely ESG impact areas (e.g. employee health and CO2 emissions), while other KPIs (e.g. energy consumption) had a dual purpose and integrated tracking of both ESG impact and financial value creation (see **Appendix H**).

Finally, during the acquisition process and throughout its ownership, Summa carefully crafted business plans which included strategic targets with clear time horizons and were executed to make Sortera a more sustainable company. The strategic targets worked as a set of results controls and guided Sortera in the implementation of operational initiatives such as the electrified waste sorting facility and the truck standardisation and speed limits. Further, these initiatives had both a positive ESG impact (e.g. reduced carbon emissions and improved employee health and safety), as well as positive financial impact (e.g. improved efficiency, decreased fuel costs).

In summary, Summa's use of results controls in Sortera came in three forms: i) financially driven, ii) ESG driven and iii) a combination of financially and ESG driven. The combination of the financially and ESG driven forms emerged as some ESG driven results controls also facilitated financial value creation and vice versa. Thus, the empirical evidence seems to point towards the prevalence of an integrated use between the two forms.

4.2.5. Behaviour controls

An overarching behaviour control mechanism implemented in Sortera was to educate the firm in how to think about ESG. The existing ESG awareness at the time of Summa's entry was more unconscious and related to health, safety and compliance to protect the downside risk rather than addressing Sortera's financial value creation and external ESG impact. First, to assist Sortera in the learning process and concretise Sortera's ESG strategy, Summa brought on board key employees with ESG background and initiated the position of Head of Sustainability in Sortera**.** This position had the role of directing the behaviour of Sortera's employees as well as driving the development of strategic ESG-related plans and ensuring continuous development. Second, Summa brought onboard a CCO, who had the overarching responsibility to form a corporate culture that would foster openness, diversity and facilitate idea sharing. Third, a Principal from Summa became the Chairman of the Board which also allowed Summa to dictate the ESG strategy through a more formal governance approach such as Troika meetings, and bi-monthly Board meetings.

Besides bringing onboard key personnel, Summa also implemented a slogan pertaining to how Sortera should operate as a group: The Sortera Way. This slogan defined how Sortera conducted business on all levels and what opportunity seeking behaviour was considered in line with the overall strategy. It worked as a set of business principles and concept of best practices and was used to delimit everyday actions and set the strategic domain for employees within which they were expected to comply. In addition, it worked as a roadmap for integrating add-ons. The slogan enabled employees on all levels to perceive ESG and financial value creation as complementary to each other rather than a trade-off. The Sortera Way enabled Summa and Sortera to form a strategic domain in which no compromises were made at the expense of either ESG impact or financial return. The strategic domain also helped to build the foundation on which other behaviour control mechanisms could emerge. For instance, it acted as a support in developing strategic business plans. Furthermore, the use of ESG KPIs and the intrinsic motivation observed in employees when trying to beat old KPI figures directly illustrate the shift in employee's mindset and their embracement of the slogan and active participation within the strategic domain. For the individual employees, the formulation of the slogan, the hiring of key ESG employees and a CCO as well as the development of a strategy and a strategic business plan acted as a roadmap and guided them in how to continuously develop Sortera, both from an ESG impact perspective as well as a financial perspective.

In summary, there was a clear tendency to design behaviour controls in a way that created i) an ESG mindset dictating how to reach ESG impact by hiring people with long experience in the ESG, ii) a common vision and strategic domain through a set of business principles tightly associated with the brand Sortera, iii) an ESG strategy by being active in the Board and developing a strategic business plan and iv) a culture that promoted openness and a shared set of values by hiring a CCO.

4.2.6. Social controls

The use of social controls was a central part in the overall design of the management control systems in Sortera. A salient characteristic observed in the relationship between the two companies was the reciprocal learning and open communication in the sense that both parties were open to acquiring skills and knowledge from each other. The relationship was perceived by both parties as a collaboration between two partners rather than a formalised, one-way governing model. As was emphasised by the Founder and previous CEO of Sortera, the composition of people in the Summa team and their approach towards a collaborative relationship was one of the main reasons Summa and Sortera had a such successful journey together in terms of ESG impact and financial value creation.

There were also multiple concrete initiatives implemented by Summa which related to social controls and facilitated the successful partnership between Summa and Sortera. First, through the recruitment of personnel with ESG competency in Sortera, Summa was able to intellectually stimulate ESG-focused discussions that took place in the various communication forums. As noted by the Principal at Summa, these recruitments were important initiatives as an ESG competency in the organisation was crucial in order to drive the company further in creating both financial value and ESG impact. Second, through the recruitment of a CCO, Summa was able to establish a culture that embraced diversity and openness to ideas, further facilitating social interactions and information exchange. By creating a more diverse Board, management team and organisation at large, Summa also ensured that the ESG-focused discussions could occur in various communication forums, where the diversity and openness to ideas served as a foundation. This, in turn, facilitated the emergence of various opinions, ideas, as well as acceptance and interactive discussions around those in both formal settings such as in Board meetings, but also in less formal settings such as in monthly reviews, bi-weekly meetings and ad-hoc discussions about important strategic topics concerning financial and ESG matters. The topics discussed revolved around, for example, add-ons or operational initiatives, as elaborated on in **section 4.1**. In addition, site visits were also occasionally made to establish relationships and have constructive discussions with employees who were more operationally involved in different parts of Sortera. Third, Summa together with Sortera introduced various health and social activities as part of improving the overall employee health and encouraged employees on all levels from both firms to participate. The activities worked as more informal channels through which Summa and Sortera built their relationship and could exchange information.

In summary, the recruitment of people with ESG background and a CCO facilitated intellectually driven discussions regarding Sortera's strategy and ongoing initiatives as well as openness and idea sharing. These discussions were conducted in various communication forums together with Summa, ranging from Board-level to ad-hoc meetings. To further foster relationship building, less formal communication channels were used including site visits and various health and social activities.

4.2.7. Interlinkages between management control systems and their involvement in the value creation levers

The substantial involvement of behaviour controls in Summa's way of controlling Sortera seems to have had an important effect on the design of the remaining management control mechanisms and different value creation tools. Three of the primary ways behaviour controls were designed in Sortera during Summa's ownership was through i) strengthening the slogan The Sortera Way, ii) creating an ESG mindset by educating Sortera and increasing the ESG competency and iii) establishing a culture supported by the recruitment of a CCO. These three initiatives seem to have paved the way for setting Sortera's strategic domain and boundaries, establishing a code of conduct, and facilitating the education of Sortera. Specifically, the ESG mindset and the culture further facilitated reciprocal discussions around strategic business planning, as management and employees had gained a perception of the strategic domain and an ESG mindset. While Summa's selection of key personnel supported behaviour controls in the sense that it facilitated to set a strategic domain, form a strong culture to control behaviour, and set an ESG mindset in the organisation, this particular control mechanism also supported social controls. By recruiting ESG competency and a CCO, Summa could facilitate intellectual discussions, both within Sortera and between Summa and Sortera, in which ideas concerning Sortera's strategy could develop. As mentioned, the discussions concerning Sortera's strategy were carried out in various forums, ranging from Board level to ad-hoc meetings. Thus, to be able to have intellectually driven dialogues, having a common way of viewing Sortera's strategic domain and a strong culture supportive of new ideas and joint decision making were advantageous. This demonstrates the interlink between the behaviour controls and social controls deployed by Summa in Sortera.

The interlink between behaviour controls and results controls could be observed in the way the strategic business plans (part of behaviour controls) translated into concrete strategic targets and ESG KPIs (results controls) relating to for example add-ons and other operational initiatives. Moreover, the strategic boundaries enabled management to target and measure opportunities that were in line with the established strategic domain. In turn, incentive programmes such as the MIP and bonuses tied to KPIs, supported both the shorter-term strategic targets as well as the longer-term strategic plan by keeping management financially motivated. The evaluation of ESG KPIs and the outcome of the strategic plans were further subject to discussions in various communication forums, where both the ESG competency and culture came in to play, demonstrating the link between results, behaviour and social controls. Linking back to the theoretical framework presented in **section 2.4.**, **Figure 2** shows an overview of the design of Summa's management control systems and their relation to the value creation levers.

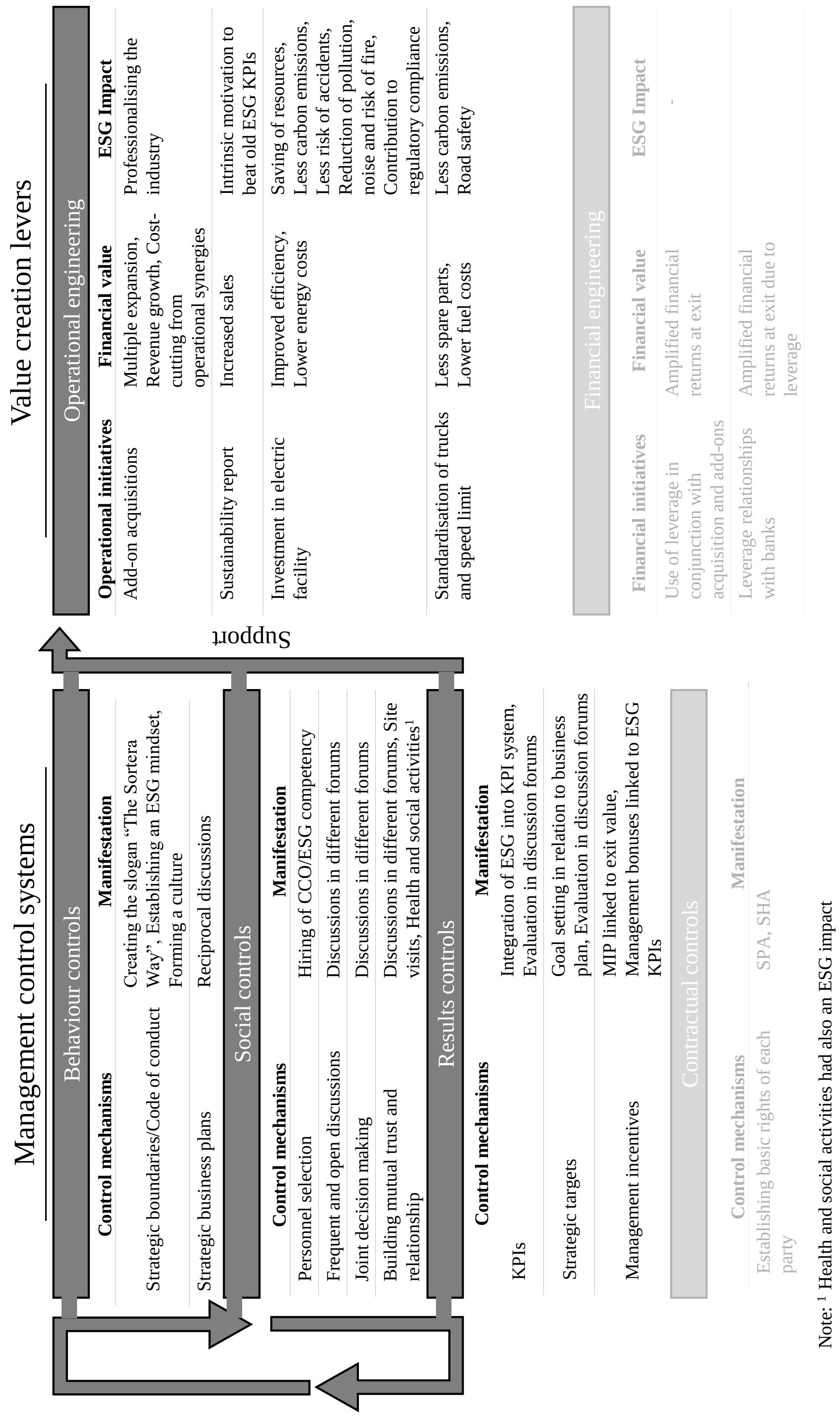

Figure 2: *Overview of the design of Summa's management control systems and their relation to the value creation levers*

While formal contracts were established at the time of Summa’s acquisition of Sortera, their use as a direct means of control for financial value creation or ESG impact were non-existent throughout Summa's ownership period. As indicated by Investment Director 2 at Summa, the purpose of the contracts was to formalise the basic rights of each party rather than to dictate any value creation goals or the strategic direction of the company. Instead, social controls seem to have been the better suited control system in establishing mutual trust between the parties and aligning on goals and strategic direction owing to the power of collaboration as well as the uncertainty of formalising financial value creation and/or ESG impact goals through contracts. Relationship building and open and constructive discussions through different communication forums ensured alignment between Summa and Sortera’s ambitions for the strategic direction in Sortera. Furthermore, social controls enabled discussions around different performance measures and the progress of various strategic targets and plans. Hence, in terms of in reaching mutual understanding and trust to execute the value creation strategy, social controls seem to have been the more dominant management control system, as opposed to contractual controls.

Although there is an example of where an ESG impact was achieved directly through a management control mechanism, i.e. health activities at Sortera, the various control systems implemented in Sortera were mostly used to ultimately support different value creation tools. The various control systems set the strategic direction, enabled Summa to evaluate the status of objectives and incentivise behaviour aligned with the overall objectives of ESG impact and financial value creation. As indicated by the case study, Summas’s involvement in Sortera’s journey had been high from start and included numerous operational initiatives such as facility upgrades and add-ons in new business areas and geographies. The operational initiatives undertaken by Summa were highly supported by the design of the control systems and helped Summa to achieve the desired strategic outcomes both in terms of ESG impact and financial value creation. The control systems were involved in different ways for different PE value creation tools. For instance, regarding add-ons, the ESG mindset, strategic domain, business plans and discussions with Summa through different communication forums were involved pre-acquisition. Directly after the acquisitions, The Sortera Way acted as a roadmap to integrate the add-on targets by explicating a clear code of conduct. In addition, as the add-on targets were integrated into Sortera as a company, other management control mechanisms such as ESG KPIs, MIPs and frequent meetings with Summa that were inherent parts of Sortera’s way of working naturally became part of the add-on targets as well. When for example looking at the ESG-focused operational initiatives such as the facility upgrade and standardisation of and speed limit on trucks, management control mechanisms involved, but were not limited to, the strategic domain, business plans, ESG mindset and competency, ESG KPIs and meetings with Summa through different communication forums. Considering financial engineering, on the other hand, there were small implications of an ESG focus on the value creation process (e.g. tailwind in credit committee discussions from strong ESG profile) and no direct links to ESG impact. Instead, this value creation lever was mainly used to create financial value through increased leverage contributing to a greater financial return for Summa and other shareholders in Sortera. From a control system perspective, there were no evidence of material support of financial engineering. Thus, operational engineering was the primary lever in which an ESG focus was implicated and through which Summa and Sortera achieved both substantial ESG impact and financial value creation, while supported by the management control systems.

5. Discussion

In this section, this study presents and elaborates on the major findings and their wider implications. Through a single case study of the Nordic ESG-focused PE firm Summa and its previous ownership in Sortera, this study examines how an ESG focus can be implicated in the value creation process in PE and how it affects how management control systems are designed to support such a process. This was done by integrating the findings of Bedford and Ditillo (2021) and Süsi and Jaakson (2020) with those of Kaplan and Strömberg (2009). These categorisations were synthesised into a framework to visualise interlinkages between ESG, management control systems and value creation levers in PE.

Contributing to the PE value creation literature (e.g. Døskeland & Strömberg, 2018; Acharya et al., 2013; Kaplan & Strömberg, 2009), this study shows how ESG was in the centre in the value creation process through the value creation levers presented by Kaplan and Strömberg (2009), thereby demonstrating how ESG not only can be integrated but also be a driving force in the PE value creation process. Although this was the case, Summa still used many traditional PE value creation tools as covered by previous research. From a financial engineering point of view, the findings of this study are in line with PE firms using significant amount of leverage in connection with acquisitions to its portfolio (cf. Døskeland & Strömberg, 2018), and that they can leverage their strong relationships with banks in this process (cf. Ivashina and Kovner, 2011; Demiroglu and James, 2010), as this was the case for Summa both when investing in Sortera as well as when conducting add-ons. Summa’s ESG focus was, however, to a small extent implicated in the financial engineering toolbox through its obtaining of debt financing in conjunction with the acquisitions where Summa’s ESG focus contributed to a stronger reputation. This is closely related to the findings of Demiroglu and James (2010) who found that PE firms with a good reputation are able to use more leverage in acquisitions and obtain better credit terms. However, in contrast, Summa’s strong ESG reputation did not necessarily mean that Summa obtained a discount on interest rates but it rather gave a tailwind in the credit committee discussions for debt financing at the bank and enabled Summa to repeatedly raise debt for financing add-ons.

From an operational engineering perspective, Summa were active in sourcing proprietary deals (cf. Schenkel and Strömberg, 2017; Kaplan and Terachi, 2003). As pointed out by Hammer et al. (2017), a buy-and-build strategy is a common strategy among PE firms, and this was also true for Summa’s value creation process in Sortera. Throughout its ownership in Sortera, Summa was heavily involved in the M&A processes where the investment professionals at Summa utilised their M&A transaction skills (cf. Døskeland & Strömberg, 2018; Acharya et al., 2013). Another aspect which is in accordance with previous relevant literature is that operational synergies are a driving force in a buy-and-build strategy (cf. Bansraj et al., 2020). In our study there were clear synergies in at least 50% of the add-ons in the form of for example higher purchasing power (cf. Bhattacharyya and Nain, 2011) and sharing of best practices to improve routines and procedures which is closely related to the finding of Gomes and Livdan (2004) who state that redundant activities are abandoned to capture synergy effects. Even though many aspects in the buy-and-build strategy are in line with previous research and a more traditional view on PE, a new nuance that the authors find is that Summa's ESG focus still permeated the buy-and-build strategy in Sortera. This was demonstrated in i) that the increased ESG focus implemented by Summa in Sortera helped Sortera in acquiring add-on targets in the sense that companies saw Sortera as an attractive business partner owing to its ESG profile and ii) that Summa's strong ESG focus with creating societal value played a central role in the buy-and-build strategy through the professionalisation of an industry with many unprofessional players. In addition to generating direct societal benefits, the professionalisation of its industry also gave Sortera a competitive advantage in the longer term thereby also enhancing its financials. Moreover, this study shows how the ESG focus implemented by Summa in Sortera drove the multiple expansion, as buyers in both the public and private markets are more willing to pay a higher multiple for a company with a strong ESG focus. Thus, the ESG focus in Sortera was a complementary factor alongside an increased size and diversification (cf. Døskeland & Strömberg, 2018; Hoffman, 2008) as well as a build-up of an M&A track record as drivers of multiple expansion. From an overall perspective regarding the multiple expansion, this study supports the finding of Acharya et al. (2013) in that PE firms create value in their PCs via multiple expansion.

Moreover, this study shows how an ESG focus not only can play a central role in a buy-and-build strategy but also in identifying and implementing purely operational improvements. Summa's ESG focus led to ESG being put on the agenda in Sortera which involved implementing ESG KPIs as well as issuing annual sustainability reports. This study demonstrates how this helped Sortera win new business almost immediately, but also how it together with increased ESG competency in the company through the recruitment of personnel with an ESG background, laid the foundation for new operational initiatives at Sortera. These initiatives consisted of an investment in a new electric recycling facility, standardisation of and speed limits on Sortera's trucks, and improvement of the environment at Sortera from a health perspective through removal of Sortera's cake tradition and introduction of workout programmes. The investment in a new electric facility and truck standardisation and speed limits improved the margins at Sortera which is a finding in line with that of Acharya et al. (2013) who suggested that on average, margin improvements is another value creation component alongside multiple expansion in PE. However, this study also sheds light on how these initiatives further had positive effects from environmental, social and governance perspectives. In other words, this finding allows for some reflection regarding the idea of doing well by doing good (see e.g. Habaragoda, 2018; Saeidi et al., 2014; Margolis & Walsh, 2003). In the longer term, these initiatives were translated into strong financial benefits as it gave Sortera a competitive advantage that enabled the company to increase its market share, as Sortera's level of ESG practices and reporting was difficult for competitors to catch up on.

In addition to showing how ESG can be implicated in the PE value creation process, this study shows how it affected how the management control systems were designed to support this process. Bedford and Ditillo (2021) find that there is significant variation of combinations of contractual, results, behaviour and social controls in PE firms in general. In addition, they find that social controls may play a central role in PE relationships. However, they also lay out the primary structures which can determine what control systems are most salient. These structures relate to equity arrangement (i.e. majority/minority ownership) and perceived cognitive style of management (i.e. entrepreneurial/managerial). Drawing on these findings, this study has discovered that Summa had a strong focus on results, behaviour and social controls, while the focus on contractual controls was limited in Sortera and exercised mainly at the acquisition stage to establish basic rights, much in line with Bedford and Ditillo (2021). Moreover, our findings do not only suggest a stronger emphasis on certain control systems, but also suggest a presence of additional control mechanisms related to for example ESG KPIs as well as management bonuses linked to those. The apparent emphasis and additional mechanisms may, however, not come as surprise as variation in control systems can be expected between different PE firms, as found by Bedford and Ditillo (2021). Nonetheless, when assigning the determining structures of control systems to Sortera, the investment would be categorised as a majority equity stake with an entrepreneurial management team. Further drawing on the study by Bedford and Ditillo (2021), this would imply an explicit focus on formal contracts, results controls and behaviour controls, and less focus on social controls. While the findings in Bedford and Ditillo (2021) are able to explain why results and behaviour controls were part of how Summa designed its control systems, the limited use of contractual controls does not seem to fit the framework (see **Appendix A)**. Instead of using contractual controls as a support for financial value creation and ESG impact in Sortera, Summa relied on social control mechanisms as they facilitated mutual trust, open communication and interactive discussions of the financial and ESG goals, among other topics. As indicated by Investment Director 2, the value creation goals were seen as too uncertain to be formalised through contracts, hence social controls were seen as more suitable to facilitate information flow and ensure objective alignment between Summa and Sortera. This discrepancy could potentially point towards the existence of an additional ESG structure besides the equity arrangement and the perceived cognitive style of management (see Bedford & Ditillo, 2021). The implications of the apparent ESG structure seem to result in the necessity of emphasising social controls and focusing less on contractual controls, as the nuances of both financial and ESG-related objectives are too uncertain to capture in formal contracts and that a continuous dialogue and collaboration is instead required.

In relation to Narayanan and Boyce (2019), the findings of this study present interesting dynamics. The various ESG-related initiatives in Sortera led to commercial impacts in terms of lower cost, improved efficiencies and reputational advantages. Furthermore, Sortera's ESG impact in relation to KPIs and strategic targets was discussed in various communication forums where conversations evolved around improvements and potential corrective actions among other topics, indicating that ESG-related information was used interactively. As Summa and Sortera ideologically view ESG impact and financial success as non-conflicting and that sustainability has a commercial value, the interactive use of sustainability information is per se in a commercial context, which would support the findings of Narayanan and Boyce (2019) and indicate that Sortera is a business case for sustainability. This would, in essence, imply that the management control systems were not playing a material role in Sortera's ESG change, as the business case for sustainability is not seen as a genuine ESG change. However, these findings should also be viewed with respect to the inherent differences between Summa's ideology and the theoretical setting of Narayanan and Boyce (2019). While Summa advocates a non-trade-off relationship between ESG impact and financial success, Narayanan and Boyce (2019) argue for a balance between economic, social and environmental considerations, thus implying a trade-off between ESG impact and financial success. While there can be, there does not need to be a trade-off between the two, as demonstrated by Summa's ability to create both financial value and ESG impact. Hence, based on this notion of sustainability, the findings of this study contrast to some extent with those of Narayanan and Boyce (2019) as the design of the management control systems in Sortera seem to have been important for the emergence of an ESG mindset, accomplished by for example recruitment of employees with an ESG background, thus going beyond a solely financial focus. This could in turn, among other things, drive change in the organisation. Additionally, there is a theoretical difference between Summa's and Narayanan and Boyce (2019) view on the non-trade-off versus trade-off of ESG and financial success and what genuine ESG impact entails. Hence, in order to make more decisive contributions, additional research with a similar theoretical lens is needed.

Sbarba et al. (2020) explore what management control mechanisms are used to align the interest of PE firms with those of their PCs'. The study was conducted with a shareholder-focused frame, hence the findings of the study primarily adhere to purely financially driven PE firms, as a shareholder perspective generally implies the objective of maximising financial value for shareholders. Nonetheless, there are multiple similarities in how Summa designed its management control systems, with regard to what control mechanisms were relied on. For instance, one of the pre-conditions of Summa's investment in Sortera was the alignment of ESG and financial goals for the company, which generated trust between the parties from start (diagnostic frame). Further drawing on Sbarba et al. (2020), the development of The Sortera Way, the strategic business plan based on the shared consensus of key financial and ESG objectives as well as ESG KPIs point to the presence of a prognostic frame in the early post-acquisition period of Sortera. Finally, evidence of the motivational frame could be seen in the establishment of incentive programmes in the form of MIP linked to the exit value of Sortera and management bonuses linked to ESG KPIs. Thus, in the case of Summa and Sortera, many of the same control mechanisms were used to control for financial value (shareholder-focused frame) and ESG impact (ESG-focused frame)[4]. The discovery suggests that there is an intersection between the ESG-focused frame and the shareholder-focused frame which the control systems design used by Summa seem to support. This supports the view that there is not necessarily a trade-off between the two frames, but rather

[4] Note that an *ESG-focused frame* is not a concept established by Sbarba et al. (2020) but has rather been constructed by the authors of this paper for the purpose of the discussion. An ESG-focused frame entails a sole focus on ESG impact.

that controlling for and achieving ESG impact directly can support financial value creation, thus supporting a shareholder-focused frame.

The alignment of ESG impact and financial value creation has been emphasised throughout this study. This finding is somewhat aligned with Süsi and Jaakson (2020), who argue that despite the short time-horizon of PE investments relative to the materialisation horizon of CSR goals, PE firms do see increased financial value from an increased CSR focus. Moreover, Süsi and Jaakson (2020) outline the control mechanisms used to support an increased CSR focus. Specifically, board composition (social controls), SHA (contractual controls), CEO selection and motivation (social and results controls), strategic advisory (behaviour and social controls), code of conduct (behaviour controls), KPIs and ESG reports (results controls) are described as the key control mechanisms. Besides contractual controls, some of the same control mechanisms were part of Summa's control systems that supported its ESG focus, indicating a somewhat similar control system design. Further building on the intersection-argument between the shareholder frame and ESG frame made with reference to Sbarba et al. (2020), the findings of Süsi and Jaakson (2020) relative to this study may support the existence of an ESG-focused frame and imply that it is not in opposition with the shareholder-focused frame. Rather, PE firms' and management teams' genuine belief in the superiority of ESG practices may enable PE firms to preserve the shareholder-focused frame of creating strong financial returns while at the same time creating ESG impact, which also resonates with Summa's investment philosophy as shown in its value creation journey with Sortera. Building on this discovery, the apparent support of financial value creation and ESG impact by the management control systems in Sortera may suggest that contractual controls are not as important as previous studies have suggested (e.g. Bedford & Ditillo, 2021; Süsi & Jaakson, 2020).

6. Conclusion

This study has sought to investigate how the changing discourse in PE with respect to ESG is implicated in the value creation process in PE firms and how it affects how management control systems are designed in supporting this process. Despite some studies declaring what value creation levers PE firms use to create value (Gilligan & Wright, 2020; Kaplan & Strömberg, 2009; Rogers et al., 2002), current research lacks explanations of how an ESG focus can be implicated in the value creation process. Moreover, current research on management control systems in PE has mainly focused on the types of control systems that come into play in the inter-relationship between PE firms and their PCs (Bedford & Ditillo, 2021; Sbarba et al., 2020) and the design of corporate governance mechanisms to support CSR oriented practices (Süsi & Jaakson, 2020). No studies have, thus, to the best of the authors' knowledge, investigated how the increasing adoption of ESG among PE firms can be implicated in the value creation process and how it affects how management control systems are designed to support such a process. Thus, this study aims to explore these identified research gaps. In order to explore the aforementioned theoretical gaps, this paper has focused on a few main topics. First, this study aimed to present how the value creation process in PE firms is conducted under an ESG centric investment model, as opposed to a purely financially driven investment model. Second, this study aimed to present a holistic view of how management control systems are designed under such an investment model.

The analysis of the empirical findings shows that the objective of driving ESG change in PCs can create an explicit focus on results, behaviour and social controls with less focus on contractual controls. In the case of Summa and Sortera, behaviour controls had an important effect on the design of the remaining control systems. The design of the behaviour controls manifested itself through i) The Sortera Way - a set of business principles, ii) the establishment of an ESG mindset through recruitment of ESG competency and iii) the establishment of a culture supported by the recruitment of a CCO which together supported in defining the strategic domain and facilitated the emergence of a strategic business plan. The three primary control systems were highly interlinked, as illustrated in **Figure 2**. First, the results controls in Sortera comprised concrete strategic targets and ESG KPIs supported by the business plan and the strategic domain. This helped Sortera to focus on the right objectives and measure the performance outcomes. In addition, results controls in the form of incentive programmes linked to the ESG KPIs employed in Sortera ensured a motivated and aligned management team. Second, social controls enabled interactive discussions around topics in different forums relating to both Sortera's strategy and performance measures in an open and intellectually driven environment supported by Sortera's culture and business principles. The analysis further illustrated how contractual controls in Sortera were seen as less important in supporting value creation, owing to the uncertainty of formalising value creation goals and strategic plans through contractual clauses. Instead, Summa used social controls to achieve mutual understanding of and trust to execute strategic plans and objectives as well as to discuss potential concerns and progress on the objectives relating to financial value creation and ESG impact.

Finally, the empirical analysis shows how different value creation tools (Kaplan & Strömberg, 2009) were supported by the different control systems. This was mainly demonstrated in the different operational initiatives and add-ons, which had their origination in the strategic business plans, but were also supported by various control mechanisms within behaviour, social and results controls. Thus, this study concludes that an ESG focus in PE firms can imply an explicit use of results, behaviour and social controls to collectively support the use of value creation tools to create financial value and ESG impact.

This study contributes to the PE value creation literature (see e.g. Døskeland & Strömberg, 2018; Demiroglu & James, 2010, Kaplan & Strömberg, 2009) by showing how ESG was in the centre in the PE value creation process thereby demonstrating how ESG not only can be integrated but also be a driving force in this process alongside more traditional PE value creation tools. More specifically, this study finds that a strong ESG reputation implies benefits in connection with the use of leverage as it leads to a tailwind in credit committee discussions. Moreover, this study contributes to the buy-and-build literature by demonstrating how ESG can help in acquiring add-on targets, in providing a long-term competitive advantage while at the same time providing societal benefits, as well as in driving a multiple expansion. In addition, this study demonstrates how a strong ESG focus can contribute to operational improvements that have a multiple bottom-line effect, with benefits from financial, economic, social and governance perspectives. Thereby, this study allows for some reflections with regard to the idea of doing well by doing good (see e.g. Habaragoda, 2018; Saeidi et al., 2014; Margolis & Walsh, 2003).

The contributions to the management control literature within PE are the following: first, this study contributes to Bedford and Ditillo (2021) by acknowledging the central role of social controls in PE relationships and by the addition of *ESG focus* as a structural factor besides the *equity arrangement* and *perceived cognitive style of management*. The ESG focus can explain why social controls are seen as more important relative to contractual controls in majority-owned PCs with an entrepreneurial cognitive style, as value creation relating to financial value and ESG impact can be too uncertain to formalise in contracts. Second, our findings highlight some contrasts relative to findings in Narayanan and Boyce (2019) in the sense that management control systems appear to facilitate change towards sustainability. There is some evidence of a business case for sustainability, concurrently this study also demonstrates how Sortera goes beyond the business case with respect to ESG by for instance recruiting ESG competency. Moreover, the fundamental theoretical view of what genuine ESG change entails differ between Summa and Narayanan and Boyce (2019). Hence, additional research with a similar theoretical view would be needed to provide more decisive contributions. Third, this study contributes to Sbarba et al. (2020) by discovering that many of the same management control mechanisms used to support a shareholder-focused frame can also be used in supporting an ESG-focused frame. Based on this discovery, this suggests that there is an intersection between an ESG-focused frame and a shareholder-focused frame in ESG-focused PE firms, where both strong financial returns and ESG impact can be achieved using a similar control systems design as in the case of Summa and Sortera. Finally, in relation to Süsi and Jaakson (2020) this study i) finds support to the findings by proclaiming that PE firms can see an increase in financial value from an ESG focus and ii) extends the study by suggesting that results, behaviour and social controls alone can support in creating financial value and ESG impact.

6.1. Limitations and future research

Naturally, this study comes with certain limitations. As this study has focused on one specific PE firm and PC, the insights gained will most likely be different in at least certain aspects compared to other cases due to the inherent differences between different PE firms and PCs. In addition, there might also be a geographical limitation to this study as the development of sustainability-focused investing practices has reached different stages in different parts of the world (Crifo & Forget, 2013). As ESG-focused investing is still in its early development stages, there will be an increasingly higher number of opportunities for further research within this field as more and more companies will be acquired and exited with time. Given differences in emphasis on sustainability across the world, with the Nordic region being in the top (RobecoSAM, 2019), conducting a similar case study in a different region could give new insights on the implications of an ESG focus in PE. Another interesting research topic would be to compare different investments made by a specific ESG-focused PE firm or multiple ESG-focused PE firms to find general patterns and case specific nuances that could be contrasted with each other. Furthermore, the authors would encourage future research to examine the PE value creation process for companies that are not ESG players as implementing an ESG mindset might be more challenging in such cases. What impact might that have on the management control systems? Will for example the contractual controls become more important? Finally, this study has not made any efforts to contrast Summa's view in that ESG impact and financial value are in no opposition to each other, as the purpose was rather to find potential implications of such a view on the value creation process and management control systems design. Hence, future research taking a more critical approach towards the ability to balance an ESG focus with a financial focus in ESG-focused PE firms, in line with Narayanan and Boyce (2019), might be able to provide new insights on the value creation process and management control systems design.

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Appendix

Appendix A

Framework from Bedford and Ditillo (2021)

Equity arrangement		**Perceived Cognitive Style** **Entrepreneurial**	**Managerial**
	Minority	FORMAL CONTRACTS Non-compete clauses and exit rights. SOCIAL CONTROLS Partner selection based on trust and ongoing interpersonal interactions to gain access to private information and influence decisions.	FORMAL CONTRACTS Veto rights, voting rights, and exit rights. SOCIAL CONTROLS Informal communication with key managers, as well as majority shareholders, to influence decisions.
	Majority	FORMAL CONTRACTS Selection rights to appoint or dismiss managers in key positions. RESULTS CONTROLS Implementation of more frequent and standardised reports; equity-based incentives. BEHAVIOUR CONTROLS Formalised board and committee meeting procedures and approval processes.	FORMAL CONTRACTS Selection rights to appoint or dismiss managers in key positions; often the CFO who acts as the primary intermediary. RESULTS CONTROLS Strategic and annual target setting and close monitoring through performance reports. Annual and long-term performance-based incentives.

Figure 1. Explanatory framework of control combinations in PE relationships

Appendix B

Overview of interviewees

Interviewee	No. interviews	Forum	Duration (minutes)	Date (1st interview)	Date (2nd interview)
Investment Manager 1, Summa Equity	1	Microsoft Teams	45	4 Oct 2021	-
Principal, Summa Equity	1	Microsoft Teams	75	13 Oct 2021	-
Investment Manager 2, Summa Equity	1	Microsoft Teams	60	15 Oct 2021	-
Investment Associate, Summa Equity	1	Microsoft Teams	45	18 Oct 2021	-
Investment Director, Bridgepoint	1	Microsoft Teams	45	20 Oct 2021	-
Investment Manager 3, Summa Equity	2	Microsoft Teams	45	21 Oct 2021	22 Oct 2021
Investment Manager 4, Summa Equity	1	Microsoft Teams	60	22 Oct 2021	-
Investment Manager 5, Summa Equity	1	Microsoft Teams	40	25 Oct 2021	-
Founder and former CEO, Sortera	1	Microsoft Teams	45	26 Oct 2021	-
Investment Director 1, Summa Equity	2	Microsoft Teams	40	27 Oct 2021	29 Oct 2021
Investment Director 2, Summa Equity	1	Microsoft Teams	75	28 Oct 2021	-
Investment Director 3, Summa Equity	1	Microsoft Teams	45	1 Nov 2021	-
Investment Associate 2, Summa Equity	1	Microsoft Teams	40	2 Nov 2021	-
Total interviews:	**15**	**Average duration:**	**50**		

Appendix C

Example interview guide

Background

Professional experience

Time and role at Summa

Broad questions about Summa Equity

How Summa defines value

How Summa evaluates ESG Impact

How Summa handles financially attractive investments with a borderline ESG impact

Business principles and philosophical view on PE firm’s role in contributing to society

Trends in the industry

Questions about Sortera

<u>Pre-acquisition</u>

Thought process around entry

Opportunities and risks with the investment

Pre-acquisition strategic plans

How did Sortera view Summa in conjunction with the acquisition process

<u>During ownership</u>

Value creation levers

Financial engineering (entry leverage, leverage in conjunction with add-ons)

Operational engineering (growth initiatives, add-ons, margin improvements)

Governance engineering (replacement/additions to management, incentive programs)

Management control systems

Purpose and design of contracts

How Summa ensured effective alignment in strategic goals for value creation

How Summa measured outcomes in relation to goals

How Summa ensured strategic alignment in Sortera

How meetings were conducted

<u>Post-ownership</u>

Why Summa divested at the particular timing

What initiatives created the most value (financial value and ESG impact)

Value creation plan versus outcome (relative to financial value and ESG impact)

Appendix D

Excerpt from Summa's 2020 portfolio report with KPIs used by Summa to track financial and ESG performance in Sortera

Sortera

Overview

Investment theme	Resource Efficiency
Location	Sweden
Sector	Waste Management

Revenue 8

2020	1 393 (12%)
2019	1 246
2018	1 151

SDG alignment

SORTERA Group

6 11 12 13

Tons of waste processed 11

2020	1.6m (-6%)
2019	1.7m
2018	1.8m

Material & energy recovery 12

2020	98% (1 ppt)
2019	97%
2018	97%

Tons CO_2 avoided 13

2020	66 629 (-5%)
2019	70 441
2018	66 152

No. of employees 8

2020	337 (6%)
2019	319
2018	303

% Female 2020 5

Total	19%
Management	11%
Board	50%

Staff turnover rate

PORTFOLIO AVERAGE 8% 8

2020	8.1% (-1 ppt)
2019	9.4%
2018	8.4%

Via Summa Compliance

Code of Conduct	✓
Supplier Code of Conduct	✓
Economic Sanctions	N/A
Competition Law/Antitrust	✓
Anti-corruption	✓
Data Protection	✓
Whistleblower	✓

Carbon intensity

TONS CO_2e PER SEKm REVENUE 13

Metal Products	181
Chemicals	154
Food & Beverage	130
Tech Hardware	94
Waste water treatment	49
Sortera	**35**
Computer & related activities	28
Financial Services	16

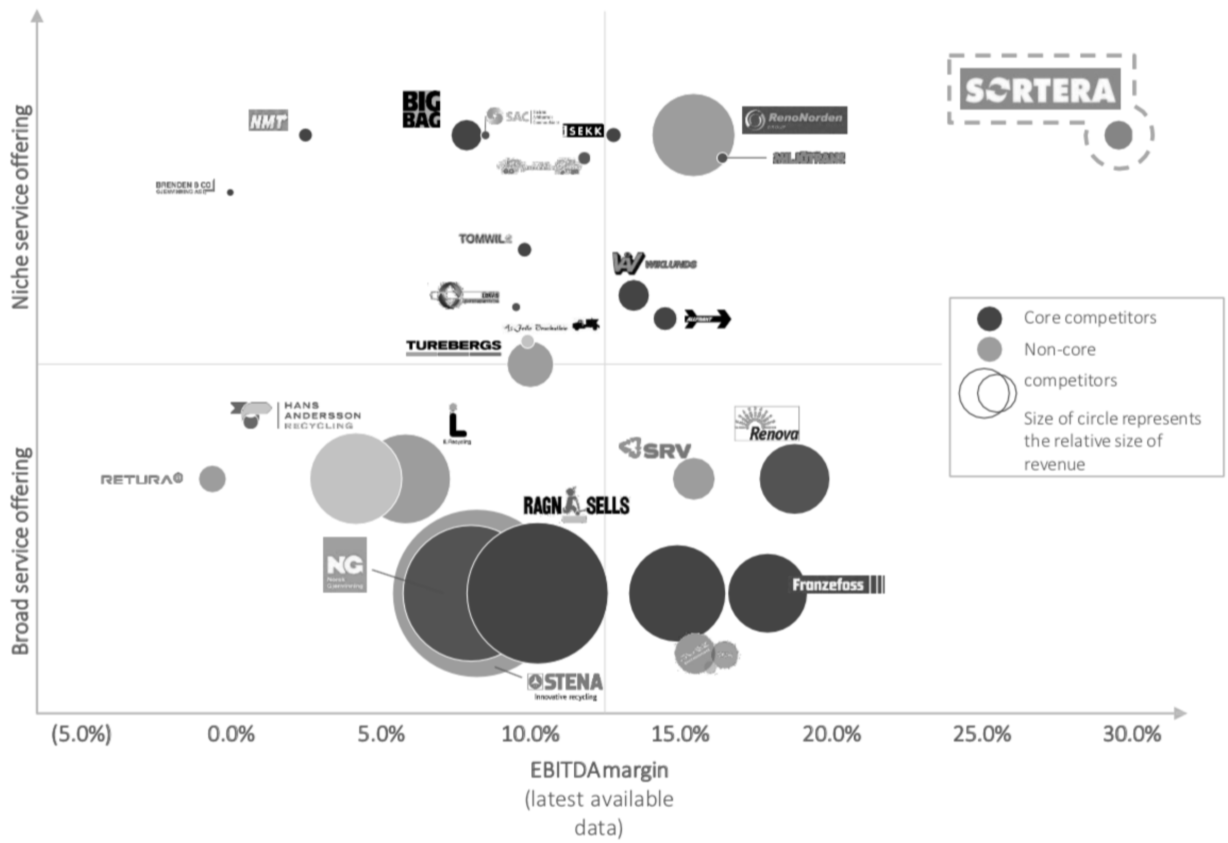
Value chain biodiversity impact intensity

PDF.m^2.YR PER SEKm REVENUE 14 15

Cattle farming	9 997
Manufacture of fish products	5 864
Tech Hardware	5 430
Waste water treatment	4 034
Telecoms	2 694
Sortera	**2 678**
Computer & related activities	1 229
Financial Services	630

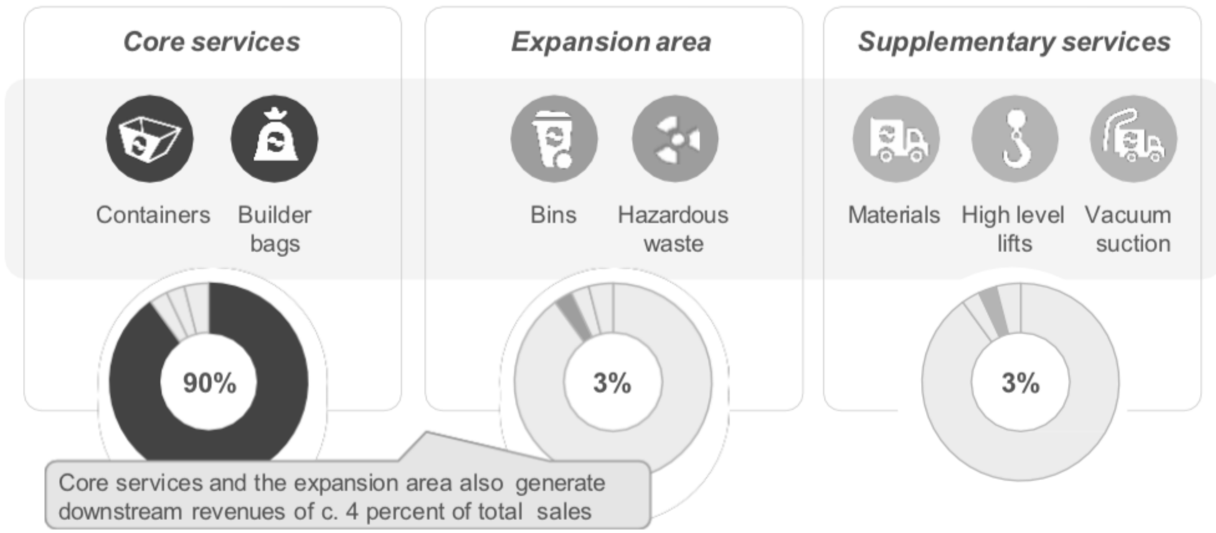
Appendix E

Breakdown of participants in the waste management industry in the Swedish and Norwegian markets at entry



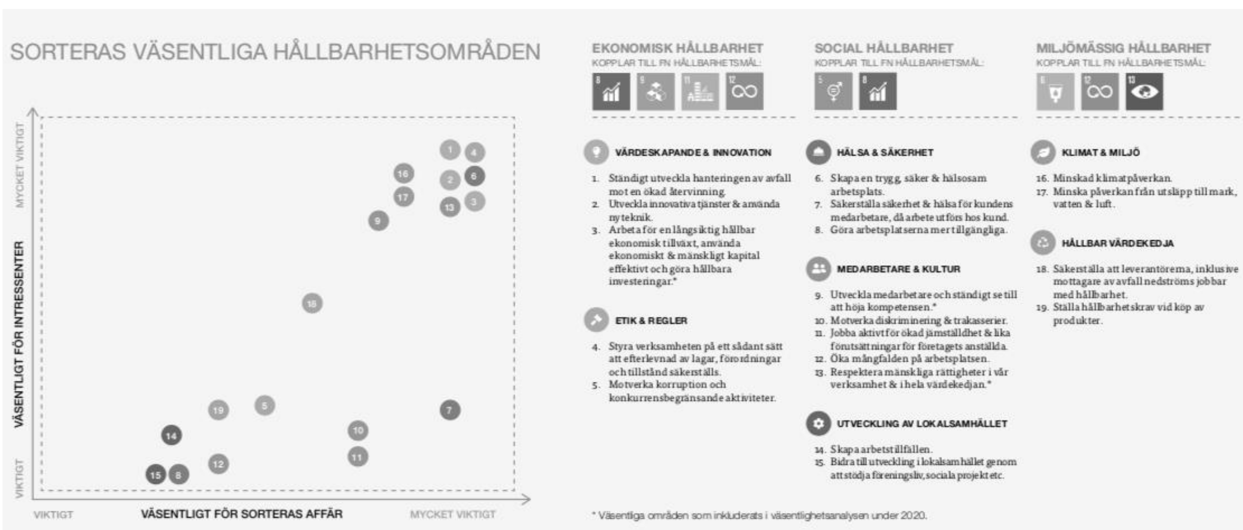
Appendix F

Product and service overview at entry with the percentages in the doughnut charts showing sales contribution



Appendix G

Sortera's materiality matrix from the 2020 annual sustainability report



Appendix H

Examples of ESG KPIs from Sortera's 2020 annual sustainability report. Here KPIs related to the climate and environment are shown

KLIMAT OCH MILJÖ

ENERGIFÖRBRUKNING	2019	2020	MÅL
Energiförbrukning totalt, kWh	28 800 058	27 036 683	
Energiförbrukning bränsle, kWh	25 491 934	24 009 887	Minska bränsleförbrukning/ ton-km med 3 % per år.
Bränsleförbrukning, liter	2 584 440	2 425 790	
Varav fossilfri andel	46 %	52 %	100 % innan 2030
Energiförbrukning el, kWh	3 254 229	3 026 796	Minska elförbrukning/omsättning med 3 % per år.
Varav miljömärkt el	100 %	96 %	All inköpt el varje år ska vara 100 % miljömärkt

KLIMATPÅVERKAN (TON CO_2)	2019	2020	MÅL
Klimatpåverkande utsläpp – scope 1	4 585	4 072	Minska växthusgasutsläpp Scope 1 och Scope 2 med 50 % fram till år 2030 (basår: 2018) samt att mäta och minska Scope 3 utsläpp.
Klimatpåverkande utsläpp – scope 2	11	29	
Klimatpåverkande utsläpp – scope 3	34 134	44 250*	

* Ökning av Scope 3 utsläpp under 2020 har främst att göra med ökade inköpta transporttjänster. Vissa av dessa transporter stod våra kunder för tidigare år.

KLIMATNYTTA (TON CO_2)	2019	2020	MÅL
Klimatnytta, brutto*	70 441	66 629	Öka med 50 % innan år 2025 (med nuvarande beräkningsmetod, basår: 2020).
Klimatnytta efter scope 1+2	65 845	62 528	N.A.
Klimatnytta efter scope 1+2+3	31 711	18 278	N.A.

* Undvikna koldioxidutsläpp genom användning av återvunna råvaror i stället för jungfruliga råvaror.

FORDONSPARK (ANTAL)	2019	2020	MÅL
Antal lastbilar (inklusive släp)	143	150	N.A.
Antal personbilar och servicebilar	63*	105	N.A.
Antal arbetsmaskiner	22	26	N.A.

* Endast personbilar inkluderade 2019.

FÖRDELNING EURO-KLASSER LASTBILAR (%)	2019	2020	MÅL
Euro 6	84 %	84 %	92 % av alla tunga fordon har Euro 6 klass (eller högre, alternativt hybrid/el) år 2025.
Euro 5	12 %	11 %	N.A.
Euro 4	1 %	1 %	N.A.
Euro 3	3 %	4 %	N.A.

Sorteras styrelse och verkställande direktör avlämnar härmed Sorteras hållbarhetsrapport för 2020 enligt Årsredovisningslagen (ÅRL).

Appendix I

Overview of Sortera's business at exit with the three divisions and add-ons made during Summa's ownership period