DRIVING VALUE FROM THE BACKSEAT

THE USE OF SOFT CONTROLS TO IMPLEMENT STRETCH TARGETS IN PRIVATE EQUITY: A CASE STUDY ON NORDIC CAPITAL'S VALUE CREATION JOURNEY IN CARY GROUP

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Driving value from the backseat: The use of soft controls to implement stretch targets in private equity

Abstract:

This paper investigates operational value creation in private equity (PE) using management control systems (MCS) to achieve acceptance of stretch targets, a relatively unexplored topic in prior literature. The study has been conducted as a single-case study to facilitate an in-depth understanding of the processes and interplay between a PE firm and its portfolio company. By applying the theoretical lens of different comfort zones, the study explores the perceived stress levels arising from PE ownership and the stretch targets they implement. The findings contribute to three literature areas. First, we provide a deeper understanding of the PE value creation process by investigating essential components of the PE firm's target-setting process. Second, we find that PE companies use controls as complements rather than substitutes and that there can be interdependence between the controls, contradicting prior literature on MCS in PE firms. Additionally, we nuance the understanding of social controls by identifying particular social control mechanisms a PE company uses. Third, we add to the existing stretch target literature by identifying components to ensure acceptance and implementation of stretch targets.

Keywords:

Private Equity, operational value creation, stretch targets, results control, social control

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Contents

Definitions

Actual autonomy: When a person or team has the ultimate right to decide

Best in class: A level of performance in line with the leading peers in the industry

Fluffy aspects: Informal tools, for example, sharing a cinnamon bun and coffee or an informal dialogue in between meetings to reduce the feeling of formality

Illusion of influence: When a person or team perceives themselves to have actual autonomy, while that is not the case

Iterative discussion: A discussion between two or more parties where each party can voice their opinions continuously

Low-hanging fruits: Operational changes that are relatively easy to achieve and have a high impact on an organizational level

Management buy-in: When management is positively aligned with the changes needed and steps forward. If lost, there is a significant risk of demotivation, and management will likely not work in line with the other party's plan

Operational advisory team: "*available to support the portfolio company boards across a number of areas, e.g., operational transformation/change management, factory footprint, logistics, lean manufacturing, low-cost country supply, sourcing, procurement, working capital management, pricing, strategic HR, management assessment and talent management, product and category management, industrial innovation, and other relevant operating capabilities"* (Nordic Capital, 2022)

Private equity business model: The private equity business model is to acquire an equity stake in a company that they divest after a limited holding period (Wright & Robbie, 1998). During the investment period, typically four to seven years (Upton & Petty, 2000), the main objective for the private equity company is to manage the portfolio company to increase the value of their investment (Metrick & Yasuda, 2011)

Tipping point: When the team goes from a stretch zone into a panic zone, see section 2.2.3. It occurs when the team is experiencing too much pressure in terms of expectations in relation to their capabilities. Combined with a lack of resources, the stress turns the team towards a point where they go from positive to negative performance

Top-up targets: Targets that are perceived as highly ambitious in relation to prior performance in the organization and compared to best-in-class targets

Target-setting process: The process the private equity firm uses to set targets, including deciding targets and their level, communicating the targets to the portfolio firm, and implementing the targets together with the portfolio firm

1. Introduction

> "In my opinion, operational [improvements] have come a long way during my time in private equity. Also, at [Nordic Capital] - now operational improvements are almost everything. Many of the old tools are seen as hygiene factors (…) so instead, what we essentially do, is that we plug in an uber charger in the company's Tesla to become faster and drive longer" – Investment Partner at Nordic Capital

The private equity (PE) industry has experienced massive traction in the last decade. In 2021, PE firms made over 24,000 deals worth USD 1.2 trillion worldwide – an increase of 40 percent[1] compared to 2020 (Farman & Sabater, 2022). Despite the increased competition, returns are consistently outperforming the public market[2] (Celarier, 2021) and have thus fueled an enormous interest in the industry. Studies typically find that companies value creation is positively affected by PE ownership. Kaplan and Strömberg (2009, p.130) explain that this is achieved by "financial engineering, governance engineering, and operational engineering." As the two former have become relatively standardized in later years, scholars argue that the latter is the primary source of value creation going forward (Døskeland & Strömberg, 2018; Kaplan & Strömberg, 2009). As seen in the quote above, the practical perspective also acknowledges the need for operational value creation.

Several studies provide evidence of a positive correlation between PE ownership and operational value creation (e.g., Acharya et al., 2013; Bergström et al., 2007; Bloom et al., 2015; Boucly et al., 2011; Davis et al., 2013; Guo et al., 2011); thus, the substance of operational value generates interest in how PE firms create such value. However, these studies do not explain *how* the PE firm achieves operating value. Furthermore, the amplifying competition in the industry adds pressure on PE companies to master this value creation process. Thus, obtaining an in-depth understanding of operational value creation is of both theoretical and practical interest.

A key component in operational value creation is setting challenging financial targets (Rogers et al., 2002, Gompers et al., 2016; Di Toma & Montanari, 2016), i.e., "stretch targets" (Sitkin et al., 2011). As stretch targets impose discomfort on top management (Bourmistrov & Kaarbøe, 2013), PE companies must carefully address this challenge. Despite this, there is a lack of studies on how PE firms ensures acceptance of stretch targets. Instead, previous studies simplify the process by stating that PE firms use a "mere list of best practices" (Dello Sbarba et al., 2020). However, the target-setting literature problematizes the complexity of using stretch targets showing that it can result in harmful stress levels and a lack of motivation (Sitkin, 2011; Lukka & Pfister, 2019). Hence, while

[1] Year-over-year
[2] Henceforth referred to as abnormal returns

stretch targets are shown to positively impact financial performance, using such ambitious goals can have the opposite effect if the organizational conditions are not beneficial (Sitkin, 2011; Lukka & Pfister, 2019). Provided the PE firms' ability to create operational value and their use of stretch targets, there is reason to believe that they have processes supporting stretch targets' implementation. Additionally, the complexity of using stretch targets indicates that the PE target-setting process is more complicated than prior research makes it out to be. Despite this, there are few studies explaining this aspect of value creation.

We aim to fill the research gap by providing a further understanding of how PE companies create operational value in their investments. To do so, this study aims to answer the following research questions:

1) *How do PE companies use target-setting to create operational value in their portfolio firms?*

2) *When PE companies use stretch targets in their portfolio firms, how do they adapt the remaining parts of the MCS to manage stress levels and maintain motivation?*

This thesis applies Bedford and Ditillo's (2021) definition of a management control system (MCS) to answer the research questions. Thus, their distinction between three types of controls - results control, behavior control, and social control - will serve as a starting point to investigate how controls come into play during the target-setting processes. To elaborate on the managerial implication of stretch targets, we apply the theoretical lens of comfort zones, panic zones, and stretch zones (Bourmistrov & Kaarbøe, 2013). This lens helps evaluate how the PE firm handles the portfolio company's perceived stress levels when imposing challenging targets. Additionally, the target-setting process is also studied from the portfolio firm's point of view to analyze their perception of stress arising from stretch targets.

To create in-depth knowledge within this particular context, we have studied the research questions using a single-case study (Dubois & Gadde, 2002; Dyer Jr & Wilkins, 1991; Siggelkow, 2007). The case uses a Swedish PE firm, Nordic Capital (Nordic), and its portfolio company, Cary Group (Cary), with empirical data gathered from interviews with both parties.

Our findings add to three research areas. First, we contribute to value creation literature in PE. While prior studies have provided aggerated findings of a positive correlation between PE ownership and operational value creation (e.g., Acharya et al., 2013; Bergström et al., 2007; Bloom et al., 2015; Boucly et al., 2011; Davis et al., 2013; Guo et al., 2011), we provide a deeper understanding of the value creation process. More specifically, we have investigated the use of target-setting processes to enable value creation. Additionally, we find the critical component of acceptance and implementation of stretch targets in the target-setting process. Second, our findings add to Bedford and

Ditillo's (2021) study on MCS in PE. Their study emphasizes three types of controls that PE firms use: results, behavior, and social control. They argue that the controls are substitutes to each other and the choice of control is based on contextual factors (Bedford & Ditillo, 2021). However, we find that the same controls are used to complement each other. We further contribute to their study by nuancing what particular social control mechanisms a PE company uses to achieve certain perceptions in the portfolio firm's management team, particularly by creating an illusion of influence. Thus, we build on the knowledge from prior studies by showing that PE firms use social controls and other controls simultaneously and show what types of social control mechanisms they use. Third, we address Sitkin et al's (2011) calls for a broadened understanding of critical components used to implement stretch targets. We contribute by identifying components used by the PE firm, to ensure the portfolio firm's acceptance of stretch targets without causing negative stress and demotivation. This is done by showing how the PE company works with social controls to impact the perception of influence and create a sense of confidence in reaching the targets, while not coming across as controlling.

The thesis is structured as follows: Section 2 provides a theoretical background, shedding light on value creation in PE and organizational target-setting practices. Section 3 introduces the applied method, the empirical setting, data collection, analysis, and data quality. Section 4 outlines the empirical findings and their relation to the literature. Thereafter, Section 5 discusses the empirical results and their implication for existing research. Finally, Section 6 provides theoretical and practical implications, limitations, future research, and the authors' final words.

2. Theoretical background

The following section will review prior research in the field. Section 2.1. introduces a brief review of value creation in PE companies, highlighting the gaps in current research. Thereafter, Section 2.2. describes the existing MCS research in a PE setting, Section 2.3. will outline the management accounting literature on target-setting, and Section 2.4. will provide a summary of studies on perceived comfort levels related to stretch targets. Lastly, Section 2.5. summarizes the theoretical concepts we will use throughout the study.

2.1. Value creation in private equity companies

Jensen (1989) observed how PE firms began to appear in financial markets during the late 20th century. Jensen identified strong operating efficiency in these organizations and recognized how they operated their businesses, creating significant value for the shareholders. According to Jensen (1989) PE firms focus on the three areas to maximize cash flow growth to achieve higher firm value, contrary to public companies solely focusing on improving earnings per share (Jensen, 1989). Jensen's (1989) three critical components for value creation are management, compensation, and financial structure. Kaserer et al. (2012) adjusted Jensen's (1989) components into another three-lever approach and defined value creation by PE companies as market timing, leverage, and operational improvements. Bruining et al. (2013) argues for an additional lever, entrepreneurial management, to complement Jensen's original value creation framework. Jensen's (1989) definition of value creation in PE is well used in later research (Bloom et al., 2015; Døskeland & Strömberg, 2018; Strömberg & Kaplan, 2009). Of these studies, we will use Kaplan and Strömberg's (2009) definition of value creation in PE, thus using their value levers. These levers are financial engineering, governance engineering, and operational engineering (Kaplan & Strömberg, 2009).

First, financial engineering stems from the capital structure and derives value from two primary sources: strong equity incentives to the portfolio company's management team and large portions of debt financing (Gompers et al., 2016; Strömberg & Kaplan, 2009). Equity incentives ensure the management team shares both upside and downside (Cumming et al., 2007; Strömberg & Kaplan, 2009), and high leverage reduces the manager's ability to waste money (Jensen, 1989). Studies on value creation from financial engineering in PE contexts have traditionally focused on the PE firm's ability to reduce agency costs (Bedford & Ditillo, 2021; Cotter & Peck, 2001; Kaplan, 1989; Renneboog et al., 2007; Schickinger et al., 2018; Siegel & Lichtenberg, 1989; Smith, 1990; Strömberg & Kaplan, 2009). Second, governance engineering is the PE firm's way of controlling the board of directors and the top management of the portfolio firm (Strömberg & Kaplan, 2009). Examples of value creation from governance engineering are PE firms introducing small and effective boards (Acharya & Kehoe, 2008; Cornelli & Karakaş, 2008; Cornelli

& Karakaş, 2012; Gertner & Kaplan, 1996; Gompers et al., 2016), strong management incentives (Cronqvist & Fahlenbrach, 2013; Cumming et al., 2007; Gompers et al., 2016), and adequate replacement of management (Cuny & Talmor, 2007).

The last area of value creation, operational engineering, refers to creating value by improving and optimizing the portfolio company's operations (Kaserer et al., 2012) by adding industry and operating expertise (Strömberg & Kaplan, 2009). While financial and governance engineering was the primary source of value creation in the 1980s, these actions are relatively standardized and easy to copy. Thus, the transaction price usually incorporates such value gains (Døskeland & Strömberg, 2018). Operational engineering is more difficult to replicate, and scholars, therefore, argue it to be the critical component for PE companies to continue to create value (Strömberg & Kaplan, 2009). The need for operational value creation has become even more prominent since the financial crisis of 2007-08 (Plagborg-Møller & Holm, 2019), and several other studies on PE firms' ability to create value support the need for operational engineering to enable value creation (Kaserer et al., 2012; Døskeland & Strömberg, 2018; Gompers et al., 2016; Kaplan, 1989; Siegel & Lichtenberg, 1989; Smith, 1990).

Research shows that PE investors define operational engineering as activities that lead to higher growth, reduced costs, or both. Examples of such activities are changing the business strategy or model (Gompers et al., 2016). However, prior research in PE rarely defines operational engineering in more precise terms than operating efficiency or operating performance. Scholars tend to study operational value creation quantitatively by looking at the aggregated impact on financial performance[3]. Although quantitative studies have several benefits, a drawback of the research method is the lack of in-depth understanding of the findings (Eisenhardt, 1989). Thus, the studies can show a correlation between PE ownership and improved operating performance in the portfolio firm (Acharya et al., 2013; Bergström et al., 2007; Bloom et al., 2015; Boucly et al., 2011; Davis et al., 2013; Guo et al., 2011). However, they lack the ability to provide an explanation of *how* PE firms create value through operational engineering. Consequently, the prior research on operational value creation does not provide an understanding of the nuances and processes of operational engineering and how it creates value.

Looking at the literature, few studies qualitatively examine how PE firms create operational value. To the best of our knowledge, only a handful of studies investigate how PE companies control and to steer the portfolio firm to realize value. To build on the existing literature, the following sections will explore these studies to understand which practices are essential and how PE firms work to create operational value in their portfolio firms.

[3] Several studies use EBITDA as the dependent variable

2.2. Management control systems in private equity

There are few studies on PE companies' use of MCS in their portfolio firms. However, the existing studies agree and emphasize the PE firms' focus on results control, mainly through target-setting. Practical findings also indicate the importance PE firms place on target-setting, where authors argue ambitious targets are a vital part of value creation (Rogers et al., 2002). Thus, there appears to be a consensus on results control, in terms of target-setting, being an essential part of the MCS that PE firms use to control their portfolio firms. The following paragraphs will describe the two studies that examine MCS in PE companies.

Dello Sbarba et al. (2020) conducted a multiple-case study on PE firms, investigating how the inter-firm relationships between the PE firm and the portfolio firm impact the choice of management control mechanisms (MCMs). The study uses the concept framing[4] to evaluate how the PE firm aligns the portfolio firms' incentives with the PE company's shareholder view. The study finds that specific contexts impact how PE firms design the MCMs to create value. The authors explain that the purpose of using MCMs is to achieve specific financial targets to maximize value creation (Dello Sbarba et al., 2020).

Bedford and Ditillo (2021) conduct a comparative field study of Italian PE firms, evaluating the type of control mechanisms they impose on their portfolio firm, focusing mainly on contractual, results, behavior, and social control. The study finds that different controls are required depending on two different contextual factors: ownership stake and the management's cognitive style[5]. The authors distinguish four types of control: contractual controls[6], results control, behavior control, and social control. Contractual control monitors the portfolio firm based on legal contractual agreements. Results control focuses on predetermined targets with pre-set levels of performance, use of incentives, and monitoring. Performance targets entail enhancing long-term value and cash flows. Behavior control is constraints, procedures, and structures that specify how and what tasks to perform. Examples of implemented behavior controls within the PE setting are still not identified. Social control enables control through social norms, trust, and implicit understanding. These controls can be informal exchanges before a meeting or informally developing close relationships with management to create shared norms, trust, and interests. Bedford and Ditillo (2021) argue that the PE firms use the controls as a substitute, where the contextual factors determine what control the PE company focus on.

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[4] The study defines framing as "*the process through which an interpretation scheme is formed and produces shared conceptions of social realities*" and applies the concepts frame blending, when alternative frames combine and produce new frame alignment processes, and frame shifting, changing frame from one to another

[5] The management cognitive style is divided into two types of mindsets: entrepreneurial or managerial

[6] We will solely focus on results control, behavior control, and social control, as contractual controls are described as relatively standardized and are of interest when comparing a majority ownership to a minority ownership

Despite prioritizing different controls in various contexts, the authors highlight the PE companies' need to monitor financial performance regardless of the conditions (Bedford & Ditillo, 2021). Thus, results control is a vital component for PE companies, which is not surprising as it focuses on cash flows and financial performance. As seen in Section 2.1, these two areas are essential for PE firms in tracking the development and creating value in their investments.

While both studies emphasize the process of ambitious targets to create value, neither explain how PE firms conduct this process or what mechanisms they use to implement such striving targets. As processes and mechanisms used in setting ambitious targets are virtually unstudied in the PE literature, we look into the management accounting literature.

2.3. The management accounting literature on stretch targets

Research often describes target setting as one crucial part of MCS (Ferreira & Otley, 2009; Ittner & Larcker, 2001; Otley, 1999; Stringer, 2007). While there is no clear definition of target setting, researchers agree that within the scope of control mechanisms, there are targets that are pre-set and communicated which steer the organization towards expected performance (Ferreira & Otley, 2009; Lebas, 1995; Simons, 1994). As aforementioned, it appears that target setting is a vital part of operational value creation in a PE setting (Bedford & Ditillo, 2021; Dello Sbarba et al., 2020; Rogers et al., 2002). While there are limited studies on the process of target setting in the PE setting, there is a widespread notion that the targets set are more challenging than other owners' targets (Bloom et al., 2015). Therefore, it is of further interest to understand how PE companies set targets in a portfolio company, particularly the application of highly ambitious targets, known in the management accounting literature as stretch targets (Sitkin et al., 2011).

The term stretch targets vary in definition; however, Sitkin et al. (2011) define stretch targets as "*an organizational goal with an objective probability of attainment that may be unknown but is seemingly impossible given current capabilities*[7]*.*" The effectiveness and appropriate use of stretch targets have been of fundamental consideration (Davies et al., 2017; Sitkin et al., 2017; Sitkin et al., 2011). However, there is no consensus on when to implement such objectives to obtain a successful result. Calandro (2012) stresses the successful use of stretch targets in PE-owned credit companies when the portfolio company experiences a turnaround situation. Sitkin et al. (2011), on the other hand, discusses stretch targets in a general setting and propose the opposite. They argue that stretch targets are appropriate when the company has a strong past performance and available resources (Sitkin et al., 2011).

[7] Defined as: current practices, skills, and knowledge (Sitkin et al., 2011)

However, finding the right level of ambition is a complex task, affecting the entire organization (Simons, 1994). Studies in management and accounting literature support stretch targets' effect on firm performance. However, they also stress the need for some optimal conditions for stretch targets to work in an organization effectively, and if not applied correctly, there is a risk of demotivation amongst employees (Pfister & Lukka, 2019; Thompson et al., 1997). For example, Pfister and Lukka (2019) highlight the need for autonomy, relatedness, and competence, for individuals to reframe negative forms of stress and maintain motivation. Consequently, the organizational conditions play a significant role in determining when companies should use stretch targets and how to implement them successfully. Because of these challenges, prior research calls for further studies to identify processes, including control mechanisms, that assist in achieving greater effectiveness in setting stretch targets (Sitkin et al., 2011).

While prior studies emphasize the perseverance of stretch targets and their relatively unpredictable outcome, findings indicate that PE firms outperform in this process (Rogers et al., 2002). Consequently, this raises interest in understanding how a PE company adopts stretch targets strategies to generate value creation in operational practices. Prior research is generally limited to the implications, introduction, and evaluation of stretch targets from the top management team to the rest of the organization (Pfister & Lukka, 2019; Thompson et al., 1997). However, when studying the PE setting, and more specifically, the value creation in a PE-owned firm, it appears more interesting to look at the processes of implementing stretch targets enforced upon top management. Prior research on stretch targets fails to explain how PE firms work to succeed in this process and calls for future studies to broaden the understanding (Sitkin et al., 2011).

2.4. Stress, motivation, and stretch targets

Studies on stretch targets indicate that a critical component of successful stretch-target implementation is to ensure motivation (Pfister & Lukka, 2019). An unsuccessful implementation may cause demotivation. There is one field of accounting research studies how stretch targets affect motivation. The field applies theories on individuals' and teams' perceived states of comfort when placed in different contexts or imposed with certain conditions (Bourmistrov & Kaarbøe, 2013; Bourmistrov & Kaarbøe, 2017). The general notion is that performance can be enhanced when moving an individual from a “comfort zone” to a “stretch zone” (White, 2009). The comfort zone is an anxiety-free state of mind where the decision-maker feels comfort and security (Bourmistrov & Kaarbøe, 2013; Kahn, 1990; White, 2009). The stretch zone implies new ways of working and adds a layer of discomfort. When imposed with stress and pressure, one moves from a comfort zone to a stretch zone. This is seen as a positive state, as it is argued to improve performance. However, too much stress may result in a “panic zone.” A panic zone state of mind entails anxiety and discomfort, which lowers performance (McKenna, 1994; White, 2009), forcing the team towards a tipping point. The paradox is the need to move a decision-maker from a comfort zone to a stretch zone appropriately, i.e., without ending up in the panic zone, which can be done by managing the stress imposed on the individual (White, 2009).

Bourmistrov and Kaarbøe (2013) investigated how a change in MCS affects decision-makers perceived comfort zone and stretch zone. The change in the case companies' MCS entailed introducing more ambitious targets, defined by the authors as stretch targets. This change places the decision-makers in a stretch zone. Bourmistrov and Kaarbøe (2013) describe facilitating the right conditions for stretch zones as: "*there is a need to find a proper balance between behavior certainties and uncertainties in terms of reaching an optimal performance zone for decision-making.*" Consequently, finding the right conditions is a balancing act between competence and challenge. The findings further show that the introduction of stretch targets changes behavior and mindset. The change requires a greater need for close interaction and integration in different areas of the organization. The increased collaboration and inclusion create a sense of empowerment. Furthermore, changes in information flow functioned as a mechanism for facilitating decision-makers to move towards the stretch zone. Thus, the study highlights the importance of the shift in information supply when switching zones without entering the panic zone (Bourmistrov & Kaarbøe, 2013).

Furthermore, Bourmistrov & Kaarbøe (2017) elaborate on how comfort and discomfort[8] come into play when different individuals in an organization perceive a MCS's usefulness differently. The authors conducted a single case study on a company in a crisis. They found that different internal stakeholders have different perceptions of how to navigate out of the crisis, creating misalignment. Due to the crisis, the management changed one part of the MCS, cutting costs in the budget. The chosen approach aligned with their will, and thus, the managers remained in their current comfort zone. However, other parts of the organization did not perceive cost-cutting as the correct solution and could not influence and formulate the budget response. This group experienced stress and entered a panic zone. Instead of working with the new budget, they focused on other areas of the MCS that aligned with their perception of the right solution. By doing so, they moved from the panic zone back to their comfort zone. Consequently, creating a situation of misalignment in how different people in the organization worked on operating successfully out of the crisis (Bourmistrov & Kaarbøe, 2017). Hence, this indicated the need to aligning the mindset on ways of working by mobilizing the appropriate efforts to induce the right mindset and behavior throughout the organization to avoid placing organizational members in a panic zone.

[8] According to Bourmistrov & Kaarbøe (2013; 2017), a panic zone and discomfort are interchangeable concepts. Henceforth, we will use the concept panic zone to describe discomfort

Using the aforementioned studies, we can observe how team members' perceived stress levels are impacted by the introduction of stretch targets and the PE company's interaction with the portfolio company.

2.5. Theoretical concepts going forward

The purpose of this paper is to study how PE companies manage to implement and achieve an acceptance of stretch targets to create operational value in their portfolio firms. As seen in prior research, creating operational value is the most important value creation lever in PE. Studies indicate that results control, mainly through target setting, is essential to achieve operational value. However, ambitious targets can impose stress and lead to demotivation, which raises further questions on how PE firms manage to implement and achieve acceptance of the targets they impose on their portfolio firms. To understand how this is done, we study how PE firms use different types of controls, namely results control, behavior control, and social control (Bedford & Ditillo, 2021), to manage perceived stress levels of top management in the portfolio firm. To study how the PE company handles the increased stress levels, to maintain motivation and performance, we will also study how they impact the teams' perceived stress levels through the use of the three concepts: comfort zone, stretch zone, and panic zone, to investigate the impact the applied controls have on the stress levels (Bourmistrov and Kaarbøe, 2013; Bourmistrov and Kaarbøe, 2017).

When conducting this study, we use theoretical concepts from prior literature. We will use the concept of stretch targets for goals following the Stikin et al. (2011) definition. Furthermore, we will apply Bedford and Ditillo's (2021) descriptions of results control, behavior control, and social controls to discuss the controls used. The results controls are identified when the PE company imposes hard financial control, through, for example, stretch targets. Examples of behavior controls are not identified in prior literature; however, the definition centers around freedom in decision-making. Therefore, the use of behavior control is seen by whether the PE firm allows the portfolio firm to participate in deciding the targets or not. The social controls are not as visual as the two aforementioned controls. These controls are informal, have a less pronounced nature, and are not perceived as controlling to the same extent as results and behavior controls. Social controls are identified when the PE company informally controls the portfolio company through social interplays rather than formal documents and structures and explicit targets.

3. Method

The following section describes the method we applied to conduct the case study and the underlying logic of the chosen method. Section 3.1. will motivate our choice of study and empirical setting. 3.2. presents the data collection process. Section 3.3. describes how we analyzed our findings, and Section 3.4., explains how we have worked to ensure high data quality throughout the study.

3.1. Research design

3.1.1. Choice of study

We have conducted a single-case study to investigate the research questions. Eisenhardt (1989) argues that "*the case study is a research strategy which focuses on understanding the dynamics present within a single setting*." Furthermore, a single-case method provides the researchers with an even more focused setting, as it isolates dynamics of interest (Dubois & Gadde, 2002; Edmondson & McManus, 2007; Dyer Jr & Wilkins, 1991; Eisenhardt, 1989; Siggelkow, 2007). A single-case study's ability to capture context and the close interaction with the organization further create a solid foundation for a comprehensive understanding. Additionally, we have applied an embedded design to facilitate a study covering numerous parameters. Yin (2009) explains the embedded design as multiple analyses constructed on different levels. In this study, the embedded design examines the PE company and its affiliated portfolio company simultaneously. This method allows for a broader view of perspectives and context.

Furthermore, the choice of study is also compatible with the theoretical concepts used. While prior studies on MCS have conducted research using multiple-case studies (Dello Sbarba et al., 2011) and comparative field studies (Bedford & Ditillo, 2021), the in-depth qualities of a single-case study allow an analysis of the organization on a team level (i.e., the PE firm's team, the portfolio firm's team, and their interplay). This component is essential to facilitate the analysis of the social psychology phenomena[9] that the Bourmistrov and Kaarbøe (2013; 2017) framework entails. Hall (2016) argues that the case study approach is favorable in the management accounting literature when studying psychological processes, such as interactions between different organizational parties. Consequently, there is a compatibility between the research design and the theories applied in the study.

Additionally, as prior qualitative studies in the field have generally conducted multiple-case studies, they have provided contextual insights with findings of a comparative nature, categorizing the use of MCS based on different variables (see, e.g., Bedford & Ditillo, 2021; Dello Sbarba et al., 2020; Di Toma & Montanari, 2016). A critique of the

[9] Comfort zone, stretch zone, and panic zone (Bourmistrov & Kaarbøe, 2013; 2017)

multiple-case study is that it fails to obtain in-depth findings, thus limiting the interesting insights (Dyer & Wilkin, 1991). As we aim to examine the interplay between the PE firm and the portfolio firm, a single-case study provides a possibility to extract interesting findings and analyze them in-depth. Provided the lack of prior single-case studies, our results can contribute to the existing literature by explaining *how* PE firms create value using MCS, rather than categorizing *why* they choose one MCS instead of another. Consequently, why use the interpretive research tradition to develop an understanding of a phenomenon (Ahrens & Dent, 1998).

3.1.2. Choice of empirical setting

We had three theoretical reasons for the chosen empirical setting. First, Nordic is one of the largest Swedish PE houses. Hence, the company has a breadth and width, which is of value to facilitate broader variation and include various dimensions (Seawright & Gerring, 2008). Second, Nordic has an ownership model that suits the study. There is a general scope in how PE companies exercise their ownership. On one end, there is active ownership, which entails that the PE company essentially runs the portfolio firms' operations. On the other end, there is passive ownership, which means limited interaction with the portfolio company (OPX Partners & Faxander, 2022). Nordic applies a hybrid ownership approach, where the portfolio company entirely runs the portfolio company, while Nordic provides tools and support to deliver the expected outcome. This hybrid approach allows both the PE and portfolio company to provide insights into operational practices. This combination creates an interesting setting to study the research questions, as it creates room for both teams to act on their own and interact with each other. Third, Nordic has an in-house operations advisory team. Provided our interest in understanding operational value creation, a dedicated team implies a certain regularity within this context and may further enhance the findings (Emmel, 2013).

Furthermore, we had a number of pragmatic reasons why we decided on our empirical setting. Emmel (2013) highlights the need for the chosen empirical setting should suit the particular social phenomena and provide meaningful data for the research. Thus, to study value creation in PE firms, we needed to find a setting where it is possible to obtain insight into both parties and understand the underlying dynamics. One critical reason for the choice of Nordic and Cary was the will from Nordic's side to participate with time and information. As obtaining data to conduct studies on PE companies is generally difficult due to the lack of public data and a high degree of confidential information, finding a willing PE company was an essential first step in enabling the study. Also, the choice of portfolio firm was somewhat determined by the successful track record, as Cary has been one of Nordic's most prosperous investments in creating value (OPX Partners & Jensen, 2022). This notion raised further interest in exploring how PE firms achieved value creation through operational practices and how they carried out the target-setting process.

3.2. Data collection

3.2.1. Interviews

We have mainly collected empirics for the study through semi-structured interviews with relevant parties from the PE firm and the portfolio company. Studies on PE firms tend to be limited due to a lack of relevant data to study (Bacon et al., 2012; Døskeland & Strömberg, 2018; Meuleman et al., 2009; Strömberg & Kaplan, 2009); therefore, conducting interviews is a suitable way of collecting valuable insights into the industry. Other case studies in a similar field use the same approach (Bedford & Ditillo, 2021; Dello Sbarba et al., 2020; Di Toma & Montanari, 2016). Also, interviews provide the opportunity to go in-depth into subjects and areas to obtain interesting findings that help shape the study (Edmondson & McManus, 2007; Eisenhardt, 1989).

The scope of the study is limited to exploring the research questions by studying the role of MCS in achieving acceptance of stretch targets and the management of stress to create operational value. Therefore, we selected the interviewees based on finding individuals with insight into the topic and case (Bryman & Bell, 2011; Maxwell, 2012). As the topic revolved around the PE firm's investment team and the portfolio firm's top management team, few individuals had insight, resulting in a limited number of relevant interviewees. We conducted the interviews using a semi-structured approach to allow the direction of the answers to lead the discussion towards interesting findings (Bell & Bryman, 2015; Bryman & Bell, 2011). While some opening questions were constant for all interviewees, the interview guide varied depending on the role and organization of the interviewee, see Appendix B, C, and D, and we adapted it over time (Bryman & Bell, 2011).

Table 1: Overview of interviewees

Nordic Capital	**Cary Group**	**External advisors**
2 Investment manager *Magnus Hammarström (IM 1)* *Joakim Andreasson (IM 2)*	1 CEO *Anders Jensen*	1 Consultant *Mia Ejendal*
1 Investment partner *Andreas Näsvik*	1 CFO *Joakim Rasiwala*	1 Industry expert ("black belt") *Anonymous*
1 Operations principal *Henrik Sandreus*	1 COO *Linda Wikström*	
Total: 4	Total: 3	Total: 2

As noted in Appendix A, we conducted eleven interviews, out of which five were from the PE firm, four from the holding company, and two with external individuals. See Table

1 for an overview of the interviewees. The external interviewees were included to complement the empirics from the case. After the first eight interviews, we started observing theoretical saturation, as the interviewees essentially repeated similar observations as prior interviewees (Eisenhardt, 1989).

All interviews took place on various occasions in February, March, and April 2022. All interviews were conducted in Swedish and lasted between 25-65 minutes each, in person or via digital devices (see specification in Appendix A). At the beginning of the interview, we asked for permission to record the sessions and later transcribed them for coding and further analysis.

3.2.2. Additional data

Aside from the interviews and observations, information was gathered by reading external and internal documents from the PE company and the portfolio company. Furthermore, we read and studied newspaper articles and listened to a podcast on PE value creation with interviewees from this specific case or the PE firm. The podcast was of particular interest as the focus of the interviews had the same overall theme as the interviews we conducted for our study. Therefore, our empirics have been complemented by analyzing the findings of four podcast episodes. The interviewees in these respective episodes and some additional information are presented in Table 2.

Table 2: Overview of podcast episodes

Interviewee	Role	Episode date	Interview length (min)
Magnus Lindquist	Chairman of the board at Cary Group	2022-01-13	42
Olof Faxander	Head of Operations advisory team at Nordic Capital	2022-01-06	45
Anders Jensen	CEO at Cary Group	2021-12-30	31
Johan Ek	Nordic Capital's external network	2021-12-15	38

These additional sources were used to find more information about historical events, the development of the portfolio firm, the partnership between the parties, and to understand how the PE firm operates. This information-gathering process was conducted before, during, and after the interview period to understand the case and verify the information gathered from interviews by triangulating our findings (Bowen, 2009; Messner et al., 2017). This process has been helpful to obtain a deeper understanding of the information and ensure the quality of the data used (Yin, 2009).

3.3. Data analysis

In line with the iterative nature of a qualitative study (Edmondson & McManus, 2007), we have analyzed information throughout the study to steer the processes going forward. Thus, we applied an abductive approach where we used the initial findings to steer the theoretical lens, and vice versa, to work towards developing our findings and turn them into theoretical concepts (Ahrens & Chapman, 2006; Bryman & Bell, 2011; Dubois & Gadde, 2002; Lukka & Kasanen, 1995). This process, see Appendix E for an illustration, started with a pilot interview with an investment manager (IM 1) from Nordic, where we asked about value creation, the investment process, and the use of different controls. After the interview, we transcribed the recordings and coded the empirical findings to identify interesting discoveries. The initial findings indicated the PE firms' high focus on setting ambitious targets to drive value creation. Thus, we allowed the new perspectives and insights to steer the direction of the interview guide in the coming interviews. Thereafter, our questions to the PE firm focused more on target-setting. The imminent findings indicated that the target-setting process was divided into various parts. Each part appeared to have its methods for setting the targets and communicating them.

At this stage, we decided on theoretical concepts that could help explain the methods and type of communication the PE firm used. Additionally, the concepts were used to understand the portfolio firms' perception of the process. Thus, the theoretical concepts assisted in pattern making, as we could identify patterns closely related to our chosen theories (Ahrens & Dent, 1998). See Appendix E for an illustration. When the theoretical concepts were in place, we could also go back and conduct a second interview with one interviewee from the PE company, to ask more precise or clarifying questions with the concepts in mind. We used the findings from the PE firm to examine the portfolio firms' perceptions of the same processes. Their perception did not align with the aim of the PE firm. To understand why, we used the theoretical concepts to identify patterns of what the PE firm did and how that was perceived by the portfolio company. In doing so, we came up with new theoretical concepts that explained how the PE firm interacts with the portfolio company and parts of the target-setting process that we had not seen in prior studies.

3.4. Data quality

There are several aspects to consider when determining the quality of the data gathered in a qualitative study. Several scholars have discussed the issue of collecting, handling, and communicating data in qualitative research to obtain a standard way of working (Bryman & Bell, 2011; Lukka & Modell, 2010; Messner et al., 2017). While practitioners use various terms, the common theme is to ensure the information provided is correct, unbiased, and sufficient. We will use Lukka and Modell's (2010) terms as umbrella terms: authenticity and plausibility. They described authenticity as "*preserving emic qualities of* *research accounts*," referring to providing trustworthy findings by giving sufficient information to ensure the reader that we have gathered enough information. Plausibility refers to our reasoning, showing the reader that the findings are plausible and make sense (Lukka & Modell, 2010).

To ensure a correctly conducted study, we have taken cautionary steps from the beginning of our research process. These steps include obtaining as much information as possible via interviews with internal and external sources to ensure the study has sufficient data. By transcribing interviews, keeping a record of analysis steps, and triangulating the gathered information, we have increased the data quality (Messner et al., 2017). Also, while case studies tend to be prone to bias (Messner et al., 2017; Yin, 2009), a constant recollection of this issue and triangulation of evidence have reduced our personal bias to the utmost extent possible (Bowen, 2009; Bryman & Bell, 2011; Messner et al., 2017; Yin, 2009). Furthermore, the data validation, including the triangulation of information from various sources, has resulted in obtaining a more comprehensive picture of the studied phenomena. To convince the reader of this we have included as many quotations as perceived necessary when presenting the empirics to show the essential findings without our interpretation and communicate them credibly (Lukka & Modell, 2010; Messner et al., 2017).

4. Empirical analysis

This section will present the empirical findings from the data collection process. Section 4.1. provides an overview of the involved parties and the timeline of Nordic's ownership of Cary. Section 4.2. describes the importance of target setting in creating operational value. Also, we introduce a two-step target-setting process used to create value. Section 4.3. and 4.4. present the two-step process in detail. Due to the delimitations of the study, we have presented the empirical material that was relevant for the case study, meaning that the provided information is not all data gathered.

4.1. Background & context

4.1.1. Nordic Capital

Nordic Capital (Nordic) is a Swedish PE company with offices in Europe, the U.S., and South Korea. The PE house was founded in 1989 and has raised 11 funds worth over EUR 19 billion. Nordic's current assets under management amount to EUR 7.3 billion, and the portfolio consists of 43 companies globally (Nordic Capital, 2022). Nordic has an active ownership role in their portfolio firms (Faxander & OPX Partners, 2022), which they hold for an average period of 3-7 years. Nordic assesses that approximately 70 percent of the value created in the holding companies during their investment period stems from operational improvements (Nordic Capital, 2022). The investment manager (IM 1) described that Nordic has a growth strategy within the operational improvements that focuses on sustainable growth rather than cutting costs to enhance value.

In practice, Nordic's team works closely with the management team of the portfolio firms to strengthen its operations. Nordic's team consists of an Investment team, an Operational advisory team, and external advisors. While the Investment team often has roles as board members during the holding period, the Operational advisory team has a more in-depth operational role at the beginning of the holding period. Nordic created an in-house Operational advisory team to respond to the increasing need for operational enhancements in the portfolio firms to create excess value (Faxander & OPX Partners, 2022). The external advisors, so-called "black belts," are a part of the Nordic's network and can be consulted on specific questions or act as board members (Investment manager (IM 1)). Furthermore, Nordic is sector-oriented, which means all parts of the team only work with one sector. Thus, the investment team, the members of the Operational advisory team, and the external advisors working with Cary are all experts within the industrial services sector: *"[Nordic works] in a sector-oriented way, which creates some similarities in our day-to-day job*" Investment manager (IM 1).

4.1.2. Cary Group

Cary Group (Cary) was founded in 1947 by the Swedish family Ryd and initially operated under the brand Ryds Bilglas. In 2020, the company changed its name to Cary Group as a part of its international expansion plan (Cary Group, 2022). Cary is a vehicle glass repair and replacement provider with a European presence in five countries: Sweden, Norway, Denmark, Spain, and the U.K. They have glass repair workshops in all countries, while their management team operates at the Swedish H.Q. In 2012, the Swedish investment company Nalka acquired a stake in Cary, which they sold to Nordic in 2017. Nordic's team describes a unique quality of Cary being their management team's way of working: "*[The management team] is very hands-on and quick operationally*" Operations principal.

4.1.3. Nordic Capital's ownership of Cary Group

In December 2017, Nordic acquired a 90 percent stake in Cary, making them the majority owner, while the remaining 10 percent remained within the Ryds family (Nordic Capital, 2022). Both Nordic and Cary believed that the fit between the two parties was perfect. Cary was a company with low operational complexity[10], a strong management team with high aspirations for the company, and a robust corporate culture. The investment manager (IM 1) described the company's potential as: *"[Having] a great market position in a favorable market. Above all, [Cary] had a high customer satisfaction and employee satisfaction."* Cary viewed Nordic as an engaged owner that enabled future growth plans: "*[Nordic] backed us with capital, which made it possible for us to continue growing internationally, and they backed us up with operational advisory models that they had used in prior investments"* CEO. The transfer of control was in January 2018, after which Nordic's work to enhance the value of Cary began.

During the holding period, Nordic worked consciously with improvements, goals, and objectives that they evaluated on an ongoing basis. With an initial growth plan of five years, the Nordic team had set a plan to achieve its base investment thesis[11]. However, the objectives were reached after 18 months, requiring Nordic to change and adapt its strategy to the new conditions (OPX Partners & Jensen, 2022). Hence, they set a new plan with an aspiration to make the company public within 2-3 years. In September 2021, Nordic made a partial exit when Cary was listed on Nasdaq Stockholm. Currently, Nordic owns 30 percent of the shares and remains Cary's largest owner (Nordic, 2022).

[10] A company with low complexity is, according to the interviewees from Nordic, defined as a company with low interdependencies in the value chain. This structure is advantageous as there is a clear cause and effect relationship, and small changes can lead to large effects

[11] The base investment thesis or base investment case is the lowest possible internal rate of return (IRR) and multiple on invested capital (MOIC) needed for the investment to be accepted by the PE firms' own investment committee

During Nordic's ownership of Cary, the company has experienced significant growth. The revenue has increased from SEK 700 million in 2017 to SEK 2.1 billion in 2021, implying a compounded annual growth rate of approximately 25 percent. The company made about 60 add-on acquisitions, and the number of workshops increased from 100 in the Swedish market to 929 workshops around Europe[12]. The top management composition has changed; however, the CEO and CFO have remained the same during the holding period. The total number of employees has increased from 350 to 1,431 (Cary Group. 2022). Notably, both the investment manager (IM 1) and the external consultant highlight the strong market momentum and strong operational prerequisite have been vital in building the company and realizing operational value.

This thesis will focus on the holding period: from acquisition (2017/2018) until the listing in September 2021. We have studied this period using our theoretical concepts (see Section 2.5.) with a particular interest in the target-setting processes and how Cary's management team perceived this process.

4.2. The central role of target setting in private equity

Nordic clearly states that the central area of value creation stems from enhancing and improving operational practices in their portfolio firms: "*[In the beginning] we set a foundation that is done by [making the portfolio company] better at [for example] sales force, efficiency, HR, IT and all that - we must be very good at it to have a solid foundation"* Operations principal. This focus is in line with the value creation literature stating the emphasis on operational engineering (Acharya et al., 2013; Bergström et al., 2007; Bloom et al., 2015; Boucly et al., 2011; Davis et al., 2013; Guo et al., 2011). Furthermore, the empirics show that target setting is vital for operational value creation in Nordic's portfolio firm Cary. The operations principal exemplifies the target-setting process that enables the foundation and his role to create more value: *"Initially, you need to have pre-set plan with base targets when buying the portfolio company - to get the investment approved. Second, my job is to see how much additional operational value we could potentially add on top of the pre-set plan through top-up targets".* As target setting is an essential component of results control (Bedford & Ditillo, 2021), it appears PE firms emphasize their use of results control to steer the portfolio company towards creating operational value. However, the investment manager (IM 2) highlights the uncertainties regarding how much value would be created, regardless of the targets: *"I honestly did not know how much [value] we would reach, what is included in the price, and what comes on top of what."*

The Investment team and the Operational advisory team focus their value creation on cash flow; thus, their targets revolve around milestones resulting in a higher EBITDA, which

[12] Scandinavia, Spain, and the UK

they use as a proxy for free cash flow. Prior studies also emphasize the target's purpose for value creation (Rogers et al., 2002); however, the consultant states that the difference between PE-owners and non-PE-owners in setting targets is the expected level of performance. The consultant reflects on prior experiences working with both types of owners and highlights the PE firms' emphasis on highly ambitious targets, i.e., stretch targets (Sitkin et al., 2011), to realize value. Other owners may not emphasize stretch targets as much, as they do not have the same value creation ambitions as the PE firm.

> "It's a bit like running; you won't become the world's greatest if you don't have that target. You may be satisfied with running (...) because you get the exercise, but if you run for another target, you get another result. PE companies run for another multiple than founders or entrepreneurs, and they will get a different output [because of it]." – The consultant

To enable value creation in this case, we identified a two-step target process that Nordic implemented in Cary: base targets and top-up targets, exemplified in Figure 1. The base targets were highly ambitious but relatively standardized financial metrics, which were the basis to reach the base investment thesis. The top-up targets were even more ambitious and more uncertain in nature due to their non-standardized and context specific characteristics. Each target has several identified social control mechanisms to ensure their implementation (see Sections 4.3. and 4.4.). Additionally, Nordic complemented the targets with a detailed process created to support Cary to reach the targets (see Section 4.4.3.) The following sections will describe the methods and mechanisms identified during the Nordic's target implementation process in Cary.

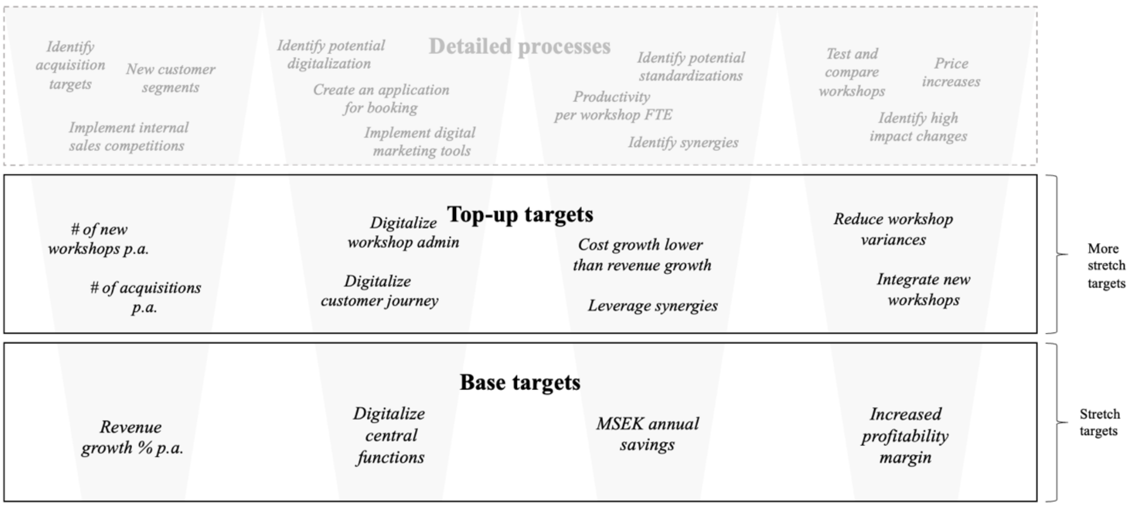

Figure 1. The target setting structure in Cary. Note that the targets are examples from data gathered; however, they do not represent all targets set. They are mere examples for clarification

4.3. Base targets

4.3.1. Identified processes of setting the base targets

Initially, during the pre-acquisition phase, the team at Nordic uses all available resources, such as data rooms, management presentations, and black belts, to obtain an initial idea of where and how the portfolio firm creates value and the feasibility of the intended targets. When Nordic gets control of the portfolio firm, the fine-tuning of the base investment thesis begins. When setting these targets, there is a need to ensure the targets align with the firm's management teams' vision: "*The starting point is to be aligned with management to have a mutual understanding"* Investment partner. Having an aligned vision is explained as important as it enables all parties to work towards a shared goal. Additionally, a lack of alignment creates a risk of placing the management team in a panic zone (Bourmistrov & Kaarbøe, 2017). The base targets that Nordic set up were relatively standardized financial targets: "*They are the purely financial targets, it is top line[13], gross margin, etc. We set those [targets] without much room for discussion. If [Cary's] management wants to raise it for discussion, we talk it over, but they cannot be lowered much"* Operations principal. See Figure 1 for examples of the targets.

As seen in the operations principal's quotes in Section 4.2., the initial phase serves as a basis for the investment thesis. It facilitates Nordic to understand what is needed to reach a minimum internal rate of return (IRR) and money on invested capital (MOIC) for the base investment thesis. Hence, the base targets indicate the expected value at the exit, with a time horizon of five years, i.e., the value creation process. All parties at Nordic emphasize the importance of having solid base targets as it establishes a foundation for the value creation opportunities in the portfolio firm. The available data points allow the responsible investment team to understand profitability estimates and wherein the business model it is possible to adjust and improve. The operations principal highlights that the targets are relatively standardized, based on playbooks[14] from prior experiences. However, all cases are different, and the base targets are a best guess, and if it is wrong, the basis of the value creation is off, which creates problems going forward:

> "It's like when I drive a car (...), if I am driving at 120 km/h and then suddenly there is a construction site by the road, and I must drive at 70 km/h for 15-20 minutes (...). To catch up, so I make it on time, I must drive very fast for quite a long time (...). It is the same if you have a foundation that is not solid. If the foundation falls, it takes a lot of work to catch up to the [lost] value." – Operations principal

Nordic's business model entails creating the highest possible return for its investors. Therefore, they aim to have their portfolio firms compete on a level that represents the

[13] Top line is another term for revenue
[14] A collection of practices from prior experiences and investments within the same sector

“best in class” in the respective industry. This high level of ambition is a prerequisite for the amplified competition within the PE industry. In line with Sitkin et al.’s (2011) definition, targets of this ambition level of ambition are categorized as stretch targets. Interestingly, what a PE company refers to as the minimum level of performance has the ambition level that management accounting research indicates as extremely high.

Stretch targets work to move decision-makers into a stretch zone or a panic zone, depending on the amount of stress they face and if the new operational practices conflict with what top management thinks are reasonable actions (Bourmistrov & Kaarbøe, 2013; Bourmistrov & Kaarbøe, 2017). Thus, the base targets’ level of ambition may impact Cary’s management teams’ performance level, depending on how the management team perceives the stress the targets implicate. The findings show that Nordic is aware of this risk and works with the perceived stress level to ensure the implementation of the stretch targets and to keep management buy-in: “*There is a risk [in the process of setting targets] that it feels forced - like a straitjacket - which is not at all inspiring”* Operations principal. Consequently, the stretch targets place Cary’s management team in a stretch zone, and Nordic works to manage stress levels to ensure they do not put management into a panic zone. See Figure 2 for a visualization of the process.

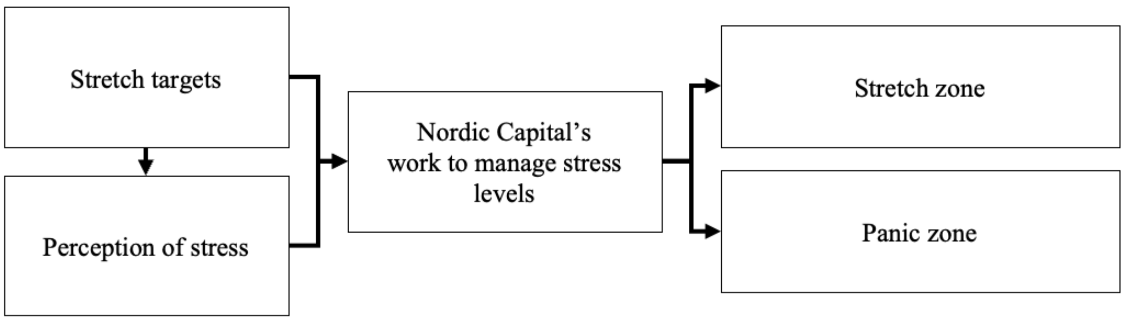

Figure 2. Illustration of the potential outcome of the implementation of stretch targets

The base investment thesis infers no option for Cary to change the pre-set targets. While Cary can have some say in which areas to focus on, there is no changing the investment thesis’ output (IRR and MOIC). Consequently, the explicit constraints indicated that the behavior controls were high (Bedford & Ditillo, 2021), leaving Cary’s team with little room for actual autonomy. Therefore, the investment manager (IM 1) describes the need to align the targets with the top management's vision of the company: “*[Nordic’s] plan for the [portfolio] company has to be in sync with the management plan for the company, that is vital.*”

Additionally, the operations principal emphasizes a need to work carefully to communicate the targets, not to lose management buy-in: *“It is extremely rare that we push something [the management team] does not want. The risk is that they feel like “[Nordic] set the targets, and I will do my job, but [Nordic] will not be here to make sure it gets done.” That is when you lose buy-in.”* Consequently, Nordic is aware of the risks and disadvantages of being perceived as micromanagers and sole decision-makers due to the high behavior controls that arise from Cary's inability to influence the targets. And maintaining management buy-in is a crucial aspect to maintain motivation: "*If they do not accept [the plan], there is a risk that they feel [demotivated] to do the work."* Operations principal. Apart from the aim to align with the initial management plan, we have identified four mechanisms of social control that Nordic uses to maintain management buy-in. These four mechanisms will be presented in the following section.

4.3.2. Four social control mechanisms to manage perceived stress and maintain management buy-in

1) Iterative discussion

> "We work a lot with the Swedish consensus model – discussing things back and forth" – Investment manager (IM 2)

As illustrated by the quote above, the Nordic team communicates the iterative process of setting the targets. The iterative discussion had two important components to facilitate the implementation and acceptance of the targets. First, the fact that there was a discussion was highlighted as necessary by Nordic's team, as they wanted Cary to feel included: "*It is not as if I would stand up in front of them and say "here is [a PowerPoint] dec with model 1 and model 2 – read it", I sit down in a discussion so they know we do it together"* Operations principal. However, as described before, Cary's management team had little actual influence as the base investment thesis was pre-set. The investment partner highlights how they communicate their pre-set agenda: "*We definitely do not present a PowerPoint dec; it is rather a dialogue between the two parties*." Interestingly, the discussions appeared to fulfill their purpose, as the CEO experienced the process as highly inclusive: *"We built the entire plan together (...) in very good spirits"*. Thus, the fact that there were iterative discussions created an illusion of influence for Cary's team in the base target-setting process.

Second, another essential component in the iterative discussions was how Nordic communicated in such instances. One part was to communicate in a way that suits the top management's terminology: "*It is vital that we can explain [to Cary's management team] why we are doing something [apart from the financials] to show what we want to achieve and why we will achieve it and how we will go about doing it"* Investment manager (IM 1). However, the terminology is not sufficient. Therefore, another part of how communication was conducted was Nordic's need to formulate the aim of the targets in a thoughtful way: "*We cannot simply state "you need to change more car glasses." Instead, we say, "you think it is boring to call clients to understand what time they booked or call suppliers or invoice clients, right? - we will fix all of that, and you can work in a way that better suits you.""* Investment manager (IM 1). The industry expert further emphasizes the importance of this: "*You need to address something that everyone can take in and understand (...) everyone needs to understand their part in the process."*

Nordic's way of including Cary created a perception of influence that enabled them to feel empowered to participate, i.e., a sense of relatedness. This reduces the feeling of negative stress (Pfister & Lukka, 2019), consequently decreasing the risk of placing them in a panic zone and thus maintaining their motivation (Buormistrov & Kaarbøe, 2013).

Using context-specific terminology also created a sense of relatedness, thus reframing the negative stress arising from the stretch targets (Pfister & Lukka, 2019). Additionally, literature (Bourmistrov & Kaarbøe, 2017; Dello Sbarba et al., 2021) states that communicating in ways the employees feel comfortable with and have previous experience enables a sense of comfort. Nordic uses the understanding of being context-specific in their way of communicating to effectively steer the company in the stretch zone as they manage perceived stress levels. Thus, the iterative discussion serves two purposes, which mitigate negative stress and enable acceptance of the targets.

2) Communicating available resources

> "The stress levels definitely changed in the company [when Nordic acquired us]. But [Nordic ensured] we would obtain solid support and resources (…). Therefore, it was more that we entered an environment where we gained high support in a better way." – CFO

Another social control mechanism used by Nordic is communicating the available resources. As seen by the quote above, the CFO experienced the additional resources as comforting since they enabled the support needed to reach the targets. An example of supporting resources was external consultants, who provided expertise. When the consultants worked together with the two parties, the CFO described that the consultants did not always share Nordic's view, even though Nordic provided the financing. Instead, they had an objective mindset: "*A third party, [the external consultants], worked well as a moderating function*" CFO. Consequently, the objective insights worked as an additional mechanism for the management team to perceive themselves as supported.

The operations principal argues that it is more complicated than just highlighting the available resources to reach targets, stressing the need to use them effectively, with examples such as learning and training modules for top management. This notion was also seen from Cary's management team, as they experienced the resources as inducing a sense of ease to reach the targets: "*If we had not received the help we obtained [from Nordic], we would never have succeeded*" CFO. The successful implementation of stretch targets relies on the availability of resources (Sitkin et al., 2011), a notion identified in the Cary case. Also, the availability of resources appears to have provided some sense of comfort in their ability to reach the targets. The findings suggest that this kept the Cary team in a stretch zone and did not force them into a panic zone. Furthermore, the available resources add to the portfolio company's existing level of competence, bringing the organization's collective competence one step further. Thus, as the level of competence increases, the organization is simultaneously more prepared for a higher challenge, and the top management team reframes the negative stress to comfort in their abilities (Pfister & Lukka, 2019).

3) Relationship building

> "Nordic has been extremely keen on having a good relationship with [top management in Cary], and we have experienced a good dialogue with the whole team throughout the ownership." – CEO

During the first period after the acquisition, all parties describe the communication between the companies as very intense. For Nordic, it was essential to take the time to get to know the management team at Cary to understand what type of people and personalities the management team consisted of and how they aspired to develop the company. "*The ways of communicating are very different depending on what kind of person is sitting on the other side of the table."* Operations principal. The investment manager (IM 1) explained that this process was essential to ensure a working relationship with trust and mutual understanding. This was important as it enabled an environment where both parties could raise concerns on an ongoing basis, while maintaining a mutual respect.

Nordic worked to achieve this kind of relationship in several ways: "*We spent extensive time talking to [Cary's management team] before and after board meetings, especially in the beginning [of Nordic's ownership] to get to know one another (...) it is vital that [Cary's management team] feel like they can talk to us*." From Cary's point of view, the effort from Nordic was seen as an indication that they wanted Cary to succeed: "*[Nordic] wanted to help us succeed (..) They even joined on trips to look at potential acquisition targets. There was no actual need to come along. There was a willingness to join from their side"* CEO. To maintain a good relationship between the parties, Nordic applied a tripartite model to alternate between the Investment team and Nordic's black belts to ensure that heated discussions did not take a toll on the relationship between Nordic and Cary: "*Instead of a relationship with two points, you have one with three points. It reduces the toll on the relationship as those with just two points can become congested"* Investment partner.

Another reason that Nordic emphasized the need to establish a good relationship was to avoid Cary seeing them as the owners; instead, Nordic wanted to be seen a collaborative partners. Therefore, Nordic's team included Cary in discussions early on. During these instances, Nordic repeatedly communicated Cary's essential role in building a better company. The operations principal explained how he could share this: "*I am sitting here with demands on you, but I also sit here to help make sure you reach them."* Consequently, building a solid relationship aimed to make Cary's management feel more comfortable in the stretch zone. Building this kind of relationship further served as a foundation for the opportunity for Nordic to convince Cary to implement specific initiatives with a higher degree of acceptance without coming across as too controlling. A well-functioning relationship created a will amongst the management team in Cary to provide Nordic with the information needed to succeed: *"The good relationship between [Cary] and Nordic enabled us to be fully transparent and open. Thus, it facilitated Nordic with the needed operational insights. If you are unwilling to let the other party in, I'm convinced you will not succeed"* CFO.

Thus, Nordic worked extensively to ensure a good relationship as this created a foundation of trust and mutual understanding and made Cary see Nordic as a collaborative partner. This was important as it facilitated management buy-in and enabled an environment where it was possible for Nordic to observe the consequences of their ongoing base investment initiatives.

4) Building legitimacy with "low-hanging fruits"

> "Initially [Nordic] focused on making Cary's operational practices more effective(..), even though we experienced that people were working more, employees felt less stressed" – Investment manager (IM 1)

The investment manager (IM 1) at Nordic explains that their introductory operational changes in Cary started with relatively standardized and straightforward solutions, i.e., "low-hanging fruits," which have proven successful in similar portfolio companies. An example provided was when Nordic's team early on identified the cumbersome ordering, booking, and invoicing process for workshops, which required administrative work for the glass repair employees. As a response, one of Nordic's first initiatives was to increase efficiency through digitalizing the system for these processes. The CEO explained that this activity increased productivity by approximately 1.5 hours per workshop per day; however, the quote indicates that the response from the company was reduced stress levels.

By making small changes with a high likelihood of success, and a high impact on the company, Nordic established legitimacy for future implementation of targets or alterations. For the management team, seeing the results from the "low hanging fruits" created a sense of legitimacy for Nordic: *"There was a lot of good changes in the beginning (...) We received a lot of help initially to streamline operations (...) from the Nordic team, which had experience working in similar business environments. This helped us a lot (...) and even enhanced our profitability margins during the first year because of the operational improvements"* CEO.

Instead of communicating the economic impact, members of the Nordic team and the industry expert highlight communicating the practical implications of the action. While the effort increased profitability and thus worked towards achieving the financial targets, the investment manager (IM 1) stated that their communication focused on how they improved the way of working for the employees, creating a sense of trust: *"We took away the administrative tasks (...) so people could focus on changing car glasses and have more fun at work".* The Nordic team and the industry expert highlighted the higher likelihood of success in target implementation when communicating in this way.

As the CEO mentioned the early operational improvements, he explained the teams were off to a good start: "*I think [the two teams] worked really well together and put up the targets and how to work together going forward.*" The early improvements appeared to have reduced the feeling of future uncertainty in reaching the targets. Thus, the "low-hanging fruits" also serve as a beneficial condition for Nordic to control the perceived stress level. When the "low-hanging fruits" reduced the future uncertainty, the stress level was limited. Consequently, this reduces the risk of putting top management in a panic zone (Buormistrov & Kaarbøe, 2013). The concrete results of the successful implementation of new operational practices generate trust in Cary's capabilities and thus create a solid basis for achieving even higher targets.

4.3.3. Interplay between management control systems when setting predetermined targets

These four mechanisms are classified as social control, as they are controls exercised informally (Bedford & Ditillo, 2021). Bedford and Ditillo (2021) mention two of these mechanisms, while the remaining two are not recognized in their findings. The two mechanisms found in the literature are iterative discussions and relationship building. However, we propose that two additional mechanisms are essential in the PE setting, namely, communicating available resources and legitimacy building. Interestingly, social control appears vital when results control is tightened through the stretch targets. Bedford and Ditillo (2021) argue that social control substitutes results control in the PE setting. However, our findings indicate that the controls cannot be substituted, as they rather complement each other. Consequently, if one is tightened, the other needs to increase.

The identified four mechanisms appear to have stress-reducing effects on top management. Some stress is expected when a PE firm acquires a company due to the high ambition level of the targets they impose. Additionally, the PE firm has a pre-set agenda in this context, which implies tightened behavior control. Thus, the management teams' autonomy is limited, a basis for stress. Therefore, there appears to be a link between tight behavior controls and increased stress levels. However, the aforementioned mechanisms enable the management team to feel an illusion of influence. They perceive themselves as having autonomy, and therefore the feeling of negative stress levels is reduced (Pfister & Lukka, 2019), and they avoid forcing the team towards a tipping point. Consequently, the management teams' experience shows that the social control mechanisms enable an illusion of influence, reducing perceived stress from the lack of actual autonomy.

Nordic highlights the key aspect of not explicitly pushing the predetermined agenda too hard to maintain management buy-in. The social control mechanisms that reduce stress affect whether the base targets are perceived as controlling or not. Thus, managing stress appears to play a role in maintaining management buy-in and consequently achieving acceptance of the targets. However, stress management is not sufficient for how PE firms implement stretch targets as other components, such as aligned interests, need to be in place to maintain management buy-in.

4.4. Top-up targets

4.4.1. The identified process of setting top-up targets

During the first 100 days, the Operational advisory team worked closely with top management to develop the value creation plan (VCP)[15]. As the operations principal explained, the plan entailed identifying what additional value could be realized on top of the base targets and setting these top-up targets. Thus, the level of ambition of the targets exceeded the base targets, indicating even more stretch targets than identified above (Sitkin et al., 2011). Consequently, the top-up targets implied a more extensive results control (Bedford & Ditillo, 2021), creating a risk of stressing the management team and entering the panic zone (Bourmistrov & Kaarbøe, 2013).

Furthermore, while the initial base targets had a specified performance level, the top-up goals did not necessarily have a defined upper limit: "[*Some top-up targets] where it has gone well have not really had an upper limit, it has been left open"* Operations principal. By not imposing a mental boundary for top management on how far they can reach, there may be an opportunity to create additional value. Furthermore, due to the imposed stress from being acquired by a PE firm, Nordic was keen on measuring and monitoring the stress to ensure high employee satisfaction. They argued it to be a reliable proxy for holistic stress levels. Furthermore, unlike the base targets, the top-up targets were highly context-specific and not standardized financial targets, as seen in Figure 1. Given their contextual nature, the operations principal argues the top-up targets are more of a bet, with higher uncertainty in success than the base targets: "*You should be aware that going [from the base targets] to the top-up, it is possible, but not as likely that you succeed."* Due to the uncertain nature of the top-up targets, the risk of negative stress on the management team increased and thus created a higher risk of reduced performance and demotivation if Nordic's team did not successfully manage the stress levels, as it would force Cary's team into a panic zone (Bourmistrov & Kaarbøe, 2013; Sitkin et al., 2011; Pfister & Lukka, 2019).

[15] The Value Creation Plan (VCP) consists of a PE company's gathered operational value creation practices, which they customize to the particular investment. These practices stem from previous knowledge and experience of successful operational changes in prior portfolio companies

When the prerequisites of the targets changed into more stretch targets with less specific outcomes, the process of determining the targets changed as well. Because the top-up targets intended to capture additional value, unlike the relatively standardized base targets, the work entailed studying the organization in detail. As neither the Investment team nor the Operational advisory team had in-depth organizational knowledge of Cary, identifying and setting the top-up targets was a process reliant on the Cary management team: "*From the outside, I can never understand the full context"* Operations principal. Thus, the behavior controls were reduced. Setting the top-up targets was a balancing act of implementing changes that added incremental value while not disrupting well-functioning areas: *"It was not only setting the targets but also preserving what [Cary] had"* Operations principal. The COO explained the complexity in this balancing act:

> "[Nordic] wants to systemize and standardize without losing the local engagement. It is easy to say but challenging to do. There is a risk of destroying the good parts of a company. It is rarely the operational processes [that are destroyed], (...) but rather the cultural dimension, which results in lost engagement and inevitably losing the magic in the company." – COO

An example from the case was Cary's high employee satisfaction rate when Nordic acquired them. Nordic was keen on not reducing the satisfaction by imposing the wrong targets. If the Nordic would set the targets themselves, there was a risk of compromising employee satisfaction, as Nordic did not understand the interlinkages in the organization. The COO further problematized the PE target-setting process: *"[The PE firm] wants to leave no stone unturned, but when you do that too much [without understanding the full context], the heart of the organization dies."* Hence, another reason why the organizational context was highly relevant to understanding when setting the top-up targets (Pfister & Lukka, 2019; Thompson et al., 1997) to ensure the right things were implemented. Because of Nordic's dependence on Cary's knowledge, the relationship dynamics between the two parties changed when going from the base targets into the top-up target-setting process.

Similar to the base targets, a key aspect of a successful implementation of the targets was maintaining buy-in from Cary's management, as they were the ones to do the work to reach the targets: "*We are not the chain of command; we are rather a support function for the CEO. Thus, the top management needs to do all the work"* Investment partner. In the top-up target process, the results control increased as Cary's management was introduced to more uncertain and ambitious targets, increasing the risk of entering a panic zone. Simultaneously, as mentioned above, the process was reliant on Cary's operational expertise. To maintain management buy-in under these conditions, Nordic's team worked to find ways to change Cary's perception of the targets. To counter the hard aspects, i.e., results control, Nordic worked more extensively with soft elements, i.e., social controls. During this process, three distinct mechanisms of social control are identified, presented in the following Section.

4.4.2. Three social control mechanisms to manage perceived stress and maintain management buy-in

1) Iterative discussions

> "[The operations principal] identified potential operational improvements and had some input, but we had to sit together [as Cary had important insight] to set the right financial targets" – CEO

The iterative communication was considered vital, similar to the base target process. However, interactive communication for top-up goals has a twofold purpose. First, it enabled Cary's management team to feel like their input was important to Nordic, and second, the actual need for Nordic to get Cary's operational insights for where and how to capture additional operational value. The inclusion and perception of their own importance indicated that Nordic worked together with Cary as a team to build the company instead of solely telling them what to do. As seen in the quote above, Cary's management team perceived the process to be a collaboration.

Nordic's need for contextual insights was an essential aspect of the top-up target-setting process. Iterative discussions enabled Cary to provide helpful insight into the process. This contextual knowledge was described by Nordic's team as a vital part of setting the appropriate targets: *"Which opportunity do you choose? The one with the most potential. How do you know which one has the highest potential? If I [as an external party] do not have all the context details (..) I won't be successful."* Operations principal. The investment partner highlighted the CEO's vital role: "*You need a CEO who is an expert in the field (...), who knows the industry down to the atoms."*

Consequently, the iterative discussion provided an environment where both parties felt their needs were met and enabled Nordic to maintain buy-in from the management team. Cary felt heard, and Nordic gained operational insight. Furthermore, the inclusion of the iterative discussions provided Cary with a feeling of empowerment: "*We felt that we were ultimately owners of the process. Henrik [the operations principle] was present and he challenged our ways of thinking. We experienced him as support rather than deciding what actions to undertake(...) when we came out on the other side, it still felt that it was our plan"* CFO. The opportunity to actually participate creates an additional layer of influence, where the chosen approach was in line with their will, reducing the risk of entering the panic zone (Buormistrov & Kaarbøe, 2017).

2) Relationship building

> "I think [the "fluffy aspects"] make the real difference. If I buy the top management lunch, my message to them is, "I am not only here with a tough agenda, but I'm here to help all of you to succeed."" – Operations principal

Like the base targets, Nordic used relationship building when implementing the top-up targets. In this process, the purpose was also to be perceived as a collaborative partner. However, in the top-up target process, they did this by using what the operations principal referred to as "fluffy aspects" to signal their joint efforts to Cary: *"There were a lot of fluffy aspects in Cary, which was of significant importance"* Operations principal. The "fluffy aspects" came across in different ways. The Nordic team highlighted the importance of physical communications and played down the formality of their presence: "*My approach is (...) discussions, finding solutions, and then during those conversations, I can bring in our frameworks. But I do it in combination with a cinnamon bun and coffee*" Operations principal. Cary's COO reflects on the importance of the "fluffy aspects": "*you need the things that sound fluffy (...) because that is how you systematize the engagement"*.

Consequently, the "fluffy aspects" were tools to balance the formal relationship to avoid a hierarchical perception while maintaining engagement. This seems particularly pronounced when Nordic needed Cary's operational expertise. Thus, the tools were used to change the relationship dynamic to ensure the management team could be bold and aim high without the threat of being penalized by Nordic in case of failure. As Sitkin et al. (2011) describe, stretch targets entails a risk due to the ambiguity of the success. Therefore, there must be a will to take on high risks to obtain the potential high reward of reaching them. Consequently, the relationship-building at this stage worked to make top management more comfortable in taking high bets on themselves, hence comfortably to a more stretch zone.

3) Confrontation avoidance

> "[Nordic's] main philosophy [with opposing views] is that we argue, and then we argue a little more. But we are always collaborative. We rarely push something that [Cary's top management] disagree on" – Operations principal

When behavior controls decreased, the actual autonomy increased, which changed the interplay between the two parties compared to the base target process. This opened a more confrontative environment if there were opposing views as there were two perspectives to consider. While Cary had invaluable operational insights to find where to extract additional value, the operations principal did not always agree with their chosen level of performance: "*The best performance level is usually higher than what management thinks is good. But if we push too much, there is a risk for demotivation.*" So, while Cary influenced the target setting, Nordic knew their ambition levels might fall short of the optimum value creation level. Simultaneously, the need to ensure motivation and that management buy-in still prevailed. Consequently, in situations where the opinions on the choice of target or the level of the target differ, Nordic aimed to avoid conflict while getting their will through. To do so, they used social control, particularly with three different tools.

First, Nordic uses proof of concept to change Cary's mind. The CEO provided an example of an instance where he was not convinced of the operations principal's idea of benchmarking workshops. Using a previous successful case, the operations principal convinced him: *"Henrik (the Operational principal) argues with concrete examples. He explained the "Ahlsell model" that he had implemented in a previous similar company. This model implies an internal competition between the workshops, revealing important insight into variance between workshops. I liked the idea, and we are using this model every day. It creates a strong driving force to become the best workshop."* Nordic also used pedagogic and logic to change Cary's mindset and achieve acceptance: "*When [the CEO] said "this doesn't work," we sat for two days discussing (...) and I [broke the problem into pieces] and tried bit for bit, and then when I put it all together and said "what do you think?", [the CEO] was convinced (...) and so we had changed the mindset"* Operations principal.

Second, Nordic used the strengths and weaknesses of personal traits in the management team to create motivation. As the CEO was seen as a highly competitive individual, the operations principal provided an example of how he would custom his message: "*Anders (the CEO), for you to become better than Anicura*[16] *(...), you need to do this…"*. On the other side, Cary's management team never experienced any forced targets, despite the ambitious level: "*They only came with concrete ideas (...) but never forced anything"* CEO.

Third, if the tools mentioned above failed, the Nordic team would not push the target on Cary without their approval: "*You should not give up. Sometimes [Nordic's] initial ideas were not accepted [by Cary]. Then we would bring it up again six weeks later when [Cary] had a successful implementation of something else. Then we had a different situation and could bring up our idea again."* Operations principal. Nordic used these three tools to get their point across without ending up in conflict.

[16] A prior portfolio company with one of the highest returns in Nordic's history

4.4.3. A detailed process to meet the stretch targets

As an extension of the targets, Nordic implemented a detailed follow-up process. The detailed process consisted of sub-goals and milestones that illustrated how Cary should reach each target, as illustrated in Figure 1. The process worked as breakdowns of the targets, creating a procedure to reach such stretch goals. Nordic's team used the detailed process to create a clear agenda for Cary to work after and to be certain Cary was working to realize as much value as possible: *"If there is no detailed level of specification, it creates a lot of nonsense discussion with a lot of emotional arguments (...) You are discussing things in circles."* Operations principal.

Compared to the base and top-up targets, the detailed process was more specific in determining how Cary's management team should work. Consequently, Nordic tightened the behavior controls. Despite this, both the CEO and COO experienced the detailed process as comforting, reducing the stress level. It provided a clear path for them to follow: *"It is much easier to work in an organization when you know what your owner expects from you in terms of performance. Nordic's clarity suited me very well"* CEO. "*I think there is a clarity and simplicity [in the targets], which makes it easy to set a plan and make decisions (...) it provides a foundation for execution and speed."* COO.

Additionally, Nordic's team distributed the responsibility for the detailed processes amongst Cary's management team, with one person being accountable for several detailed processes. The development in reaching the targets was followed, using a traffic light system[17]: "*Accountability is very important. It should be clear who is responsible for what (...) we followed up at least once a month"* Investment manager (IM 1). Consequently, the detailed process was used as a mechanism for behavior control, imposing constraints, procedures, and structures on how the Cary team should work (Bedford & Ditillo, 2021). However, Nordic explains that there is a risk of measuring too much, which causes the process to take too much time and resources from Nordic and Cary. To reduce risks of problems, such as wasting resources, Nordic provided freedom in determining which targets to focus on:

> "You can never be responsible for 10 KPIs and have all [be green], but from the outside, you don't have the context (...), so you [the decider] say [to the person accountable] "make the red one green." And so the red one turns green, but the three yellow ones are still yellow. It would have been much better to leave one red and turn the other three yellow ones into green ones. But you can't see that [without context]. It's not the level you're after; it's the combination." – Operations principal

[17] The traffic light system is a system used for monitoring the newly implemented operational practices. For example, a red light implies off-tack, and a green light indicates the target is on track

The operations principal explains an additional reason why an illusion of influence is essential. The feeling of being told to do something you know is not the right solution will impose too much stress on the management team: *“When you cannot decide anything yourself, individuals can get very stressed and feel pressed into a corner”* Operations principal. The CEO does not experience the detailed processes to control him: “*They have not controlled in detail; they have been very good at handing over the company's operation to the company. They are not controlling us in detail at all.*” However, the CFO described instances of reluctance on Cary’s part as the process was too detailed and time-consuming: “*At times we felt as if they were controlling the way we were working and running the company a bit too much.”* As supported by Pfister and Lukka (2019), when the CFO experiences a feeling of lack of autonomy, it demotivates him and increases the risk of feeling stressed. In such instances where tensions arose, Nordic’s team responded by meeting the Cary teams’ needs, which the CFO argued could be a consequence of their successful track record: *“Having this kind of opinion is only possible when you have a solid track record.”* Thus, there appeared to be an indirect threat of discipline, with more behavior controls imposed on the management team if they do not live up to Nordic’s expectations. *“I know Nordic can be tough when it is needed (…) I’m fully convinced that if our financial performance would not have met the expectations, the relationship between us would be completely different”* CEO.

Consequently, Cary's autonomy was restricted as the behavior controls tightened due to the clear processes, constraints, and procedures. While a sense of comfort was experienced due to the clarity, Nordic was still aware of the risk of stress from micromanaging. Such pressure can create risks of panic zones (Buormistrov & Kaarbøe, 2013) and misalignment of what operational practices are essential (Buormistrov & Kaarbøe, 2017). As Nordic acknowledged the risk of stress, they used social control to create an illusion of influence. In this instance, social control was used by allowing Cary to choose how to prioritize their assigned processes. However, Cary’s management team is aware that their influence is dependent on their financial performance. Thus, the tight monitoring of the detailed processes created a threat of discipline if performance deviated from the plan. Nordic uses social control to create a sense of “freedom of choice”. However, Cary is aware that the freedom is conditioned on their need to meet Nordic’s expectations. Therefore, despite their perception of freedom, the consciousness of the freedom being conditional creates a threat of discipline and reduces the effect of the social control. Consequently, the management team appeared to operate in a state close to the tipping point.

4.4.4. Interplay between management control systems when setting the top-up targets

Similar to prior findings, social control mechanisms become more prominent when results control increases. Once again, it indicates that soft and hard controls increase simultaneously. Like the base target process, the mechanisms are clear examples of social controls, given their informal nature (Bedford & Ditillo, 2021). Once again, iterative discussions and relationships building are mechanisms identified in literature. However, conflict avoidance does not appear in prior findings (Bedford & Ditillo, 2021). The main difference with use of social control mechanisms used in the base target process is that the mechanisms used in the top-up target process focus on informally steering the management team when they have autonomy. Reduced behavior controls enable autonomy as a consequence of the need for contextual insight. Consequently, more controlled interaction between the parties becomes essential, facilitated by the identified social control mechanisms. When going into the detailed process, the behavior controls are tightened again, which once again changes the use of social control. The degree of behavior control appears to steer the choice of social control mechanisms. The result of the interplay of the controls is that the management team does not end up in a panic zone. However, the detailed process indicates that the conditions pose a risk of pushing the team over the tipping point.

5. Discussion

The following section will discuss what has been of particular interest in the empirical analysis section. Section 5.1. will summarize the empirical findings. Section 5.2. will provide two main implications related to the existing research within MCS in PE and stretch targets.

5.1. Summary of empirical findings

The findings indicate that Nordic applies results control in terms of stretch targets to steer the operational value creation process. In this case, the PE firm applies stretch targets in two instances: base targets and top-up targets. These targets are complemented with a detailed process to ensure the portfolio firm will meet the targets. Both the PE company and the portfolio company noted that stretch targets could lead to unfavorable stress levels, affecting performance negatively. To manage the potential negative stress and maintain management buy-in, we identify the use of various controls depending on the stage of the process illustrated in Table 3.

Table 3: Controls applied in the target-setting process

This table presents the empirical findings in relation to the defined MCS. We have used a range of low, moderate, and high depending on how extensively Nordic exercise their control over Cary in the case. The text in italic provides examples of these types of controls in each part of the process

	Base targets	Top-up targets	Detailed processes
Results control	High *Best in class targets*	High *More ambitious than best in class*	Moderate *Breakdown of targets*
Behavior control	High *No actual autonomy*	Low *Actual autonomy*	High *Low degree of actual autonomy*
Social control	High *Four identified mechanisms*	High *Three identified mechanisms*	High *Communicating Cary's choice to prioritize freely*

The consequence of the use of the controls appears to influence the perceived stress levels of Cary's top management, as they never force the team towards a tipping point. This is interesting as Nordic uses results and behavior control throughout the process, two controls that the study indicates have prerequisites for negatively impacting perceived stress levels. However, the extensive use of different social control mechanisms appears to maintain the management team in the stretch zone without forcing them into a panic zone.

The main contributing factor to the desired level of behavior control is the degree of contextual insights needed from the portfolio firm. Nordic gives more autonomy when there is a need for insight. The use of social controls depends on the level of behavior control, as social control appears to play a vital role in creating an illusion of influence. Hence, when behavior controls are high, the social control mechanisms are used to create an illusion of influence. When behavior controls are low, the social control mechanism serves another purpose, informally steering the collaboration between the parties. By adapting the social control mechanisms, the PE company manages to ensure that the portfolio firm reframes negative stress, maintains motivation, and ensures acceptance of the targets. The following section will discuss the findings' implications for the relevant literature.

5.2. Using controls to set stretch targets in private equity

As indicated in prior literature, the case demonstrates that target setting plays a crucial role in the operational value creation process (e.g., Rogers et al., 2002). In particular, the ambition of the targets appears to be far higher than the organization had experienced before, aligning with the academic concept of stretch targets (Sitkin et al., 2011). However, what has been relatively unexplored in prior studies is the practices the PE companies use to implement the stretch targets. Previous literature focuses on how PE companies emphasize different types of control depending on various contextual factors (Bedford & Ditillo, 2021). Our single-case study has observed the different interplays and dynamics between MCS and identified new social control mechanisms. These findings will be discussed in more detail below.

5.2.1. The importance of an interplay between controls

As mentioned in the empirical analysis, it becomes apparent that results control and social control are not seen as substitutes, which Bedford & Ditillo (2021) argues. In this case, these controls are rather complementing each other. This interplay appears to be vital to ensure that the portfolio company accepts the stretch targets the PE company imposes. Using results control by implementing stretch targets can potentially result in negative perceived stress levels. Therefore, the PE firm uses social control to manage stress levels as the social control appear to have a comforting effect on the hard results control. If the PE firm does not manage the stress levels using social controls, there is a risk of demotivated employees and low performance. Thus, highlighting the need for human interactions in a process that is centered around applying hard, formal controls.

Ultimately, the findings imply that results and social controls are not used as substitutes - the hard aspects need to be compensated by softer aspects. Therefore, we contribute to the literature on MCS in PE by highlighting a limitation in prior studies. They have failed to provide nuances of the use of control, as they have aimed to identify variables that steer the choice of different controls. For example, Bedford and Ditillo (2021) find that majority owners mainly apply results control. However, we argue that while there is evidence of high results control, there is an equal need for increased social controls. Furthermore, Bedford and Ditillo (2021) acknowledge trust as one key component of social control, which can function as a substitute for formal contracts. However, their assumption that controls work in silos is further contradicted. Our case indicates a significant need to build trust between the parties despite the existing formal agreements.

Furthermore, the need for social controls requires the PE firm to be thoughtful when applying stretch targets, as it requires more engagement, in terms of time and resources[18], from the PE company's management. While prior studies on stretch targets focus on the company's organizational and financial conditions (Sitkin et al., 2011; Pfizer & Lukka, 2019), our findings add implications to the practical and social requirements between the parties. The practical implications are seen by the extensive engagement the social controls require. The social requirements entail a working relationship with trust, legitimacy, and a perception of being equals. Interestingly, the relationship appears to be dynamic, changing over the stretch target setting and implementation process, which requires work from both parties. From a practical point of view, this shows that the PE company's ability to create operational value in the portfolio firm using stretch targets is dependent on managing stress levels through extensive use of social controls mechanisms.

The identified social control mechanisms appear to be a vital component to achieve acceptance stretch targets as they manage stress levels and works to maintain management buy-in. Contributing to prior literature on MCS in PE, our findings can provide insight into the social controls PE firms use. Also, we shed light on the necessity of social controls to implement stretch targets, contributing to the existing stretch targets literature (Sitkin et al., 2011; Lukka & Pfister, 2019). Our findings show five distinct social control mechanisms, which a PE company applies to steer the target setting process. All five mechanisms are social control in the broad definition of being used informally. However, only two mechanisms are identified in prior PE MCS literature (Bedford & Ditillo, 2021): iterative discussion and relationship building. The three remaining mechanisms: legitimacy building, communicating existing resources, and conflict avoidance, are, to the best of our knowledge, not identified as social control mechanisms in prior literature in the field. Our findings further build on Dello Sbarba et al.'s (2020) conclusion that social controls are most prominent in the early stages. The result from our study builds on this by showing that social controls change, in terms of what mechanisms are applied, throughout the PE ownership.

[18] Examples of such resources are competence, expertise, and capital

5.2.2. The dynamics between behavior control and social control

Simultaneously, the findings show that there appears to be a dynamic between how the behavior control and social controls develop throughout the target-setting process. The degree of behavior control is dependent on whether the PE company requires contextual insight. For example, the level of behavior control is seen by whether the PE firm incorporates the portfolio firms' input or sticks to the pre-set targets in the dialogue. This is a consequence of whether the target setting process is standardized based on the PE company's prior experiences or not. As social control is used, the management team's perception of their influence is constant. However, the actual autonomy is sometimes limited, which entails that the portfolio company's opinions have limited influence. Thus, social control creates a perception of participation from the portfolio firm's point of view.

When there is limited actual autonomy, the PE company uses social mechanisms to create an illusion of influence. This illusion of influence reduces the potential harmful perceived stress levels as the portfolio firm's management feels inclusion, empowerment, and autonomy. A sound level of stress creates a solid basis for implementing stretch targets and maintaining motivation. However, the social controls can at times fail in disguising the high behavior controls, which creates a sense of being micromanaged, causing tensions between the two parties. As the portfolio firm does not feel their insights are used to steer the firm, such tensions can result in demotivation and risk entering the panic zone. Consequently, finding the right balance is complex, and the risk of failure results in low performance. Thus, it is a craft of the PE company to find the proper level of controls.

When the portfolio company has actual autonomy, social control mechanisms serve a twofold purpose. First, the control mechanisms create a perception of being seen as a collaborative partner. This creates a sense of comfort in the stretch zone to enable ambitious bets to set high targets. Second, the social control mechanisms are used by the PE company to informally steer the autonomy to control the uncertainty an autonomous portfolio company entails.

Consequently, we contribute to shed light on the simultaneous need for all types of controls and describe how behavior controls can be applied in a PE setting, which has not been previously explored in the literature (Bedford & Ditillo, 2021). Our findings contribute by showing that the behavior controls and social controls appear to have an interdependence, where their levels are dependent on the need for contextual insight.

However, it is inevitable not to speculate on whether the PE firm's achievement of attaining the portfolio firm's acceptance of the stretch targets would differ depending on external factors. The portfolio firm was positively affected by market momentum, a strong management team, robust corporate culture, and low operational complexity. Thus, the organization has favorable conditions, which both Sitkin et al. (2011) and Pfister and Lukka (2019) stress as prerequisites for implementing stretch targets. If there were opposite conditions, one could argue that it may be risky to implement stretch targets, causing risks of negative stress and demotivation. Therefore, there had been of interest to understand whether the social control mechanisms identified in the case had been sufficient to manage stress levels if the conditions were not as favorable. Additionally, the interplay between behavior controls and social controls raises the question of how social control would be impacted by the changes in behavior control that low financial performance entails. Consequently, different prerequisites may have led this case in another direction.

6. Conclusion

This section will provide the study's main implications and answer the research questions. Section 6.1. provides a summary of the main contributions and implications. Section 6.2. highlights the study's limitations and proposes future studies, Section 6.3. will end the thesis with final reflections from the authors.

6.1. Main contributions and implications

The increased competition within the PE industry creates an interest in understanding how PE firms earn abnormal returns, despite the competitive landscape. Research highlights the significant importance of operational value creation and the correlation between PE-ownership and increased operational value (Acharya et al., 2013; Bergström et al., 2007; Bloom et al., 2015; Boucly et al., 2011; Davis et al., 2013; Guo et al., 2011). However, prior studies do not provide an understanding of how PE firms manage to create operational value in their portfolio firms. We have studied this process using a single-case study to answer the following research questions:

1) *How do PE companies use target-setting to create operational value in their portfolio firms?*
2) *When PE companies use stretch targets in their portfolio firms, how do they adapt the remaining parts of the MCS to manage stress levels and maintain motivation?*

First, we found that PE firms use stretch targets as a part of their MCS to create operational value in their portfolio firms. As PE companies use hard financial controls on the portfolio firms, we have identified a need to balance the hard with soft by using social control mechanisms. Second, the findings indicate that stretch targets can result in negative stress levels for top management in the portfolio firm. To reduce the risk of low performance and demotivation in top management, the PE firm uses social controls to ensure a perception of influence for top management. The use of controls differs depending on the context, as different contexts require different controls to create the perception of influence.

The results have both theoretical and practical implications. Given the limited insight into the PE industry, we contribute to literature and practice. The following section will provide a more in-depth explanation of the theoretical and practical implications.

6.1.1. Contribution to research

The findings of our study contribute to three research areas. First, we contribute to the PE literature on operational value creation. Although existing research shows a correlation between PE ownership and operational value creation, they do not provide an understanding of how PE firms create value in their portfolio firms. Our findings create a more nuanced and detailed understanding of the PE firms' value creation practices. We find that target-setting, particularly using stretch targets, plays a crucial role for PE firms to realize value. To enable value creation through stretch targets, we find that a critical component is achieving acceptance from the portfolio firm's top management team.

Second, our findings build on the existing literature on what MCS are used by PE firms. We argue PE firms use results control, social control, and behavior control simultaneously. In the PE firms' use of controls, we show that results controls and social controls appear to complement each other. This finding contradicts Bedford and Ditillo (2021), who argue that these controls are used as substitutes. We further build on Bedford and Ditillo's (2021) findings by showing the interdependence between behavior control and social control. The use of behavior control appears to steer the social control mechanisms used by the PE firm. Additionally, we provide a deeper understanding of what social control mechanisms are used by PE firms. Apart from providing additional examples of social controls, we further explain how the choice of social control mechanisms is dependent on the current stage of the target setting process.

Third, our findings address the current calls from the stretch target literature to understand processes and mechanisms used to implement stretch targets (Sitkin et al., 2011). We find that there is a need to use social control mechanisms to manage the stress and demotivation that stretch targets can impose. The social control mechanisms work to harmonize perceived stress levels, create an illusion of influence, and maintain management buy-in. Thus, increasing the likelihood of acceptance of the targets.

6.1.2. Practical implications

The findings provide a practical understanding for the PE companies by providing insight into what is required to use stretch targets. As their business model requires ambitious target-setting to enable abnormal returns, it is interesting to understand what mechanisms facilitate the implementation and execution of the targets. As the ambitious target-setting is perceived as a hard control, there is a need to complement the hard aspects with soft controls. The reason for this is the increased perceived stress for the top management team from being acquired by a PE firm. The findings explain how that stress can be alleviated using social control. However, this high level of social control requires extensive time and engagement from both parties. Therefore, our findings explain the amount of effort this approach requires. Furthermore, the use of various controls is dependent on the stage of the target-setting process, as different stages require, for example, different levels of contextual insight. As different stages alter the setting, controls must also change to ensure stable stress levels and maintain management buy-in.

6.2. Limitations and future research

Our study is not without limitations. General limitations of single-case studies are that providing in-depth findings comes at the cost of providing general findings applicable in a broader view and the risk of personal bias (Dubois & Gadde, 2002). There may be a reason to believe that our study's findings are not geographically generalizable. For example, the Swedish culture, values, and organizational practices are argued to be variables that impact social interactions, which play a significant role in our case. Additionally, the authors of this thesis are Swedish natives, which potentially provides a bias towards certain practices. For example, Swedish organizations are generally not hierarchical in nature; thus, we may be biased in perceiving soft controls as something positive. As described in Section 3.4., we have had a constant recollection of this risk; however, we cannot be sure that the issue of bias is eliminated. Therefore, we call for future research on similar studies with different geographical scopes, cultures, and PE companies with portfolio companies in different countries that can help control our study's limitations.

Furthermore, issues raised throughout the study relating to external factors'[19] impact on the portfolio company's success also raise questions about the robustness of the findings. If the financial performance of the portfolio company had been different, there is a risk that our findings would have changed. To provide further understanding, we propose future studies on non-successful and other successful companies make it possible to understand operational value creation better. Additionally, we have conducted an ex-post study, meaning that the interviewees reflect on their past experiences. This creates a risk that people rationalize retrospectively, highlighting the good rather than the bad. We propose future studies on value creation practices in real-time to obtain immediate reactions from both parties. Lastly, the setting in which the research was conducted entailed a limited number of relevant interviewees. This practical limitation was mitigated by including additional data from other sources and ensuring theoretical saturation. However, we cannot preclude that a wider interviewee pool could provide a more comprehensive and widespread understanding. Therefore, we propose future research on similar settings with more individuals involved.

6.3. Final reflections

Throughout this study, a question that has been raised among the authors is how the increasing competition in the PE industry will impact future value creation opportunities. Throughout history, the value creation levers in PE have become increasingly incorporated into the transaction price. Historically, value creation from financial and governance engineering has become a relatively standardized practice. While conducting

[19] Market momentum, low operational complexity, corporate culture, and a management team with high aspirations for the company

this study, the question of whether operational engineering is heading down the same path has been discussed. As operational advisory teams are becoming a more frequent part of PE companies, this raises the question of whether the operational engineering processes are indeed becoming easier to replicate? In our case, implementing stretch targets while maintaining motivation in the portfolio firm has been portrayed as a relatively straightforward process where the PE firm has been aware of each necessary step. Thus, it makes us wonder whether the operational value creation process is easy to replicate or if the well-executed process is isolated to this particular case.

After conducting this study, we are convinced that the practices used to create operational value in the PE industry will develop in the near future due to increased competition, high industry scrutiny, and a remarkable financial track record. We will continue to follow the development of the PE industry and hope for more research within the field.

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Appendix

Appendix A: Comprehensive interview list

Interviewee	Role	Id no.	Interview no.	Forum	Duration (min)	Date
Nordic Capital						
Magnus Hammarström	Investment manager	1	1	Physical	64	2022-02-03
Joakim Andreasson	Investment manager	2	1	Teams	25	2022-03-25
Andreas Näsvik	Investment partner	3	1	Physical	56	2022-03-10
Henrik Sandreus	Operations principal	4	1	Physical	60	2022-02-17
			2	Email	n/a	2022-03-06
No. interviews: 5						
Cary Group						
Anders Jensen	CEO	5	1	Telephone	30	2022-02-22
Joakim Rasiwala	CFO	6	1	Teams	47	2022-03-11
			2	Teams	25	2022-04-13
Linda Wikström	COO	7	1	Zoom	45	2022-03-23
No. interviews: 4						
External advisors						
Mia Ejendal	Consultant	8	1	Zoom	28	2022-02-28
Anonymous	Industry expert ("black belt")	9	1	Physical	32	2022-02-28
No. interviews: 2						
Total interviews:			**11**	**Average duration:**	**41**	

Appendix B: Interview guide Nordic Capital

Background

- Prior experience
- Current role
- Potential involvement in Cary Group
- What distinguished Cary Group from previous holding companies

Operational value creation

- What the process looks like to create operational value
- Your job in creating operational value
- How standardized is the value creation process
- Examples of operational changes that create value
- Formal and informal processes

Target setting

- Process of setting targets
- Who sets the targets
- How does the collaboration between owner and portfolio firm work
- How targets are received / reactions from CG
- Communicate the targets
- Follow-up and measurement processes
- Provide examples of targets and processes to reach said targets

Stress

- Components needed to set ambitious targets
- Experiences of resistance to accepting the targets
- How do you handle the stress

Value creation

- What is value creation to you

Appendix C: Interview guide Cary Group

Background

- Current role
- Role at Cary during the studied time
- What distinguished Nordic Capital from the prior owner
- How did your role change with Nordic as an owner

Operational value creation

- Examples of operational changes that were made to create value
- Formal and informal processes
- Changes in ways of working with Nordic compared to the prior owner

Target setting

- Process of setting targets with Nordic capital
- Who sets the targets / your level of influence
- How does the collaboration with Nordic work
- How did you react to the targets Nordic presented
- How did Nordic communicate the targets
- Follow-up and measurement processes
- Provide examples of targets and processes to reach said targets

Stress

- What tools/resources has Nordic provided to reach the targets
- Experiences of resistance to accepting the targets
- How do you handle the stress of the ambitious targets
- What motivates you to reach the targets

Value creation

- What part of Nordic’s work to create value has had the largest impact
- What is value creation to you

Appendix D: Interview guide external actors

Background

- Current role
- Potential role in Nordic's ownership of Cary

Operational value creation

- How do PE firms create operational value / changes
- Do you work with the management team or the PE company

Target setting

- Why do you think PE firm can set ambitious targets successfully
- What are essential components in setting ambitious targets

Stress

- How do you experience the interplay between the PE company and the portfolio firm

Value creation

- What is value creation to you

Appendix E: Coding tree

The coding tree illustrates the process of how we came up with the findings in the study. The white boxes represent findings from interviews with people from the Nordic team. The grey boxes represent findings from interviews with people from the Cary team.