Management control mechanisms in a private equity buy-and-build investment

The balancing act of taming and enabling a fast-growing beast: balancing coercive and enabling logics using management control mechanisms in a private equity buy-and-build investment

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Abstract

With the aim of contributing to the management control literature within private equity ("PE"), this paper investigates the management control mechanisms ("MCMs") implemented in a PE investment with a buy-and-build ("B&B") strategy by utilising a single case study. The case company is a fast-growing acquirer of entrepreneur-led companies which operate fairly autonomously, hence leading to a constant balancing act between controlling the discourse whilst simultaneously enabling action. Firstly, our findings shed light on the 'package' of MCMs deployed in such a case, where we identify similarities and discrepancies compared to previous literature on management control relevant to our setting. We find that previous literature on control mechanisms does not capture the full complexity of a B&B strategy and that social controls are more prevalent than expected in our case. Secondly, by drawing upon previous literature on coercive and enabling logics as an analytical lens, we nuance the management control literature within the PE context by providing colour on the interplay of enabling and coercive logics and the inherent balancing act of the logics in the package of MCMs. In this case study, we find that there exist MCMs with elements of the coercive and enabling logics that contribute to the balancing act.

Keywords:

Management control mechanisms, buy-and-build, coercive, enabling, private equity

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1. Introduction

1.1 Background

A few years ago, a newly founded Swedish private equity firm ("PECo") acquired its first company. The company became the platform upon which the future group ("PortCo") was founded. The group consists of entrepreneur-led companies specialising in a low-technical installation industry, managed by a group company, i.e., PortCo, with a slim management team. The investment strategy is a so-called 'buy-and-build' ("B&B") strategy and since inception, PortCo has acquired more than 20 companies in Sweden and Norway, hereafter referred to as the "subsidiaries". At the time of writing this paper, the group has a consolidated revenue north of a billion SEK, making it the largest company in the Nordics within its industry. By carrying out an active acquisition agenda, utilising both equity and debt in leveraged buyouts, PECo has provided PortCo with the necessary capital and guidance to consolidate the market in under three years, an impressive achievement by itself. The case company PortCo is run by managers appointed by PECo which operates as a holding company for the portfolio of entrepreneur-led subsidiaries. The subsidiaries are predominantly run by the founders of the now subsidiaries to PortCo and are also co-invested in the group. The PECo deal team members, PortCo management as well as the entrepreneurs in the subsidiaries all have an equity stake in the investment.

The topic of leveraged buyouts, specifically those conducted by private equity ("PE") firms, has been a subject of much debate in the financial industry and by researchers. On one hand, proponents of leveraged buyouts argue that PE firms bring about improvements in governance, financial and operational engineering, resulting in increased economic value for their portfolio companies (Jensen, 1989). However, there are also those who criticise PE firms for taking advantage of tax breaks and superior information, without creating any operational value, and for being short-sighted (e.g., Schleifer & Summers, 1988). The value-creation part, outcome and consequences of PE transactions are undeniably up for debate. Nonetheless, PE firms have become a crucial part of the worldwide financial markets (Gilligan & Wright, 2020; Wood & Wright, 2009). In 2000, global PE assets under management ("AUM") amounted to approximately 1 trillion USD. Two decades later, in 2021, PE AUM reached a record high with global AUM amounting to 6.3 trillion USD. One reason as to why PE firms' AUM reached new all-time highs can be attributed to that, following the global financial crisis of 2008, PE funds have consistently shown superior performance when compared to other private markets assets and similar public market investments (McKinsey, 2022).

While the literature on PE governance and its effects is fairly extensive, it does not adequately cover the management control mechanisms ("MCMs") used by PE firms to control and manage portfolio companies. The difficulty of gaining access to PE firms for researchers is a well-known issue in the industry (Bedford & Ditillo, 2022). Despite the abundance of information and data available, the PE sector remains relatively opaque, making it challenging for researchers to gain access to the necessary information and resources needed to conduct meaningful studies. While scholars (e.g., Bedford & Ditillo, 2022) make use of a range of terminology related to control mechanisms, we will use the terminology MCM as we study control mechanisms predominantly targeted towards management (see e.g., Sbarba et al., 2020). The limited number of studies on the subject of control mechanisms used in controlling portfolio firms in the PE field results in an incomplete understanding of the MCM arrangements (Bedford & Ditillo, 2022). We argue that MCMs can, to a certain extent, be better understood by examining and reviewing them from a 'coercive' and 'enabling' lens.

The coercive and enabling logics in the domain of management control within PE relate to the inherent balancing issues between exercising control whilst simultaneously empowering the freedom to act. In some instances, the two approaches are at odds with each other. This balancing act becomes important in managing PE investments, where there is a need for exercising control to mitigate risk whilst simultaneously empowering the portfolio company management towards value creation activities. To elaborate on this line of reasoning we turn to previous literature on coercive and enabling logics. Adler & Borys (1996) introduce the concepts of coercive and enabling formalisations from a workflow and employee management perspective. They describe coercive formalisation as "formalisation designed to coerce effort and compliance from employees" (p.62) and enabling formalisation as "formalisation designed to enable employees to master their tasks" (p.62). Within the domain of MCMs in a PE setting, we define MCMs of coercive nature as MCMs that *reduce choice*. MCMs of enabling nature we define as MCMs that *inspire* and *leverage competencies*. Importantly, the perception of the coercive or enabling nature of MCMs do not necessarily rhyme with the intended nature of the MCM (Tessier & Otley, 2012). For example, a vision that is meant to inspire and guide the portfolio company may be perceived as totalitarian and hence coercive. In summation, we argue that the concepts of coercive and enabling logics can be used as a tool to analyse the MCMs package composition.

As mentioned, MCMs in a PE setting have been largely ignored in the previous literature, especially for a specific investment strategy such as the B&B strategy. Hence, the literature on the characteristics of control mechanisms deployed and how the 'package' of MCMs varies with the specific setting of the PE investment is scarce. With rapid growth and plenty of acquisitions of previously separate entities, conforming to a common vision and collaborating, our case becomes interesting to investigate due to the inherent need of coercively controlling the actions of the portfolio company and its subsidiaries whilst also enabling action to foster growth. Our case sheds light on the characteristics of MCMs implemented, which in the previous literature only is described and examined on a higher level, as well as analyses the package of MCMs from the theoretical lens of coercive and enabling logics. With this analytical lens applied to a single case study, we investigate the inherent balancing act of MCMs in PE investments.

In relation to management control practices in a PE setting, recent papers provide new insights into MCMs deployed by PE firms (Sbarba et al., 2020; Bedford & Ditillo, 2022). The first article shows the variety of MCMs that may be used in aligning the interests of portfolio firm managers with the PE firm. The paper classifies within a frame approach the different forms of MCMs which arise during the processes of consensus-building, developed by the PE firms to foster a shareholder focused frame. The second article describes the role and characteristics of control mechanisms implemented by PE firms, as well as the factors that impact the emphasis on the various control mechanisms. The findings show that control mechanisms have a crucial impact on managing portfolio companies and that there is a notable difference among PE investments in the mix, or package, of contractual agreements, results controls, behavioural controls, and social controls that they utilise depending on the equity arrangement and the perceived cognitive style of the portfolio firm.

This thesis contributes to the scarce literature on MCMs in PE controlled firms. Moreso, the thesis investigates a newly founded PE firm and its investment in a B&B case. The investment targets high growth through an acquisitive agenda in a mature market, where a large degree of autonomy is granted the subsidiaries. Simultaneously, control is necessary to ensure a successful investment and general alignment between the PE firm interests and the portfolio company and its many subsidiaries. As such, the context of our case yields an interesting setting to explore MCMs. Furthermore, we find it suitable to employ the concepts of coercive and enabling logics as a theoretical lens for data analysis in our discussion to better understand the balance of letting the subsidiaries run freely whilst also ensuring control and order. The thesis answers the following research question:

What characterises MCMs in a PE B&B case compared to previous literature on MCMs in a PE setting and how do they interplay with the balancing act of coercive and enabling logics in managing a PE investment?

1.2 Purpose

A B&B strategy, with many different entities under the same roof does not come without its inherent challenges. As a deal team member in PECo, who is partially responsible for the investment and handles the day-to-day interaction with PortCo, states:

With [PortCo], we are trying to build a large company by combining numerous separate entities with different best-practices and somewhat varying cultures. To be able to control for any unwanted deviances, we need to exercise control. At the same time, too much control may hinder growth and in turn value creation

This quote illustrates the relevance of understanding MCMs in a PE setting and the importance of balancing coercive and enabling logics. The thesis can be broken down into two main areas of focus. The first objective is to explore what MCMs are implemented as previous literature exploring this in a PE setting is scarce. The second objective is to understand how the package of MCMs interplay with our analytical lens of coercive and enabling logics to better understand the balancing act of MCMs in a PE B&B case.

1.3 Outline

The first section began with a brief introduction, outlining the background of our case and the thesis subject. It then states the research question and describes the purpose, including the contribution, of the thesis. Section 2 presents the literature review, covering previous literature related to PE, MCMs, a B&B strategy as well as literature on our analytical lens of coercive and enabling logics and ultimately introducing our theoretical framework. Section 3 outlines the research methodology and section 4 presents the empirical findings. Section 5 discusses our empirical findings in relation to previous literature and our theoretical framework. Finally, section 6 concludes our paper, states limitations to it and provides suggestions for further research.

2. Literature review

This section will introduce PE where we describe what PE is and the qualities and characteristics of the ownership form. Moreso, we will include an overview of previous findings related to MCMs, primarily in a PE setting, and introduce a conceptual framework that will guide our study. Further, this section will discuss literature on the properties of a buy-and-build strategy as well as introducing our analytical lens of coercive and enabling logics. Finally, we summarise our findings of the previous literature and build a theoretical framework used to discuss and analyse the empirical findings.

2.1 Private equity

While many definitions of PE exist, PE at its simplest form can be described as an equity investment in a non-public company. PE, broadly speaking, includes buyout transactions, venture capital ("VC") investments, hedge-fund investments, private investments in public equity as well as angel investments (Cendrowski et al., 2012). Our case study will exclusively focus on buyout transactions, more specifically leveraged buyouts. A leveraged buyout is a transaction where a PE firm acquires a company, using both equity and outside debt to finance the transaction, boosting returns on the initial equity ticket if the investment turns out successful. In a typical transaction, the PE firm acquires a controlling stake of a mature firm (Kaplan & Strömberg, 2009). Moreover, the PE fund is often organised as a limited partnership between several limited partners ("LPs"), who provide capital, and a general partner ("GP"), i.e., the PE firm that makes the investment decisions. The objective is to generate returns for portfolio investors through the appreciation of portfolio company values upon an exit. To achieve this, PE firms select targets that have the potential for e.g., enhanced performance and post-acquisition growth (Wilson et al., 2022). Post investment, companies that a PE firm owns are called portfolio firms.

In the article by Bedford & Ditillo (2022), they describe that PE differs from other forms of financial intermediation in primarily three different respects. 1) PE firms invest in privately held organisations, unlike investment firms that take ownership stakes in public listed firms. 2) PE funds have capital locked in during the fund's duration, typically seven to ten years. Thus, PE funds are closed-end investments, which differs from the likes of hedge funds and other mutual funds. 3) PE firms' significant ownership stake, often majority ownership, permits them to "influence actions of the management of the companies they invest in" (p.845). As a result of the predetermined lifetime of the PE fund, naturally, exits become an important part of the PE process (Kaplan & Strömberg, 2009). The most frequently used exit strategies are, in order of global exit value, selling to a strategic buyer, selling to another PE firm, and lastly, taking the company public through an initial public offering ("IPO") and selling stakes of the company at listing, and subsequently to the public market (Bain & Company, 2022).

2.2 Management control mechanisms

The literature on MCMs in the PE context has mainly focused on two research areas: (1) how portfolio firms adopt and use management control systems and mechanisms during PE ownership (Bacon et al., 2008; 2012; Bloom et al., 2015; Bruining et al., 2004; Cuny & Talmor, 2007) and (2) how PE firms manage and monitor portfolio firms by the use of MCMs (Barber & Goold, 2007; Di Toma & Montanari, 2017; Kut et al., 2007; Rogers et al. 2002; Plagborg-Møller & Holm, 2017). MCMs deployed by PE firms aim to influence and monitor the behaviour of the portfolio firm management during the post-investment period (Bedford & Ditillo, 2022). The literature on these control mechanisms has predominantly been focused on agency theory and achieving control through formal controls such as contractual arrangements and corporate governance (Wright et al., 2001; Bedford & Ditillo, 2022).

The formal controls set the groundwork for the PE relationship, such as specifying the roles and responsibilities of each party and sanctions in case of non-compliance as well as monitoring procedures. Particularly important formal control mechanisms in PE relationships are the contractual rights that enable PE firms to directly intervene in the operations of the portfolio firm, such as veto rights over major strategic decisions (e.g., liquidation decisions), veto rights over changes in management, determination of compensation and rewards, veto rights over raising additional capital and the ability to influence major decisions through board positions (Fenn et al., 1997; Metrick & Yasuda, 2011).

More specifically, in the venture capital literature, the contractual agreements concern three classes of rights (Kaplan & Strömberg, 2003). First of which are the cash flow rights, referring to the claims different investors have to the portfolio company's equity value, i.e., the redistribution of cash flows to investors. The second class of rights are the control rights which provide influence over corporate decisions through, primarily, board participation and voting rights. The third class of rights concern liquidation rights, relating to the possibility of triggering default and forcing liquidation. The liquidation rights, as opposed to the cash flow rights, come into effect in a bad state of the investment and regulate that the cash flow rights go to the senior claims. The liquidation rights typically ensure that the investor receives the initial investment. Additionally, non-compete clauses for senior management and exit rights (e.g., having influence over the exit-route of the investment) are additional contractual arrangements that often are included in the formal controls of the PE relationship with the portfolio firm (Bedford & Ditillo, 2022).

The study by Bedford & Ditillo (2022) found that the contractual clauses implemented by the PE firms were relatively standardised, although there were some variations, especially in terms of perceived importance of the different clauses implemented across investments. In particular, the PE firms stressed the importance of exit and liquidity rights given the limited life of the funds as well as control rights which enabled vetoing major decisions, approval of annual budgets and business plan, managerial selection, and determination of non-executive board directors. Interestingly, the researchers find evidence supporting that the "...main role of contracting is in formalising mutually understood investment objectives, rights and responsibilities, and as a means for developing trust, rather than being primarily an ex-post control tool" (Bedford & Ditillo, 2022, p. 858). Once the basis of contractual control mechanisms is constructed, it is generally acknowledged that PE firms deploy a wider set of control mechanisms beyond the ex-ante contractual specifications (Fenn et al., 1997; Bedford & Ditillo, 2022). The literature commonly distinguishes between results controls, behaviour controls and social controls (Dekker, 2004; Bedford & Ditillo, 2022).

Results controls aim to achieve predetermined objectives and typically include performance measures and tied to this are often incentives for achievement. Fenn et al. (1997) argue that incentives are regarded as one of the primary control mechanisms deployed by PE firms. The incentives are commonly structured as managerial equity ownership, meaning that management holds significant ownership in the portfolio firm, and 'earn-outs', referring to managers receiving increasing ownership stakes if meeting performance objectives over time (Kaplan & Strömberg, 2009; Bedford & Ditillo, 2022). On this topic, the study conducted by Sbarba et al. (2020) shows that the PE firms structure rewards and incentives for portfolio firm managers in two ways in order to keep managers motivated towards defined objectives as well as promoting actions coherent with the formed objectives. First of which relate to annual bonuses and rewards, typically tied to predetermined simple financial measures such as earnings targets and targets related to net financial position of the portfolio firm. Second of which concerns exit rewards that are tied to economic value creation throughout the investment period.

Moreso, Bedford & Ditillo (2022) found in their study that financial incentives were particularly critical to align interests of portfolio firm managers with the PE firm. The authors describe that there were three main incentive mechanisms deployed; (1) co-investment, (2) short-term incentives and (3) earn out clauses (or 'sweat equity'). The first incentive mechanism the authors found relates to the co-investment of both portfolio firm managers as well as responsible investment professionals at the PE firm. It was found that the latter type of co-investment, i.e., by the investment professional, is a double-edged sword that both incentivises the employee(s) managing the investment to put in extra effort as well as functions as a basis for trust-building with the portfolio firm management. This type of incentive mechanism could be viewed as an exit reward with the perspective of Sbarba et al. (2020) and is in line with the findings of Kaplan & Strömberg (2009) concerning managerial ownership. The second incentive mechanism Bedford & Ditillo (2022) found was the implementation of short-term incentives which encompass share options, annual bonuses and rewards as well as salary increases for the portfolio firm managers. The short-term financial incentives were tied to key financial metrics, i.e., predetermined simple financial measures, which is also supported by the findings in Sbarba et al. (2020). Finally, the third incentive mechanism brought up in the study by Bedford & Ditillo (2022) relates to earn out clauses, concerning additional payments to the portfolio firm management if the exit value exceeds a predetermined target.

Behaviour controls regulate portfolio firm activities by specifying the way tasks and operations are to be performed or by placing constraints on the behaviours of portfolio firm managers. Bedford & Ditillo (2022) describes that behaviour controls typically target processes such as planning processes, operating procedures, structures of authority and processes of approval. For more concrete examples of how investment firms specifically implement the behaviour controls, they find answers in the venture capital literature. The examples include venture capitalists participating in the board of directors, thereby influencing strategic and financial decisions of the firm, being involved in developing and reviewing strategic plans as well as conducting site visits at the invested firm on a regular basis which enhances the monitoring and oversight of the firm.

In line with the findings of the venture capital literature with regards to behaviour controls, Bedford & Ditillo (2022) found that the PE firms in their study implemented behaviour controls in the form of board meetings, typically monthly, specialised committees (e.g., strategic reviewing committees) along with company site visits. Also, in line with the venture capital literature presented in this area, joint business planning was considered an effective behaviour control mechanism, including developing the business plan in the initial stage of the investment. Regarding business planning, the study found that this activity also serves the purpose of defining roles of the parties, including the degree of involvement of the PE firm in terms of resources and advisory services. The PE firms also regulated and placed constraints on portfolio firm behaviour through setting boundaries around the operational and strategic activities of the firm as well as set rules and procedures.

Social controls allow for the ability to manage through implicit understandings, social norms and mutual trust through fostering socialisation and interaction between the PE firm and the portfolio firm (Bedford & Ditillo, 2022). More specific examples of social controls include site visits, meetings (both formal and informal), shared decision-making, joint goal setting and problem solving as well as partner development activities (Dekker, 2004; Bedford & Ditillo, 2022). Through these MCMs, the PE firm and the managers of the portfolio firm develop closer personal ties and an understanding about the expectations of the parties, respectively (Bedford & Ditillo, 2022). Moreover, 'partner selection' is another form of MCM that is brought up by Dekker (2008) in the context of interfirm relationships. Bedford & Ditillo (2022) stress the importance of partner selection in the PE context and describes it as essential for building trust between the PE firm and the portfolio company management. The idea of partner selection as an MCM is also brought up by Sbarba et al. (2020) as an indirect MCM performed by PE firms during the phase of diagnostic framing, i.e., the consensus-building process aimed to direct or mobilise the portfolio firm's management towards predetermined objectives.

The importance of partner selection is evidenced in the study by Bedford & Ditillo (2022). The foundation of the social controls is built upon a sound partner selection, which is based on social ties, reputation, business networks and direct past knowledge. Moreover, the study showed that the partner selection and the development of trust often initiated several years prior to the actual contractual agreement between the parties. Moreso, the beginning of the relationship between the parties was most important with regards to social controls, although social controls and continuous interactions are important throughout the holding period. Examples of social control mechanisms found in the study concern joint activities and problem solving such as setting objectives, making decisions and coordination of activities.

2.3 Factors influencing variations in the package of management control mechanisms

The combinations of MCMs implemented by PE firms vary across investments due to varying circumstances (Bedford & Ditillo, 2022). This is because given different circumstances, some MCMs are more relevant and therefore naturally emphasised to a larger extent. The literature on MCMs for B&B strategies specifically has been largely ignored by researchers. However, there exist some previous research on MCMs in 'build' strategies. While previous literature does not discuss a build strategy specifically from a PE B&B perspective, an active M&A agenda can be an essential component for achieving growth, i.e., the cornerstone in the B&B strategy (BCG, 2012).

Build strategies are linked to higher levels of unpredictability and uncertainty compared to harvest strategies which is similar to a cost reduction strategy (Govindarajan, 1988). Gupta (1987) also suggests that choosing a build strategy instead of a low-cost strategy would result in increased uncertainty in a company's task environment due to both unpredictability and complexity. The control systems literature argues that as the level of uncertainty in tasks varies, the behaviours required for successful performance also vary. Furthermore, since different control systems evoke different behaviours, the best way to achieve superior performance is by adapting control systems to match the level of task uncertainty. Coping with uncertainty is a central challenge in executing strategies effectively, as noted by Govindarajan (1988). Although studied from a build through differentiation lens, a build strategy is likely to be associated with de-emphasised budgetary goals. Moreso, Govindarajan & Gupta (1985) find it logical that build managers, who place more emphasis on the long-term rather than the short-term, should be assessed and incentivised with a more subjective approach compared to harvest managers who are evaluated based on immediate results.

2.3.1. The equity arrangement dimension

In the study by Bedford & Ditillo (2022), the researchers explored the factors associated with the variation in adoption of combinations of control mechanisms and in doing so, they found that there are two dimensions regarded as predominant in explaining the emphasis on certain control mechanisms under certain circumstances. The first dimension was found to be the equity arrangement of the PE investment, i.e., whether the PE firm holds a majority or minority ownership stake. The second dimension was found to be the perceived cognitive style of the portfolio firm executive(s), where the authors distinguish between an entrepreneurial cognition and a managerial cognition (i.e., if the firm executive(s) is an entrepreneur or a 'manager').

As for the equity arrangement dimension, certain control rights are difficult to obtain for minority shareholders and contractual clauses need to be carefully negotiated between the parties. For minority shareholders there are two contractual rights that are considered especially necessary in an investment: (1) having access to information (financial as well as operational) and (2) exit rights with regards to timing and exit-route. The first necessary contractual right for a PE investor in a minority position is crucial for monitoring and evaluating the portfolio firm. The second necessary contractual right ensures that the minority investor can exit the investment and not be ‘stuck’, i.e., relying on the majority shareholder accepting offers (Bedford & Ditillo, 2022). Furthermore, Bedford & Ditillo (2022) highlights that for PE firms to be able to implement results and behaviour controls in the invested company, they often have one representative on the board of directors. Moreso, they emphasise that the main mechanisms used to control the portfolio firms are of social nature, through informal relationships with the portfolio firm management. On the contrary, the study found that the majority shareholders rely to a higher degree on formal controls and contractual agreements with the portfolio firm. This is because a PE firm holding majority ownership does not necessarily need to rely on informal controls to influence portfolio firm behaviour, but instead has it easier to simply implement formal measures.

2.3.2 The executive cognition dimension

It was evidenced by Bedford & Ditillo (2022) that the perceived cognitive style of the portfolio firm management influences the ‘package’ of MCMs implemented, i.e., if the portfolio firm has a management of entrepreneurial nature or of a managerial nature.

The study found that in portfolio firms run by entrepreneurs, formal control mechanisms tend to be less effective. In the context of entrepreneur-led portfolio firms, it is found that the most effective way of control is achieved through trust-building and development of a mutual understanding of objectives and goals (Bedford & Ditillo, 2022). Interestingly, PE firms may have problems enforcing contractual rights. An example of this could be a trade sale of the portfolio firm, during which process the entrepreneur easily can cancel the deal through emphasising weak areas of the business even though there are exit rights in place. PE firms often resort to other control mechanisms rather than to enforce contractual rights in order to preserve an affective deal commitment, i.e., positive feelings and emotional attachment to the deal, which is considered an important driver of success and is generated by mutual goal setting and trust (Sbarba et al., 2020). Contrarily, PE firms tend to put more emphasis on results controls in the context of manager-led portfolio firms, such as budgeting and performance-based incentives (Bedford & Ditillo, 2022).

2.3.3. The explanatory framework of control combinations in private equity relationships

Bedford & Ditillo (2022) interweave their findings on the influence of the equity arrangement and the perceived cognitive style of the portfolio firm management and derive a framework explaining the combination of control mechanisms in PE relationships. The framework is presented in figure 1.

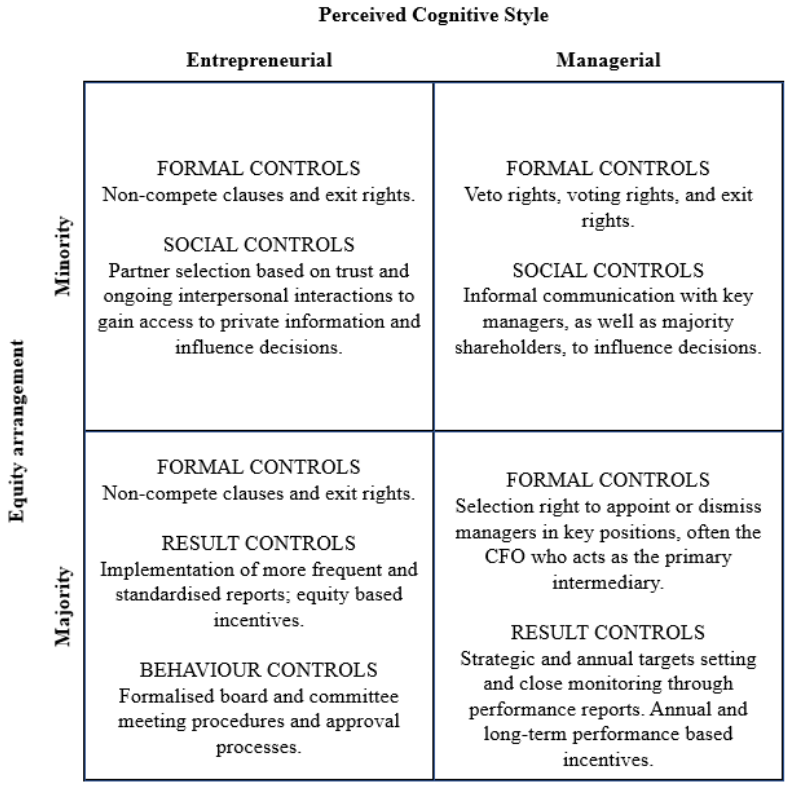


Figure 1. Bedford & Ditillo 2022 framework

The authors argue that in a context in which the PE firm holds a minority ownership and the management of the portfolio firm can be characterised as entrepreneurial, PE firms typically have a harder time implementing formal control mechanisms and often have less contractual rights to rely on. Consequently, PE firms must rely on social controls more heavily, where partner selection plays a vital role and serves as a foundation for the partnership.

If the PE firm holds a majority stake in the portfolio firm run by entrepreneurs, PE firms are more inclined to implement formal controls. However, it is important that the entrepreneurs still have room for making decisions based on personal convictions and informal processes (Bedford & Ditillo, 2022). Additionally, PE firms often implement results controls such as reporting systems for performance (and formalise the frequency of the reporting) as well as formalise procedures and processes whilst balancing the entrepreneur’s way of operating.

A PE relationship where the PE firm holds the majority ownership of a portfolio firm run by a management of the managerial cognition style, the PE firm can rely more heavily on implementation of results controls. In fact, for strategic objectives, the managers of the portfolio firm will often retain discretionary power over decisions where the PE firm rather manages by exception, i.e., intervening if performance targets are not met or if the strategic trajectory is not supported (Bedford & Ditillo, 2022).

Lastly, PE relationships typified by minority ownership and managerial cognition put emphasis on contractual arrangements as post-investment controls are limited. In these cases, contractual rights such as voting and board decision rights as well as exit rights are particularly important. As formal controls are harder to implement as a minority shareholder, PE firms often resort to social controls to influence the strategy and decision-making of the portfolio firm (Bedford & Ditillo, 2022).

2.4. Buy-and-build strategy

A B&B strategy can generally be described as an investment in a 'platform company' or just 'platform' which is subsequently used as a base for further acquisitions of similar companies, typically referred to as add-on investments or simply 'add-ons'. The B&B strategy is viewed by participants in the PE industry as a crucial way to generate value, but it has not been extensively studied in the literature (Borell & Heger, 2013).

PE backed B&B strategies have garnered significant attention in recent times, not just for being a significant part of the PE market but also because they differ from many commonly held beliefs about PE investing (Hammer et al., 2022). In the PE industry, it is a widely held belief that firms tend to favour investments in mature, low-growth companies that require minimal investments. A reason as to why is that these types of companies tend to have a more established customer base and revenue stream, making them less risky investments. In comparison, B&B strategies often require significant capital investments to grow the portfolio company through acquisitions and to create synergies among them (Hammer et al., 2022). The notion that an active M&A agenda has become more and more common amongst PE firms is also backed by previous survey results conducted by The Boston Consulting Group, indicating that M&A is widely considered as the primary means of enhancing operations in PE buyouts (BCG, 2012). However, as in our case, a B&B strategy can also entail multiple acquisitions of more traditional mature, low-growth companies.

2.5. Coercive and enabling logics: an analytical lens

Adler & Borys (1996) discusses two types of formalisations, enabling and coercive, from a workflow and employee management perspective. From our point-of-view, studying MCMs in a PE setting, coercive behaviour is when the PE firm uses MCMs to force the portfolio company to comply with its wishes, implementing e.g., rules and procedures, ultimately *reducing choice* of the portfolio firm. Enabling efforts, we define as those that empower the portfolio firm to achieve its goals, ultimately *inspiring and leveraging competencies* of the portfolio firm. Here, perception becomes an important aspect as we must acknowledge that a distinction can be observed between the managerial intentions for controls, considered a fundamental design attribute of the control system, and the way in which employees perceive these controls, which is not considered a design attribute (Tessier & Otley, 2012).

Ahrens & Chapman (2006) analyses management control systems in the case of a restaurant chain with the lens of coercive and enabling systems. Interestingly, the authors find that the coercive vision of restaurant control was based on a culture of mistrust. I.e., the coercive controls implemented in the case was a response to the worries of the head office which in turn was based on mistrust towards restaurant managers. Interpreting this, the level of trust between the parties somewhat determines the extent of the coercive logic in the controls deployed.

We argue that the enabling and coercive logics literature can be applied to analyse the MCMs deployed by a PE firm in a portfolio company as PE firms must strike a balance between coercive and enabling logics to ensure the success of their portfolio companies. As such, there exists an inherent tension related to the phenomena. On the one hand, the portfolio company needs to be inspired and competencies need to be leveraged. On the other hand, the portfolio firm needs to be controlled to ensure a successful investment by reducing choices of the managers. In the discussion, we will use the coercive and enabling lens to analyse the package of MCMs in a PE B&B case.

2.6. Summary of literature findings & theoretical framework

The previous literature provides guidance on what to expect regarding what MCMs are employed by PE firms depending on the setting of the investment. Particularly, the framework developed by Bedford & Ditillo (2022) describes how the package of MCMs might look like in the case of a majority investment in a manager-led portfolio company. Specifically, in such a case, i.e., resembling the setting of our case, we would expect a package of MCMs with an emphasis on formal contractual controls as well as results controls. The PE firm should monitor the achievements on predetermined targets and intervene only when objectives are not met. Also, as majority owners, the framework describes that in such a setting the PE firm retains most contractual control rights, including e.g., the right to appoint managers in the portfolio company. With an emphasis on the formal controls, there should be less of a focus on the social and behavioural controls.

However, given that the case company has a B&B strategy and that the entrepreneur-led subsidiaries are the core operations of the business, we may expect there to be limitations to the framework developed by Bedford & Ditillo (2022) in its description of how the package of MCMs is affected by the perceived cognitive style and equity arrangement. This is because the core operations are entrepreneur-led and would consequently call for a MCM package for such a setting. As a result of this, we expect the MCM package to look differently depending on if the MCM is targeted primarily towards the PortCo management or the entrepreneurs of the subsidiaries.

While previous literature on management control in PE B&B strategies is limited, the findings of Govindarajan (1988) on how to manage build cases, which he argues have inherent uncertainties, show that there should be less emphasis on results controls. This implies that control should be exercised more through social and behavioural approaches given that the uncertainties need to be managed. Furthermore, the literature also indicates that build managers are to be assessed and incentivised with a more subjective and long-term approach as opposed to immediate results. Considering this, we would expect PortCo management not to be assessed and incentivised by short-term objective results but rather through a subjective assessment coupled with long-term financial incentives.

Generally, as in all PE investments, the B&B strategy has inherent tensions with regard to coercive and enabling logics and there is a constant balance between the two. On the one hand, the PE firm needs to control the actions of the portfolio company with rules and procedures which are of coercive nature. These MCMs aim to *reduce choice*. On the other hand, there needs to be enabling control mechanisms that function as overarching guidance so that the portfolio firm can mobilise knowledge and experience appropriately to goals and objectives, without needing rules and procedures to guide the actions. These MCMs *inspire* and *leverage competencies*. According to the literature, there appears to be a conflict between coercive and enabling methods, and determining how to achieve a well-functioning balance between them with different control mechanisms is of importance. Connecting the theoretical framework to the findings of Ahrens & Chapman (2006), we also expect the extent of coercive logic in the package of MCMs deployed to be reflective of the level of trust between the parties. Also, we expect to find deviances on how these MCMs are perceived in relation to the coercive and enabling logic as addressed by Tessier & Otley (2012). Intertwining the domain of MCMs in a PE setting with the analytical lens of coercive and enabling logics, the mix of MCMs determines the balance of coercive and enabling logics in the management control of the portfolio firm. As such, we argue that the package of MCMs constantly balances the two logics and is adapted to the setting in play, which in our case is the PE B&B setting. As a result, our theoretical framework can be illustrated by figure 2.

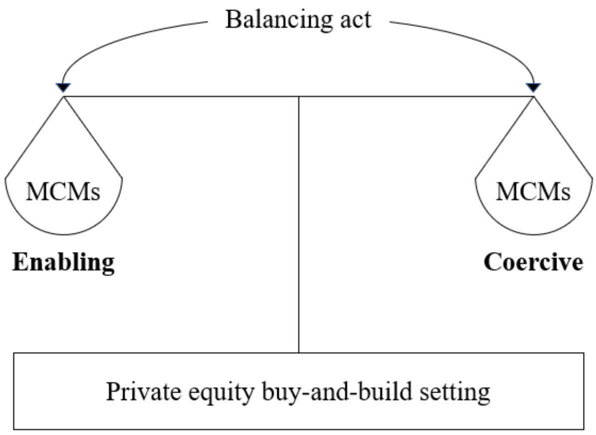


Figure 2. Illustration of the theoretical framework

3. Methodology

The next chapter outlines the research methodology and approach in this study. The initial section 3.1 motivates the use of a single case study approach and details the process of selecting the research setting. The methods used for data collection and analysis are then outlined in sections 3.2 and 3.3 respectively, followed by an examination of the data quality in section 3.4.

3.1 Research design

3.1.1. Single case study

Ensuring the quality of research is important, and one way to do this is by ensuring internal consistency between the research design, research question, prior academic work and theoretical contribution. To accomplish this, the concept of methodological fit was taken into consideration to ensure alignment between the method and theory (Edmondson & McManus, 2007).

A single case study approach allows for a holistic examination of the subject matter (Cousin, 2005). Furthermore, a single case study can offer a more thorough and in-detailed understanding of the subject being studied. By focusing on a single case, it allows for the examination of old theoretical relationships and the exploration of new ones. This is because the researcher can conduct a detailed and thorough study (Gustafsson, 2017). The case study approach is advantageous because it is independent of previous literature or empirical observations, making it "*particularly well-suited to new research areas or research areas for which existing theory seems inadequate*" (Eisenhardt, 1989, p. 548-549). This holds importance in our paper since we will be closely investigating the subject matter, examining the framework developed by Bedford & Ditillo (2022) and other theoretical accounts in conjunction with the usage of the coercive and enabling lens which opens up the investigation of novel connections. Previous research highlights a trade-off between depth and insights on one hand and generality on the other, relating to single case studies (Otley & Berry, 1994). However, although some generalisation can be made, it is not the primary concern of our paper.

For emerging areas of research, known as nascent theory, qualitative methods are often considered the more suitable choice (Edmondson & McManus, 2007). In this study, we have adopted a qualitative approach with an open-ended research question to enable us to explore and understand the phenomenon of interest, rather than just describing it (Otley & Berry, 1994). Moreso, to improve comparability to previous studies, e.g., Bedford & Ditillo (2022), the choice of a similar design was considered appropriate, i.e., a single case study with similar characteristics to that of a field study as conducted by the mentioned article. The choice of interview subjects improved the comparability of the study, i.e., interviews with investment professionals of a PE firm following previous research. However, this study goes a step further by also including interviews with the portfolio firm's management, the portfolio firm's board members as well as representatives of different subsidiaries. This approach provides a comprehensive view, giving insight into those responsible for implementing MCMs, i.e., PECo and PortCo, and into those impacted by MCMs, i.e., both PortCo and the subsidiaries. Moreso, interviewing several entrepreneurs allows for observations across several different subsidiaries.

3.1.2 Selection of research setting

The research for this study was undertaken when a PE firm was still holding its portfolio company as part of an ongoing B&B strategy. Consequently, MCMs had already been implemented extensively, starting from zero as the PE firm founded PortCo. The following reasons led to the choice of this case.

Firstly, the PE setting introduces a fairly new empirical context to the management control literature. We study a PE owned B&B investment, which has gained increasing importance as a value creation strategy in the PE space but has been largely ignored in previous research related to control mechanisms. Secondly, the research setting of a current investment enabled data collection during the exercising of control mechanisms. This enabled contemporary data to be collected on the interplay of MCMs during a time they were still developing. Thirdly, the selection of the case company was guided by practical criteria, and the company had to meet the following requirements to be deemed suitable. 1) The company of the study had to be situated closely geographically, i.e., in the Nordics. 2) The investment firm had to have a portfolio company with a clear B&B strategy. 3) Both the PE firm and the portfolio company, together with the subsidiaries, all had to allow us access to interviewees and relevant company information.

3.2 Data collection

This study primarily relied on in-depth interviews as its main source of data, with internal data and documents serving as supplementary sources.

Table 1. Overview of interviewees

PECo	PortCo	Subsidiaries
1 Partner*	1 CEO*	2 Entrepreneurs*
2 Investment directors	1 CFO	1 Entrepreneur
2 Investment analysts		
Total: 5	**Total: 2**	**Total: 3**

*Notes: 1) do not include 2nd interviews with the same interview subject. 2) *also hold the capacity as board member in PortCo*

The data collection for this study took place from February to May 2023 and was conducted through a combination of, in person interviews, video interviews, phone calls, e-mails, internal documents and direct observations. The interviews, which lasted between 30-90 minutes, were conducted with employees, management representatives and board members of PECo, PortCo management and entrepreneurs of the subsidiaries. The interviews with the PE firm were conducted on-site, through video calls and phone calls, and interviews with PortCo as well as with the subsidiaries were conducted over video due to their scattered geographical presence. To rightfully describe and analyse the MCMs, we aimed to conduct an equal number of interviews from all the relevant parties i.e., PECo, PortCo and the subsidiaries. This approach was taken to secure various viewpoints as we want many different sources and points of view so we can triangulate the sources and create as complete a picture as possible of how things function. However, as the relevant PortCo management consisted of a rather slim team, and due to the PE firms' importance in relation to the MCMs, the final number of total interviews were skewed towards PECo.

3.2.1 Primary data

This study consisted of 14 semi-structured individual interviews with 10 participants, detailed in Appendix A. As such, we started with pre-developed questions but were able to explore adjacent areas of interest dependent on what we discovered during the interviews. Moreso, the 4 follow-up interviews let us further explore tensions and clarify matters in various interviewees' descriptions.

The goal of qualitative research is to achieve a comprehensive understanding of the context, which is referred to as theoretical saturation (Boychuk Duchscher & Morgan, 2004). Theoretical saturation was achieved after the final number of interviews as no new observations were made during the last interviews. First after gaining a comprehensive understanding of the MCMs and their impact from all parties involved in the PECo, PortCo, and from selected relevant subsidiaries, we made the decision to conclude our fieldwork.

Before the interviews, all participants were made aware of the anonymity of the study, its purpose, and their contribution. The anonymity strived to achieve subjective reflections of the interviewees. After consultation with the interviewee subjects, we decided to refer to interview subjects as 'PECo deal team member', 'PortCo management member', 'Entrepreneur' in the empirical findings due to the rather thin organisations to keep our promise of anonymity. Interviewees were also asked for their consent to have the interview recorded, which was granted by all. The interviews were conducted in Swedish, recorded, transcribed into text, and translated into English for inclusion in the paper, with the original Swedish version kept as backup. However, not all phone-calls were recorded, but noted. Both authors were present during each interview, with one leading the discussion using an interview guide and the other taking notes and asking clarifying questions. Apart from conducting semi-structured interviews, we have gathered observational information as well. We were able to perform casual observations at PECo by visiting their office. This allowed us to witness their work, contemplate the surroundings, and listen to casual conversations. Nonetheless, we were not given permission to observe during formal meetings because of the sensitive nature of the organisation and the business.

3.2.2 Secondary data

In addition to the interviews, we collected secondary data in the form of company material on e.g., company organisational charts and publicly available information on financial performance, investments, and size of subsidiaries. Additionally, publicly available information was used to map potential interview subjects in parallel to recommendations from previous interviewees. This secondary data helped us gain insight into the context of the ownership relationship between the PE firm and the portfolio firm, as well as the formal MCMs, by reinforcing and controlling the findings from the primary data.

3.3 Data analysis

The findings of Bedford & Ditillo (2022) on the characteristics and classifications of MCMs, i.e., the domain of management control in a PE setting, were used as a basis in the data analysis. Their findings on how the package of MCMs look like depending on the equity arrangement and portfolio company perceived cognitive style serve as a guiding framework in our analysis. Furthermore, our approach was influenced by Lukka & Vinari (2014), and this influenced how we worked with the data we collected. We maintained boundaries between the research area we aimed to contribute to and the research area that supported our contribution by classifying our theoretical domain and method theory. We used the method theory, i.e., the concepts of coercive and enabling logics as an analytical lens with our domain theory to develop our theoretical framework, which helped us analyse the empirical findings. Our contributions were built on the interaction between the theoretical domain, method theory, and empirical findings, working together.

3.4 Data quality

Lukka & Modell (2010) recommend evaluating interpretive research based on authenticity and plausibility, which measure the trustworthiness of the research. Whilst our research is not interpretive research per se, we can still be inspired by the papers' guiding principles which can help ensure that our findings are substantiated.

The concept of authenticity in research refers to the validity and reliability of the description of the empirical case, such that the reader is confident that the researcher has accurately portrayed what they observed (Lukka & Modell, 2010). In qualitative research, authenticity can be elevated through the provision of detailed and multi-faceted accounts, and by acknowledging any inconsistencies or tensions in the data. This report follows these principles, offering a thorough and comprehensive depiction of the empirical findings, including any contradictions. To ensure reliability and validity of the data, interviews are conducted with all key deal team members in PECo, the PortCo managers and several subsidiaries, thereby helping us to confirm information as well as noting any contradictions in the empirical findings. The concept of plausibility refers to the degree to which an explanation can be considered reasonable and likely to be accepted by others (Lukka & Modell, 2010). To establish plausibility, the range of possible explanations for a phenomenon must be narrowed effectively. We have tried to determine the underlying causes of new developments by utilising our method theory, coercive and enabling logics, as an analytical lens.

4. Empirical findings

The findings are presented in the following order. First, the empirical background is introduced, including information about the case study entities and the organisational structure of the investment case. Second, we describe the package of MCMs implemented by PECo in PortCo as well as the MCMs implemented by PortCo in the subsidiaries. Third, we summarise our empirical findings.

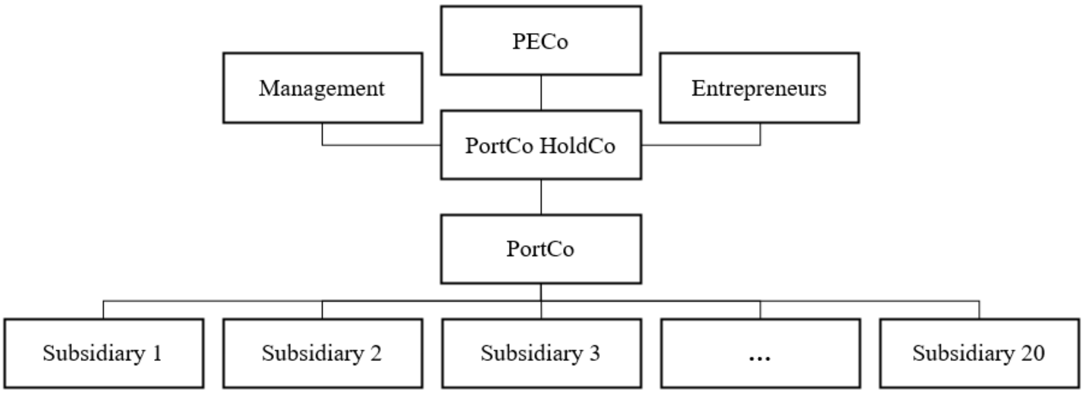
4.1 Empirical background

4.1.1 The PE firm and the portfolio company of the study

This case study investigates the relatively newly founded PE firm, PECo, and one of its portfolio companies, PortCo, which has a B&B strategy. PECo is industry agnostic in terms of the type of investments they explore and has a flexible range with regard to the size of the investments. PECo is currently in a ramp-up phase, focusing on expanding the investment team, strengthening the portfolio companies with continuous add-on investments, as well as looking for new platform investments to build upon. Although PECo was founded fairly recently, the PECo deal team has extensive experience within the PE industry with a majority of the deal team, including the liable partners, having prior employment at some of the most well-known PE firms in the Nordics.

PortCo is the first investment and thus the first portfolio company of PECo and has grown from foundation, to now comprising more than 20 subsidiaries in both Sweden and Norway. The group reached a turnover north of a billion SEK in just about 18 months. In fact, PortCo has grown rapidly enough through the B&B strategy to become the largest company in the Nordics within its industry. PortCo was founded a couple of years ago by PECo as a group company, which acts as the acquirer of the businesses that comprise the B&B case, i.e., the subsidiaries of PortCo. By founding the portfolio company, PECo needs to install a functioning board of directors which in turn appoints the management of the group company. The management of PortCo is hired on the basis of previous relevant experience and through business networks of PECo. The add-ons are acquired by PortCo in collaboration with the PECo deal team in the capacity of M&A advisor. This somewhat differs from the industry norms of having external advisors as opposed to the owner acting as the advisor. The acquired companies subsequent to the transactions continue to operate independently in a decentralised manner. The subsidiaries of PortCo are characterised by a PECo deal team member as "*local champions with high customer satisfaction and a good reputation*". The PECo deal team member emphasises that the subsidiaries, which are entrepreneur-led, still operate under the same brand as before as the strong local brands are considered a key success factor in the operations. Therefore, at this stage in the B&B strategy, PortCo can be viewed as a group company to a portfolio of local businesses led by entrepreneurs. A typical subsidiary's workforce is made up of a rather slim management team and administrative workforce, with the bulk of employees working on customer projects out in the field.

4.1.2 The organisational structure



Note: the figure illustrates the overall investment structure and do not provide an exact view

Figure 3. An illustration of the investment structure

Figure 3 illustrates the organisational structure of the B&B investment, where the more than 20 subsidiaries are fully owned by PortCo which in turn is owned by a holding company. PortCo HoldCo is owned partly, but with a majority by PECo but also, importantly, by the entrepreneurs of the subsidiaries. When the entrepreneur-led companies are acquired by the PortCo, the entrepreneurs are required to reinvest a part of the consideration into the group through the PortCo HoldCo, as explained by a PECo deal team member. The management team of PortCo is also invested in the PortCo HoldCo as well as the deal team of the PECo.

4.2 The management control mechanisms in our case

Theory suggests that MCMs, in a PE context, can take the form contractual, results, behavioural and social controls. In the following sections, we review these MCMs in the case of PECo facing PortCo and the subsidiaries as well as PortCo in relation to the subsidiaries.

4.2.1. Characteristics of management control mechanisms implemented by PECo

As part of the B&B strategy, PortCo was founded as a group company by PECo, which is an established approach for B&B cases that have refrained from investing in a larger platform company directly. This implies that, amongst other things, MCMs had to be designed from scratch as there were no existing systems in place to ensure control from an owner point of view.

When investing in [PortCo], we do not have an existing management or any structures in place, as is often the case with these types of B&B strategies as opposed to investing in more mature businesses directly. As a PE actor, we then must create control mechanisms and build a structure out of thin air - PECo deal team member

The primary formal control vehicle is the board of directors which is appointed in conjunction with founding the portfolio group company PortCo. It is therefore of importance that there are contractual controls in place to ensure that control can be exercised throughout the investment period through that vehicle. By controlling the board of directors, PECo can also by extension control the management of PortCo, which also needs to be contractually stipulated. The contractual controls aim to ensure control over critical elements in the investment such as the right to decide on exit routes, decisions regarding major investments, such as company acquisitions, and appointment of the management team. However, while PECo have contractual rights in place, they try to not rely too much on these as they can be difficult to enforce without causing badwill between the parties.

There are contractual arrangements in place ensuring that we [PECo] have formal control through the board of directors, although there are external board members and representatives from the subsidiaries on the board as well. Such contractual arrangements include veto rights with respect to major strategic decisions such as exit route, M&A decisions, appointment of key managerial positions and so forth - PECo deal team member

PECo owns a majority of PortCo and initially appointed all board members. However, to increase alignment of interests between PECo and the subsidiaries, they have contractually arranged that two representatives from the subsidiaries will take a seat on the board. Evidently, this is a way for the subsidiaries to influence and exercise control towards the group, resembling a '*reverse control mechanism*'. When speaking with the entrepreneurs, this channel has rarely been used to influence group level decisions. However, it is still regarded by the entrepreneurs as an important tool to be able to influence the overall discourse of the group as they have a significant financial stake in the investment and this channel still helps in conceiving overall comfort amongst the entrepreneurs towards PECo.

We need to work with alignment of interest and a common vision to make this investment a successful one. The board seats granted to the subsidiaries help us with the overall alignment as well as transfers a great deal of knowledge to the group - PECo deal team member

The board representatives [entrepreneurs] understand our business in full, so it is important to have them there. To me, it feels comforting to know that I can turn to the entrepreneurs that represent us on the board should there be any major issues I need to raise on a group level - Entrepreneur

If, for any reason, a representative of PortCo or an invested employee from a subsidiary chooses to depart from the company, they are covered by a pre-leaver clause. The PE firm has the option to decide on whether the departing employee is either a good-leaver or a bad-leaver where the latter infer a substantial discount of the co-invested employee's initial investment. Hence, as key employees often are highly financially incentivised as a result of their reinvestment, many would restrain from leaving early and on bad terms. Employees are also subject to non-compete clauses and recruitment bans if they choose to leave the group, which hinders the entrepreneurs from working within the same industry and from recruiting employees from their former firm if and when they depart from the group.

In a B&B case like ours, you are creating something new that does not yet exist, it is a unique context. For an investment in a mature company, a new management can be appointed without much hassle. However, for our investment, given the entrepreneurs' local expertise, *network and customer relations, it is crucial to prevent key people from leaving by aligning incentives - PECo deal team member*

Co-investment is considered a critical tool for aligning incentives with regard to creating shareholder value. It is considered particularly important in a B&B case, both in terms of reducing information asymmetry in the acquisition process, as well as ensuring that the entrepreneurs, PortCo management and the PECo deal team all work towards maximising shareholder value without the need for exercising excessive control. In terms of reducing information asymmetry, entrepreneurs willing to reinvest a meaningful part of the acquisition consideration into the group signal goodwill whilst entrepreneurs unwilling to have ‘skin in the game’ signal serious badwill. In fact, an unwillingness to reinvest is considered a deal breaker from the PECo perspective. Furthermore, by having key employees, including the entrepreneurs and essential employees of the subsidiaries co-invested in the firm, there is less need for formalising control mechanisms as maximising shareholder value now constitutes the frame in which they operate i.e., an overarching guiding principle. On top of the co-investment, short-term financial incentives, in the form of annual bonuses, are in place for the PortCo management based on the reported results.

The management of [PortCo], the key personnel of the subsidiaries and us [PECo] are financially invested. You want all key personnel to have ‘skin in the game’ to align incentives. Therefore, we require the management of the acquired companies to reinvest into the group. It is a deal breaker for us if they are unwilling to do this as this shows badwill. As there is information asymmetry in the acquisition process, the reinvestment is a signal of good faith. - PECo deal team member

Several entrepreneurs highlight the pay-out scheme, structured such that the value of the reinvestment is dependent on group valuation, not on subsidiary specific profit and loss statements. While this incentivises increased cooperation and sharing of best practices between subsidiaries, thereby driving the group forward, it may create negative sentiment among the different subsidiaries if a company starts to fall behind in performance, driving everyone's reinvestment valuation down. The entrepreneurs of the subsidiaries are updated on the respective companies' finances during the CEO meetings held every other quarter.

At the CEO meetings, you share each other's results. Of course, there will be pressure as you want to deliver. It is never fun to rank as the worst performer in the group, you want to be the best in the group, especially since everyone’s reinvestment is dependent on the subsidiaries’ performances on an aggregate level - Entrepreneur

In terms of results, PECo follows up on financial performance of the group on a monthly basis and through these processes detect any potential deviances in performance. This provides an opportunity for PECo to hold PortCo management responsible. Moreso, the PortCo management is not only incentivised by the co-investment, but also through annual bonuses which function as short-term incentives. There are no short-term financial incentives for the entrepreneurs of the subsidiaries.

We get the results of the group monthly which allows us to follow up on the performance of the business [...]. The financial performance of the group also has an effect on the annual bonuses of [PortCo] management - PECo deal team member

A behavioural form of control which is exercised by PECo towards PortCo is the discussion forums between representatives from PECo, PortCo management and the PortCo board that are held when called for. The reason behind these discussion forums is to discuss major strategic decisions, predominantly concerning bids on potential add-on companies given that the PECo also holds the capacity of M&A advisor for PortCo. By having these discussion forums, PECo ensures that they have control over and insight into the strategic direction of PortCo on an ongoing basis.

Every other week or so, the responsible partner from [PECo], the chairman of the board of [PortCo] and the CEO of [PortCo], get together to discuss major strategic decisions such as potential acquisition targets - PortCo management member

The forums are held ad hoc but can also be planned in advance. By having these forums, you can influence the strategic direction not only via the board - PECo deal team member

In terms of social controls, PECo deal team has frequent dialogues with PortCo management primarily concerning potential new acquisitions. These social interactions are on a weekly and ad hoc basis, facilitating the more formal processes as alignment is created in advance. In order to maintain trust between PECo and PortCo, there are social gatherings taking place where PECo deal team and PortCo management deepen social bonds. When appointing the PortCo management, PECo first needed to ensure the right competencies and previous experiences for the task of running a B&B case under PE ownership. Secondly, it was vital for PECo to make sure to build a joint vision and mutual understanding together with the PortCo management. Furthermore, PECo is involved socially with the entrepreneurs in the acquisition stage as part of their capacity as M&A advisor to ensure the right partner selection, by determining which entrepreneurs to bring on via acquisitions. The partner selection in conjunction with new acquisitions is considered crucial given that the joint vision and mutual understanding of the entrepreneurs of the potential add-ons serve as a foundation for the success of the investment. With a sound partner selection, PECo can help ensure that there is less need for interventions during the holding period as the joint vision functions as an overarching guiding frame of the operations, thereby enabling a thin PortCo management team to focus on the acquisitive agenda and high-level strategy implementations.

Together with [PortCo] management, we have developed a vision for the direction and the way of working, and it is of utmost importance that the newcomers buy into that vision. Otherwise, there would be too many deviances from the group direction which would need to be managed. The 'engine' of the operations are the entrepreneurs, and we must ensure that they buy into our joint strategic vision and share our values, otherwise things can quickly turn south - PECo deal team member

4.2.2. Characteristics of management control mechanisms implemented by PortCo

The contractual arrangements in place, implemented by PortCo in relation to the subsidiaries, mainly relate to the salary levels and appointment of management.

An overarching principle in the relationship between PortCo and the subsidiaries is to, on the one hand, not interfere too much with the operations and the entrepreneurs' 'way of doing things'. On the other hand, there is a need for controlling the subsidiaries to ensure a successful investment. Given the structure of a B&B case like this, consisting of rather small firms led often by the firms' founders, it is of essence not to consume too much of the entrepreneurs' time when implementing MCMs as the financial results can be negatively affected. This setting creates a ceiling to the extent visible and time heavy MCMs can be implemented which creates an interesting dynamic regarding which MCMs PortCo can lay emphasis on in relation to the subsidiaries.

As we are dealing with small entrepreneur-led companies, with little to no previous experience conforming to control mechanisms, we must go about this with precision and care. We [PortCo] do not want to interfere too much, but at the same time, we need to control the subsidiaries, both through formal and informal means - PortCo management member

It is not good to take too much of the entrepreneurs' time. If you consume more than 15% of their time with meetings and overall reporting procedure, then that will start to affect the performance of the subsidiaries. This is something we need to account for - PortCo management member

Although the importance of not interfering too much with the subsidiaries' operations has been stressed, PortCo must implement results controls to track performance and identify deviances in the portfolio of subsidiaries. In a B&B strategy, where the entrepreneurs often are unaccustomed to reporting results on an ongoing basis, and also meeting the professional standards of a PE firm, the need for reporting results and explaining deviations to the PortCo management can become an additional burden.

There are entrepreneurs who before the acquisition only prioritise having accurate and organised accounting, and there are no other interested parties who inquire about their performance. Now, entrepreneurs have to answer to both management and the board. Reporting is not always a familiar task, and adding new accounting and bookkeeping principles for projects can be an additional burden. For instance, if they are working on a project where profits come irregularly, entrepreneurs must explain the reasons to management, despite only having an intuitive sense that cannot always be quantified - PECo deal team member

PortCo management and the entrepreneurs affirm this overall statement as well. Especially, for companies with less administrative capabilities, the experienced burden around monthly reporting becomes heavier. Interestingly, the complexity of the reporting is interpreted as being rather simple, at least from a PE point of view.

The most formal way for PortCo to control the behaviour and decisions in the subsidiaries are through the board meetings in the subsidiaries. However, there are other ways to behaviourally control the actions in the subsidiaries and a formal effort is to hold semi-annual budget meetings with the entrepreneurs. By having these meetings, PortCo ensures a mutual understanding of the expectations ahead as well as provides a forum to discuss potential issues the subsidiaries face. It becomes visible from the interviews that budget discussions can be a sensitive topic for the entrepreneurs. The subsidiaries often have a clear vision on how to best grow the business organically, meanwhile the budget is oftentimes questioned or discussed as a way of motivating the subsidiaries to perform better which can result in pressure. Further, the strategic plans and objectives are also communicated through both 'information meetings' held by PortCo with the subsidiaries' CEOs every sixth week and through semi-annual CEO gatherings, which are also aimed to achieve knowledge-sharing and facilitate socialisation amongst subsidiary entrepreneurs.

In terms of interactions with [PortCo], there are the budget meetings, the information meetings and the CEO meetings that take place twice a year. The budgets we mostly develop ourselves but are revised by [PortCo], which can be quite a sensitive process if [PortCo] does not think we are doing well or aim high enough. The information meetings held by [PortCo] act as forums for [PortCo] to update on current initiatives, strategic plans and M&A pipeline. Finally, the CEO meetings function as good forums for socialisation between the entrepreneurs and for knowledge-sharing between the subsidiaries. Here, strategic plans are also communicated - Entrepreneur

An example of such strategic plans communicated during the CEO meetings and information meetings is that PortCo has started to implement regional meetings where subsidiaries meet regularly together with others in the same geographic region. From the subsidiaries' perspective, the regional meetings are a channel for sharing best practices and general knowledge to facilitate growth and harvesting synergies. However, it becomes evident from interviews that the discussion forum also acts as a behavioural form of control where a common vision, strategic goals and other forms of group-wide procedures and ideas can be aligned between subsidiaries. Moreso, if too many mandatory activities are invoked it can interfere with the subsidiaries day-to-day business, which some entrepreneurs express concern about.

While many of us like the idea of meeting with management and employees of other subsidiaries, activities like this take up time that we could spend on working on projects. The financial targets will not change, and as such, we will have to work extra if these things occur too frequent and become time consuming - Entrepreneur

Our idea is that the regional meetings can be a win-win situation for both the subsidiaries who can discuss business activities locally, and also for us to be able to try to create consensus *around the strategic direction as well as the values and vision we try to develop in the group - PortCo management member*

To help ensure that the subsidiaries take on profitable and 'good' projects and consequently minimise the risk of project losses, proposals estimated over a certain amount require sign-off from the PortCo management. Being able to control this helps protect group level margins and cash flow generation, important for generating value during the investment period and ensure stable financials throughout the holding period, affecting the valuation at the time of exit. However, actually declining a project based on a second-hand analysis by PortCo rarely happens. A CEO of a subsidiary together with a representative of PortCo management provides colour to this dynamic.

In the acquisition process, they ensured us that we, to the extent possible, should be able to run the business as we have always done. While they [PortCo] have the possibility to involve themselves in the projects we take on, and potentially decline a project proposal, they restrain from doing so - Entrepreneur

Having the possibility to overlook a larger project proposal provides us with some comfort. However, vetoing a proposal requires it to be too financially risky or against the strategy. The subsidiaries are rather thin in terms of management, and it becomes important to keep them happy. Notwithstanding the ownership, the entrepreneurs certainly have extra influence compared to employees of an 'ordinary' company - PortCo management member

As the group grows, PortCo has realised that there is a need for a code of conduct which resembles rules and procedures on how to act and behave, thereby a MCM of behavioural nature. This type of MCM could more easily be handled socially and more informally previously, but as the number of subsidiaries grow together with a vision of professionalising the group further, the need for a formalised code of conduct increases.

A code of conduct is developed with guidelines and rules on how to act and behave regarding, for example, business ethics, drug policies and such. This becomes increasingly important now when we grow, especially as we strive to operate even more professionally - Entrepreneur

A joint vision between the entrepreneurs and PortCo, and by extension PECo, is considered to be a foundation for the partnership guiding the actions of the subsidiaries. The joint vision, as a consequence, enables PortCo to implement less rules and procedures and instead rely on mutual trust that the actions are in line with overarching goals and objectives. This is especially important in a B&B strategy like this with many different entities as rules and procedures would interfere with the daily operations of the entrepreneur-led businesses. Therefore, in the acquisition processes, the partner selection is considered a crucial aspect. The 'right' partner selection is ensured through thorough due diligence of the entrepreneurs through business networks and through socialisation before any deal is made. Post acquisition, the trust between the parties is further strengthened through frequent social interactions and site visits, ebbing out as trust is achieved.

In the acquisition process, we are not interested in companies run by entrepreneurs that do not share the vision and values of the group. That would require us to more closely monitor the business and exercise control in more detail. With so many businesses under our roof and us having a slim management team, we do not have the capacity for such efforts and instead we need to rely on a joint vision guiding the actions of the subsidiaries. It is therefore important that the entrepreneurs 'buy in' on the group vision. The trust is built up already before the acquisition and strengthened in the beginning of the partnership by having more frequent social contacts, for example, through site visits, which then ebbs out as mutual understanding and trust is ensured - PortCo management member

The vision and shared values of the entrepreneurs are thereafter fostered partly through the semi-annual CEO meetings and the information meetings every sixth week. As new entrepreneurs join the group, these forums play an important part to foster them into the group culture, vision, and values beyond just identifying a fit in the partner selection phase, i.e., through socialisation to actively ensure the right vision and values.

4.3 Summary of empirical findings

4.3.1 Summary of management control mechanisms implemented by PECo

Contractual controls serve as the basis for the MCMs implemented by PECo in PortCo, and by extension the subsidiaries. Such contractual arrangements include veto rights with respect to major strategic decisions such as exit route, acquisitions, and appointment of management. Other contractual arrangements include pre-leave clauses, non-compete clauses and recruitment ban for key personnel in the group. Interestingly, PECo has also created a form of 'reverse control mechanism' by having two entrepreneurs on the board in PortCo.

Furthermore, PECo has structured a form of results control with a co-investment scheme which covers the management of PortCo as well as the entrepreneurs and other trusted key people in the subsidiaries. The value of the subsidiaries' reinvested amount is based on a valuation dependent on group performance rather than entities' individual performance. Moreso, the PortCo management team is short-term incentivised through annual bonuses tied to the financial performance. The interviews highlight other results controls in place in the form of monthly financial reporting, enabling PECo to detect potential deviances in financial performance.

Discussion forums between a predetermined set of representatives from PECo, PortCo management and the PortCo board act as an important behavioural control mechanism. The discussion topics typically concern major strategic decisions, enabling PECo to gain increased insights into the business and providing them the ability to influence the strategic direction.

Frequent social interactions between the PECo deal team and PortCo management serve as continuous alignment with regard to strategic directions and the social bonds are further strengthened through joint activities. In the acquisition process, PECo interacts socially with potential targets in the capacity of M&A advisor to ensure the right partner selection, which is considered a critical element.

4.3.2 Summary of management control mechanisms implemented by PortCo

Concerning PortCo, contractual controls pertain to appointing management and deciding salary levels. Albeit PortCo has the opportunity to appoint the management of the respective subsidiaries, having the entrepreneur engaged and active in the business is considered vital.

The monthly reporting system acts as the primary mechanism for PortCo to follow up on and control the subsidiaries' performance. Whilst rather common for most PE owned businesses, this reporting procedure is something the entrepreneurs stress as a somewhat burdensome task as it interferes with the business due to them being unaccustomed with the process. This is also interesting since the complexity of the reporting requirements can be interpreted as low in a PE setting.

Board meetings, budget meetings, code of conduct, CEO gatherings, information meetings and approval processes are all behaviour control mechanisms put together by PortCo. From the subsidiaries' angle, these partly facilitate knowledge sharing and sharing of best practices. However, they are also designed to develop and align PortCo´s vision amongst the subsidiaries. Regarding approval processes, PortCo has the ability to decide upon which projects the subsidiaries take on, however, the subsidiaries' influence over the business is telling as PortCo would refrain from declining a proposal.

Anchoring a joint vision, before the acquisition, is very important and accomplished by a comprehensive partner selection process. This allows them to reduce the number of rules and procedures and depend more on mutual trust post acquisition. Few time-consuming tasks outside the ordinary business activities is almost a necessity as too many compulsory activities can interfere with the subsidiary's operations.

5. Discussion

In the following section, the case findings are analysed and discussed using our theoretical framework from the ground up (see figure 2). Firstly, we analyse the findings in the PE B&B setting by contrasting the empirical findings to previous literature in the field. Thereafter, we interpret and consider the findings from a coercive logic point of view followed by an enabling logic point of view. Ultimately, we conclude the discussion by reviewing the balancing act.

The findings from the PE B&B case can be analysed using our theoretical framework of balancing coercive and enabling logics through an adequate package of MCMs. We must first acknowledge that there is no 'one package' that balances the logics for all cases, and generalisation is indeed not the primary aim of this paper. However, we argue that the theoretical framework nuances the previous literature and can be used to analyse the package of MCMs.

5.1 Management control mechanisms in a private equity buy-and-build setting: contrasting to previous literature

As previously noted in our paper, research from other scholars have mainly contributed with a high-level overview of common MCMs in a PE setting with no specific investment theme focus.

In our case, contractual arrangements serve as a foundation for the package of MCMs and do not really 'tip the scale' in any direction. Overall, the contractual controls in place support the existing literature in terms of the significance of these MCMs and their rationale. PECo, being the majority owner, faced minimal difficulties in implementing contractual control mechanisms and they did not have to make any significant compromises in relation to PortCo and the subsidiaries. In a sense, more contractual MCMs had to be implemented by PECo, compared to a more 'traditional' PE investment, because of the investment having a B&B strategy, and as such, there are no previous control mechanisms in place. However, the final package composition of contractual controls does not materially differ from the framework developed by Bedford & Ditillo (2022) in the case of a majority-owned investment being managed by executives of managerial cognition. Notably, the businesses themselves are rather 'typical' from a PE point of view, i.e., being mature and low growth. Therefore, the contractual controls should not differ significantly, with the exception being the intensive acquisitive agenda and the rather autonomously run subsidiaries.

The empirical findings discover that the investment case has common contractual controls in place that PECo can rely on, such as veto rights, selection rights to appoint business managers, non-compete clauses, recruitment bans and exit rights. Actual enforcement of these rights is also in line with previous findings, as PECo often makes use of a wider set of control mechanisms, i.e., minimises the use of contractual MCMs to preserve deal commitment, which is deemed critical for success (Sbarba et al., 2020). While PECo from start had the capability, by the investment being majority-owned, to appoint all board members, they structured a set-up where the entrepreneurs of the subsidiaries were to elect two members to the board of directors. With the B&B strategy, the entrepreneurs run the core operations and consequently become the key to success. Therefore, dissatisfaction among the entrepreneurs could compromise the investment which is why it is important to keep them inspired and motivated. The board seats appointed to the entrepreneurs have not had much of an effect on the overall discourse, however, this 'reverse' control mechanism still possesses enabling characteristics by them having the optionality to influence the board and by extension the group and through doing so leverage competencies within the group.

Short-term incentives, structured as bonuses tied to short-term financial performance implemented by PECo, are directed to PortCo management, which is consistent with the findings in Sbarba et al. (2020) and Bedford & Ditillo (2022). Govindarajan & Gupta (1985) find that in build strategies there are inherent uncertainties and therefore the managers of such strategies should be assessed and incentivised more subjectively and in the long-term. Interestingly, in our case, PortCo management is incentivised both in the long-term as well as objectively assessed and incentivised in the short-term with annual bonuses. In a sense, this is congruent with both Govindarajan & Gupta (1985) and the Bedford & Ditillo (2022) framework and as such reflects the characteristics of the PE B&B strategy. Notably, the entrepreneurs are only incentivised in the long-term, congruent with how to handle uncertainties in build cases. As such, we would argue that uncertainties in our case, characterised by the B&B strategy, are predominantly 'located' further down in the organisation which explains the different approaches to financial incentivisation vis-à-vis PortCo management and the entrepreneurs of the subsidiaries.

Previous literature argues that MCMs in a manager-led case with majority ownership should emphasise results controls (Bedford & Ditillo, 2022). Meanwhile, Govindarajan (1988) in his work on managing build cases, claims that due to their inherent uncertainties, less focus should be placed on "budgetary controls", i.e., results controls. PortCo has implemented a monthly financial reporting package. However, the extent to which reporting procedures seems to be implemented is on the low end of the spectrum of common PE reporting requirements according to PECo deal team members. The subsidiaries are in general unfamiliar with a monthly financial reporting scheme and this in combination with thin administrative staff in the subsidiaries puts a cap on the level of reporting that can be required of the subsidiaries. Some entrepreneurs find the current reporting package quite demanding and that it may have a negative impact on the operations and performances if it becomes too time consuming. PECo assured the subsidiaries in connection with the transactions that they, to the extent possible, should be able to operate as prior to joining the group. Heavy reporting requirements from PortCo opposes the pre-acquisition discussion around conducting 'business as usual'. Connecting the budgetary controls or the results controls to the literature, we argue that these controls are de-emphasised which would be in line with the reasoning of Govindarajan (1988). However, we argue that the reason as to why this is the case might not be because of inherent uncertainties to the build strategy, but rather because of the limited administrative capabilities in the subsidiaries due to the B&B strategy.

In line with the findings in Bedford & Ditillo (2022), PECo tries to align incentives by requiring a significant co-investment of the acquisition consideration from the entrepreneurs. The pay-out scheme is structured so that it depends on the overall performance of the group and not on the subsidiaries' individual and relative performance. The entrepreneurs describe that while this exposure leads to peer pressure amongst subsidiaries, it also fosters cooperation and coordination. If the entrepreneurs choose to, for whatever reason, depart from the investment, PECo has the mandate to enforce a significant discount to the initial investment ticket by labelling the entrepreneur as a 'bad-leaver'. This creates strong incentives to continue working for the group and on their terms if opinions were to differ amongst the relevant parties. From the PECo point of view, the co-investment and the legal components tied to it creates a foundation of trust between the parties which enables the entrepreneurs to operate more independently as interests are aligned and that this trust then can serve as a basis for the enabling logic in the MCM package. Furthermore, the pre-leaver clause helps ensure that the entrepreneurs stay with the group post acquisition. This becomes increasingly important for a B&B strategy as many of the subsidiaries are dependent on the entrepreneur's business network and expertise.

According to the framework by Bedford & Ditillo (2022), in a setting of majority ownership in a manager-led portfolio company we expect less emphasis on behavioural controls. This is somewhat congruent with what we find in the PECo relationship with PortCo, where the behavioural controls are of relatively standard nature with formalised board meetings and discussion forums. The fact that PECo also acts as M&A advisor to PortCo, however, constitutes a behavioural control that grants PECo with additional insights and influence over the strategic direction of the investment, i.e., reducing choice for PortCo and thereby constitutes coercive behaviour. The need for this additional insight and influence may be called for given the uncertainty of the B&B strategy, as argued by Govindarajan (1988).

Moreso, as described in Bedford & Ditillo (2022), in a majority investment in an entrepreneur-led business, we expect more emphasis on behavioural control. We find that this holds true in the relationship between PortCo and the subsidiaries. Here, behavioural controls are exercised in the form of formalised approval processes, formalised code of conduct as well as formalised regular meetings such as CEO meetings, budgetary meetings, and information meetings. The behavioural controls all aim to a certain degree reduce choice for the subsidiaries, meaning that they are to some extent of coercive nature. The approval processes ensure that for projects larger than a certain amount, the decision or choice is transferred from the subsidiaries to PortCo, albeit it may be challenging for PortCo to turn down a project proposal given the subsidiaries strong position in the group. The code of conduct puts clear boundaries as to how to behave and consequently reduces choice in terms of behaviour. The formalised meetings such as the CEO meetings and the information meetings aim to anchor new group-wide initiatives and strategies among the subsidiaries, thereby reducing the choice of direction in the future. In summation, it holds true that there is an emphasis on behavioural controls in the setting of an entrepreneur-led business with a majority equity arrangement.

In the framework by Bedford & Ditillo (2022), social controls are not emphasised if the PE firm holds a majority ownership. Interestingly, in our case the social controls play a vital part of the MCM package, with the mutual understanding and joint vision serving as the overarching guiding principle for both the entrepreneurs as well as the PortCo management. The reason as to why social controls are de-emphasised in the Bedford & Ditillo (2022) framework is due to the majority equity arrangement and consequently the ability to control the discourse through more formal controls, thereby decreasing the need to exercise social control. However, in our B&B case, the entrepreneurs play an indispensable role and controlling the discourse through formal controls cannot simply be done without consideration of the entrepreneurs. Therefore, although PECo can control the investment through formal means, in practice this is not possible without risking compromising the satisfaction of the entrepreneurs. As a consequence, social controls are implemented as if PECo could not formally enforce its wishes since PECo cannot in practice do this without compromising the investment. Moreso, the framework only touches upon partner selection for a minority investment in entrepreneur-led businesses, but for our case, this is deemed critical for PECo to ensure a joint vision, which is not emphasised for majority investments of any type.

Bedford & Ditillo (2022) argue that a MCM package in a PE investment that is majority owned and manager-led should focus on contractual controls together with results controls and lay less emphasis on behavioural and social controls as a result. We find that their framework might be limited in the respect that it does not capture the full complexity of a B&B strategy. While the investment is led by managers in PortCo, the investment case is simultaneously driven by the entrepreneurs who constitute the 'engine' of the investment. Therefore, our case study also showcases attributes of that of a majority investment led by entrepreneurs, i.e., a focus on behavioural and social controls as outlined in Bedford & Ditillo (2022).

5.2 Coercive: reducing choice

Our theoretical framework helps us look at the management control exercised in the PE investment and analyse what efforts aim to coerce the actions as well as enable efforts. Clearly, from an investment perspective it is important that there is a frame in which actions are to be taken to ensure that managers do not run amok and potentially compromise the investment. These coercive efforts can be viewed as elements in the package of MCMs and they aim to ultimately reduce choice for managers.

Obviously, contractual arrangements are somewhat coercive in nature. For example, PECo veto rights regarding exit route, managerial appointment and major strategic decisions are in place to ensure that these issues are not to be decided on by PortCo, thereby reducing their choices by removing decision-making authority. The same reasoning applies in the relationship between PortCo and the subsidiaries.

The co-investment scheme can be viewed as a crucial coercive effort in the way that it sets an overall shareholder focused frame for the entrepreneurs and the PortCo management. Without the co-investment scheme, the investment strategy could fall apart as the entrepreneurs would not have any financial incentives to work towards common goals post realising their exit proceeds. In a sense, the co-investment scheme creates a foundation of trust between involved parties as it effectively reduces choices other than those that are perceived to benefit shareholder value. Viewing this with our theoretical framework, the coercive elements pertaining to the co-investment scheme bear heavy weight in the balancing act. On the topic of results controls, the short-term financial incentives in the form of annual bonuses to PortCo management also have coercive elements to it. These short-term financial incentives make sure that PortCo management is not 'too' visionary but also ensures short-term healthy and growing profitability along the journey. By doing so, the MCM reduces choice for PortCo management and forces them to make decisions that to some extent benefit current financial performance. The monthly reporting provides visibility for PortCo management in its quest for sound short-term financial performance.

From a coercive logic point of view, the behavioural controls in the form of budgetary planning meetings, the CEO meetings and the more frequent information meetings can be viewed as efforts to reduce choice in the subsidiaries. The budgetary planning meetings are coercive in the way that by jointly setting the agenda for the year, it disallows the entrepreneurs to choose another direction in terms of goal setting and pace. The CEO meetings and the more frequent information meetings partly aim to communicate new initiatives and agendas set by PortCo, consequently making sure that actions are taken by the subsidiaries in line with the group agenda, thereby coerce efforts by directing decision-making towards a common strategy. Moreso, the coercive logic is clearly displayed through the project approval processes with the only aim of transferring decision-making authority from the entrepreneurs to PortCo management and by doing so reduce choice. The approval process reduces choice by transferring decision-making authority, but the process also reflects the coercive logic in the steps before the approval process. The entrepreneurs know that they cannot pursue projects that would not pass through an approval process which then reduces choices for them in their everyday business and interactions with potential customers.

The frequent dialogue between PECo deal team members and PortCo management typically do not aim to inspire and leverage competencies, but rather to make sure on an ongoing basis that actions are taken in line with PECo wishes. By having these dialogues, the PECo deal team reduces choice for PortCo management as any potential deviances from the PECo agenda would be captured in the dialogue, creating a barrier for PortCo management to pursue initiatives outside the scope of the agenda. I.e., the social control of having a frequent dialogue reduces choice for PortCo management. The same line of reasoning can be applied to the social interactions between the PortCo management and the subsidiaries, where deviations from the group agenda would be captured on an ongoing basis, forcing subsidiaries into compliance.

5.3 Enabling: inspiring and leveraging competencies

Although a coercive approach is necessary, it is just as vital to motivate and leverage skills to expand the business. These supportive actions can be seen as enabling components within the set of MCMs, with the goal of inspiring and leveraging competencies in the group.

As outlined in section 5.2, the contractual clauses do not contain many enabling elements. Exit-clauses, managerial selection, veto rights and others are designed such that it gives PECo complete control over the terms of the agreements towards PortCo and the subsidiaries. A noteworthy aspect of the current business arrangement is the provision that grants subsidiaries the right to appoint two board members. This provides a unique opportunity for the subsidiaries to have a voice in the decision-making processes of the group. By allowing the subsidiaries to have a say in the decision-making process, PECo can promote a culture of inclusivity and encourage the subsidiaries to feel invested in the success of the entire group, although this route to influence is rarely used by the entrepreneurs. Indeed, by having entrepreneurs on the board, it enables knowledge transferring from subsidiary level to group level, facilitating leveraging of competencies.

Unlike PortCo management, the entrepreneurs are not incentivised by short-term performance-based compensation. Disregarding short-term rewards can be considered enabling behaviour as they have no short-term incentives to guide their decision-making processes. Instead, they rely on a long-term vision and a commitment to their goals to guide their actions which is kept by the non-negotiable co-investment program. Whilst co-investment has coercive elements to it, it is also congruent with the overall theme of letting the subsidiaries ‘run free’ as long as they operate within the shareholder-focused frame, which can be considered enabling as it encourages and harnesses competencies to achieve success.

Although some of the behavioural MCMs have enabling elements, we argue that the bulk of the behavioural control mechanisms in place aim to reduce choice in PortCo and among the subsidiaries. However, although, e.g., the CEO meetings and the information meetings are ways for PortCo to coercively control behaviour in the subsidiaries, they also function as forums for inspiration and knowledge-sharing, i.e., having enabling elements to them. Moreso, looking from the standpoint of the subsidiaries, regional meetings serve as a means to exchange best practices and general knowledge that aid in promoting growth and realising synergies. Despite some behavioural control elements being of coercive nature, the perception of these does not necessarily rhyme with the intended nature of the MCMs as described in Tessier & Otley (2012). The subsidiaries view most of the behavioural control mechanisms as being enabling and as forums for being inspired and facilitate cooperation. However, as previously outlined, the behavioural controls are very much also coercive efforts.

Interestingly, the social controls towards the subsidiaries are of more enabling nature with a basis in partner selection which is considered a critical element. In conjunction with the partner selection, a joint vision and mutual understanding of the strategy and the roadmap ahead is established and later built upon through social gatherings, e.g., the formalised meetings that are not only behavioural control mechanisms but also forums for socialisation. The establishment of a joint vision and mutual understanding is the foundation of trust that enables less formalised controls and functions as an overarching principle guiding the entrepreneurs’ operations without the need for rules and procedures. In line with the reasoning of Ahrens & Chapman (2006), it is the foundation of trust that the joint vision and mutual understanding creates that enables the entrepreneurs to run the operations more freely, being guided by the vision. Although there are many coercive elements in the package of MCMs, the core of the operations is not run by rules and procedures, but instead by the entrepreneurs’ own judgements anchored in the joint vision and mutual understanding on where to go, i.e., enabling them to act. Clearly, the joint vision and mutual understanding that is anchored in the partner selection and thereafter fostered throughout the journey is inspiring for the group and facilitates leveraging of competencies.

5.4 The balancing act: analysing the package of management control mechanisms

There is a need to balance enabling and coercive logics with MCMs. On the one hand, PECo needs to control the business and the discourse to ensure a successful investment. On the other hand, especially given the strategy being of ‘build’ character, the MCMs need to enable and empower the organisation as well as foster a go-ahead spirit. Excessive coercive control, e.g., through excessive use of rules and procedures, would hinder the organisation in its growth journey. Therefore, we argue that there is a constant battle between the two logics.

We find that the primary enabling MCM is of social character, being the joint vision and mutual understanding that originates in the partner selection phase and is subsequently built on during various socialisation events with behavioural control intentions. Once having established and anchored a joint vision and mutual understanding with new-coming entrepreneurs, the vision serves as an overarching principle permeating the operations of the subsidiaries, thereby leading to less need for coercive control. It is therefore important that the vision and mutual understanding is fostered along the journey, which is achieved through the regular socialisation meetings between the entrepreneurs and PortCo management. These meetings are also intended to behaviourally control the actions of the subsidiaries, not with strict rules and procedures, but also to set the frame for the overarching vision. I.e., the coercive elements of the behavioural control to some degree set the frame of the enabling logic.

In order to foster the vision further, and by doing so, strengthen the enabling logic in the B&B case, the vision is incentivised by the rather extensive co-investment scheme. This form of MCM coercively ensures that the vision does not diverge from PECo’s underlying shareholder focus agenda, which is another means of setting the frame for the enabling logic. The balancing act becomes clear when observing that PortCo management is also incentivised through short-term performance-based bonuses, not only the long-term co-investment program. This approach assists PECo in limiting the options available to PortCo's management, compelling them to make choices that partly favour the company's present financial performance which somewhat contrast the results by Govindarajan & Gupta (1985).

Interestingly, although the enabling vision and mutual understanding originated in the PortCo management together with PECo, the primary role of PortCo management is to anchor the enabling logic, i.e., the vision, with newcomers and to foster the enabling logic amongst the existing portfolio of subsidiaries. The role of PortCo is also to implement other MCMs of coercive nature, e.g., approval processes and budgetary planning processes, but these are only controlling the operations in parallel to the daily operations of the otherwise autonomous subsidiaries. We argue that these control mechanisms function as support wheels, keeping the subsidiaries from getting ‘off track’ and from deviating from the strategy. As such, some of these MCMs are seldom ‘enforced’ given that the enabling logic already underlies the operations but any deviations from the strategy would be mitigated by these MCMs, thereby ensuring control.

The MCMs implemented by PECo in PortCo are primarily of coercive nature and in line with what is expected from the framework by Bedford & Ditillo (2022) in the setting of a majority investment in a manager-led company. In a B&B case like this, the role of PortCo is rather to act as a vehicle of control for PECo and does as such not require a package of MCMs of an enabling logic. Notably, the enabling logic is emphasised further down in the organisation as opposed to the top, i.e., directing the enabling logic towards the ‘engine’ of the operations.

Another important aspect worth considering in the package of MCMs implemented in our case is the perception of the MCMs compared to their intention, in line with the reasoning of Tessier & Otley (2012). The most apparent example of this discrepancy in our case, we argue, are the behavioural controls in the form of CEO meetings and the more frequent information meetings. These events are perceived to be inspiring and forums for socialisation and cooperation in the eyes of the entrepreneurs, which obviously holds true, but the coercive elements to the MCMs are not as recognised as much amongst the entrepreneurs. Other behavioural control mechanisms such as the approval processes are more purely coercive and perceived as such. Importantly, since the meetings are perceived as enabling and empowering instead of controlling, the group manages to exercise additional control whilst still enabling the subsidiaries to act freely and by leveraging competencies.

As we analyse the MCMs in our PE B&B setting, we make use of coercive and enabling logics to make sense of and better understand the MCM package. Balancing these logics is vital to ensure control through reducing choice, whilst at the same time encouraging growth through inspiring and leveraging competencies. The importance of this balancing act becomes crucial to ensure a successful investment, which is on display throughout our case study.

6. Conclusion

While PE and management control have both been extensively studied respectively, their intersection remains relatively unexplored (Bedford & Ditillo, 2022), despite the significant role that PE plays in the economy (Gilligan & Wright, 2020; Wood & Wright, 2009) and its recent growth (McKinsey, 2022). Moreso, the B&B strategy, which is commonly used among PE firms, has not been extensively studied (Borell et al., 2013) although the strategy represents a significant part of the PE market (Hammer et al., 2017). This study has investigated the MCMs in a PE B&B strategy. The research was carried out through a single case study of an ongoing PE investment with a B&B strategy. By contrasting the research by primarily Bedford & Ditillo (2022) and applying the lens and method theory of coercive and enabling logics (e.g., Adler & Borys, 1996; Ahrens & Chapman, 2006), the objective of this study was to provide an answer to; *What characterises MCMs in a PE B&B case compared to previous literature on MCMs in a PE setting and how do they interplay with the balancing act of coercive and enabling logics in managing a PE investment?* This study makes two main contributions.

Firstly, we contribute to the literature on MCMs in a PE setting by investigating the MCMs implemented in a PE B&B case, which is an area largely ignored in the literature. In doing so, we make use of the framework developed by Bedford & Ditillo (2022) and the MCM categorisation made in their paper. The framework distinguishes between two major factors influencing the set of MCMs employed by PE firms, namely the equity arrangement dimension and the perceived cognitive style dimension. We display that in our case, the framework does not fully capture the complexity of a B&B strategy. Indeed, the framework does seem to adequately capture what categories of MCMs that are to be emphasised in the relationship between the PE firm and the portfolio firm in a setting with managerial cognition of the management and majority equity ownership. However, the core operations are run further down in the organisational structure, by the entrepreneurs of the subsidiaries. Here, the framework did also seem useful when looking at the dimension of entrepreneurial cognition of managers. Concludingly, the framework needs to be looked at from two different perspectives in order for it to make sense for our B&B case.

If doing so, there is one major discrepancy with our B&B case when comparing to the previous literature. In an investment where the PE firm has a majority equity ownership, social controls are de-emphasised given that the wishes of the PE firm can be enforced through formal means. However, in our case where PECo could enforce actions through formal means, the social controls still play a crucial role in the package of MCMs. We argue that this is because the B&B strategy has a strong emphasis on the entrepreneurs further down in the organisation being satisfied, inspired, and motivated. Because of this, enforcement of formal controls clashing with the wills of the entrepreneurs are not preferable. This means that, in practice, social controls are more prevalent as if formal controls could not be exercised, similar to a minority investment case.

Moreso, although the literature on management control in build cases is scarce, Govindarajan & Gupta (1985) describes that such cases have increased unpredictability and uncertainty. Coping with this, the authors find it logical that build managers, who place more emphasis on the long-term as opposed to the short-term should also be assessed and incentivised accordingly, i.e., more subjectively and in the long-term. We find this to hold true for the entrepreneurs of the subsidiaries, where we argue most of the uncertainty lies. However, the managers of PortCo are also more objectively assessed and incentivised in the short-term, reflecting our assessment of PortCo being more of a vehicle of control for PECo in this strategy.

Secondly, we also contribute to the literature on coercive and enabling logics by applying such a lens in analysing the MCMs in the PE B&B setting. Here, Adler & Borys (1996) provides context by discussing two types of formalisations, enabling and coercive. We redefine these concepts in a PE context where coercive control mechanisms aim to ultimately reduce choice whilst enabling MCMs strive to inspire and leverage competencies. By intertwining our literature domain of management control in a PE setting, with the concepts of coercive and enabling logics we develop a theoretical framework. The theoretical framework displays how MCMs interplay with each other and how the package of MCMs ultimately needs to balance, adequately to the setting, the coercive and enabling logics. We argue that too much of a coercive or enabling logic would lead to an imbalance and ‘tip the scale’, potentially causing problems to the investment. By applying the analytical lens of coercive and enabling logics, we argue that we can better understand the composition of the package of MCMs. In our case specifically, we found that there are a few key elements of coercive and enabling nature that jointly contribute to the balancing act. The enabling logic is primarily carried by an MCM of social control nature, namely, the joint vision and mutual understanding, functioning as an overarching guidance which inspires the entrepreneurs and the PortCo management. The enabling logic is anchored in the partner selection phase, i.e., in conjunction with the acquisitions of new add-ons, and subsequently fostered through various MCMs. To balance this, there are multiple MCMs with coercive elements ensuring that the investment is on track. One of the most important coercive efforts is the co-investment scheme that sets an overarching shareholder focused frame to the operations, meaning that the entrepreneurs and subsidiaries will act on the vision within the frame of shareholder value creation. Additionally, we find that there are other MCMs with coercive elements that function as ‘support wheels’ which are only acted on should there be deviations. An example of this would be the project approval processes for larger projects which make sure that any significant deviations from the plan are captured and corrected. The same reasoning applies to the behavioural controls in the form of CEO meetings, budgetary meetings, and information meetings, where strategic initiatives and visions are communicated to set the frame for the enabling logic.

A limitation to consider is that our study addresses an ongoing investment. As such, it is difficult to reach definitive conclusions about the long-term effects of MCMs. Also worth considering is that the package of MCMs may undergo changes in the future, which potentially affects the balancing act. Also, some components present in this B&B strategy might be context-specific to our case study, and we acknowledge that other factors might be prevalent in B&B strategies in other instances.

In this study, we present the concept of studying MCMs implemented in a PE B&B case through the analytical lens of coercive and enabling logics. For further research, we suggest exploring these concepts on a multitude of PE firms and portfolio companies with different investment strategies. We encourage scholars to investigate any differences in the balancing acts to provide more colour to how different MCMs interplay with the coercive and enabling logics as defined by this paper.

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8. Appendix

Appendix A: Conducted interviews

Interviewee	Number of interviews	Interview length	Interview date
PECo			
Partner	1	45 min	23-05-02
Investment director	2	90 min 60 min	23-02-15
Investment director	1	60 min	23-04-13
Investment analyst	2	60 min 30 min	23-04-13 23-04-25
Investment analyst	2	60 min 30 min	23-04-13 23-04-25
PortCo			
CEO	2	60 min 30 min	23-02-19 23-05-09
CFO	1	45 min	23-04-25
Subsidiaries			
Entrepreneur / PortCo board member	1	75 min	23-03-06
Entrepreneur / PortCo board member	1	75 min	23-03-09
Entrepreneur	1	60 min	23-03-20
Total interviews:	**14**		