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The Final Act: A Comprehensive Analysis of The Private Equity Exit Processes

Benjamin Zarif (24912) Adam Holgén (25187)

Abstract

This thesis draws upon eight in-depth interviews, with top-level executives in the Private Equity industry to explore the overlooked divestment phase of the investment process. The study aims to provide insights into the divestment process and the significant factors that influence its outcomes. Using Icek Ajzen's Theory of Planned Behavior, the attitudes of Private Equity firms towards divestment were found to have a degree of uniformity, but differences in investment strategies, risk tolerance, and perceptions can influence them. External factors like societal expectations, investor pressure, and industry benchmarks can also play a role in decision-making. Private Equity firms tend to adopt similar strategies to reduce the complexity and uncertainty of the exit process and enhance their perceived control over it, such as formulating a clear strategic plan. The study identifies three critical factors that influence the outcome of the divestment process. The fund structure shapes the behavior of Private Equity firms and influences their investment decisions, risk appetite, and exit strategies. The performance of the portfolio company and market conditions are key determinants of an investor's attitude towards a potential exit, and Private Equity firms may shift their investment strategy during unfavorable conditions. Continuation vehicles offer an alternative method that provides greater control over the timing and method of exit.

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Key words: Private Equity, Exit, Divestment, Theory of Planned Behaviour, Investor Behaviour, Behavioural Finance

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1. Introduction

1.1 Background

Investments and growth are fundamental components of modern society and serve as essential pillars of its foundation (Ritzer, 2016). These concepts can be divided into three distinct components, namely the investment process, investment decision-making, and divestment (Mason & Harrison, 2006). While these factors are critical in determining the success of an investment, numerous other factors also play a significant role (Deloitte, 2022).

In order to gain a deeper understanding of these concepts, we will narrow our focus to one of the most significant industries within investments and growth, namely Private Equity (hereafter PE) (Entrepreneur, 2022). This industry has become a major force in the global economy, with assets under management reaching an all-time high of $6.3 trillion globally in Q2 2021 (Mckinsey, 2022). However, the industry is currently undergoing significant shifts due to macroeconomic trends (Bain, 2022). Notably, European PE firms are holding onto their investments for longer periods due to a lack of attractive exit opportunities in the current market. This trend is reflected in the increase in the average holding period, rising from an average of 4.7 years before the financial crisis in 2008 to 5.8 years post-crisis (Mäkiaho, 2016).

1.2 Problematization

After conducting a thorough investigation of prior research and engaging in discussions with industry professionals, we have identified a two-fold problem. Firstly, there is a lack of information regarding the divestment process, both in general and specifically within the context of PE. Secondly, there is a scarcity of qualitative studies within this field.

Current research has overlooked a significant and critical aspect of the investment process, which is the divestment phase. Research by Kaplan and Weisbach (1992) indicates that a significant majority of completed investments are divested with a profit. This provides compelling evidence that despite the inherent risks and high costs associated with investments, they have the potential to generate significant returns. In contrast, other researchers have focused on exploring the factors that impact and contribute to investment decision-making processes. Hellman's (2009) research provides insights into the incorporation of macroeconomic and private information, as well as various investor conditions in the investment decision-making process. Furthermore, Nagy and Obenberger (2018), demonstrate that investors typically do not rely on a singular, comprehensive approach when making investment decisions but employ various strategies in making investment decisions.. Behavioral finance has provided valuable insights into investor behavior, especially concerning the rational expectation of maximizing profits. Despite investors' goals to make rational decisions that optimize wealth, human beings are prone to a variety of behavioral anomalies that can impede their ability to do so (Chaudhary, 2013).

Remarkably, there exists a paucity of research on the divestment process and its significance (Decker & Mellwigt, 2007). This knowledge gap hampers a complete understanding of the investment process and overlooks crucial insights regarding divestment. The existing research, therefore, fails to provide a complete understanding of the investment process, and crucial insights regarding divestment are overlooked. Harrigan's (2017) research suggests that multiple factors influence the timing of exiting an investment in a mature industry, with the primary determinants being the presence of excess capacity and the perceived attractiveness of the industry. Research conducted by Drummond (2014) examines the intricate decision-making process involved in determining whether to retain or sell an investment. The lack of qualitative research in this field is problematic since quantitative research alone provides only one aspect of the overall picture. To present a comprehensive understanding of the topic, we aim to supplement earlier quantitative studies (Harrigan, 2017; Schmidt et al., 2010) with qualitative insights.

1.3 Aim and Research Question

The objective of this report is to analyze and shed light on a neglected component of the investment process, namely the divestment phase, with a focus on the PE sector. This study aims to provide insights and a more comprehensive understanding of the divestment process, including the significant factors that influence its outcomes. The purpose is to offer a nuanced perspective on the divestment phase, which is often overlooked, in order to enhance the overall investment decision-making process. Furthermore, our qualitative research presents a unique opportunity to conduct in-depth interviews with established PE firms, as many Swedish PE firms are open and willing to support the research endeavors of enthusiastic students, motivated to learn about the PE industry. We are privileged to have this opportunity, as these interviews will provide us with invaluable insights into the practicalities of exit strategies in the PE industry. The resulting research question is as follows:

How does the Private Equity exit process unfold, and which factors play a critical role in shaping its outcomes?

1.4 Contributions

It can be observed that there exists a certain degree of uniformity among PE firms in how the exit process unfolds. PE firms generally view the exit process as a necessary step to maximize returns for their investors, but their attitudes towards divestment may vary based on their past experiences, risk tolerance, and investment strategies. The industry norm of exiting portfolio companies reinforces the practice across firms, but individual decision-making may not always align with this norm, leading to longer holding periods. To reduce complexity and uncertainty, PE firms formulate clear strategic plans and engage advisors, but external factors can still impact their perceived control over the exit process.

The outcome of an exit is shaped by three primary factors, namely the fund structure, the performance of the portfolio company, and the market conditions. The fund structure establishes the parameters within which the firm operates and influences its investment decisions, risk appetite, and exit strategies. The performance of the portfolio company remains a key determinant of an investor's attitude towards a potential exit, as it can influence their beliefs about the likely outcomes of that action. In situations where market conditions are unfavorable, the ability to initiate an exit may be limited, but PE firms can mitigate this risk by utilizing alternative methods such as continuation vehicles, which can provide greater control and flexibility in achieving their exit objectives.

1.5 Delimitations and Limitations

The study is subject to two primary delimitations. Firstly, it is confined to PE firms that have offices in the Stockholm area. The rationale behind this geographical restriction is to comply with the strict time limit, as expanding the geographic scope would make it unfeasible. Secondly, the empirical investigation and interviews are restricted to Partners or Directors at the PE firms and not to lower-level employees. This limitation was put in place to prioritize interview subjects who are expected to provide the most explanatory value to the research question. Regarding limitations, eight in-depth interviews were conducted, which is deemed adequate given the time constraints, although a larger sample size of 30 or more would have been desirable. Lastly, the most significant limitation identified thus far is the evident lack of diversity amongst the interviewed Partners and Directors, with a noticeable absence of female Partners in larger firms.

2. Literature Review

This section contains a review of four blocks of literature relevant to the present study. The two first blocks focus on previous literature about the subject. The third block presents a comprehensive view of how Private Equity works. The fourth block gives an overview of our chosen theoretical framework.

2.1 Investor Decision-Making Processes

Two commonly discussed investment strategies in financial literature are value and growth investing strategies. Value investing involves identifying undervalued stocks based on metrics like earnings, book value, or cash flow. Value investors believe these stocks have been overlooked by the market and have the potential to generate higher returns. Growth investing, on the other hand, involves identifying stocks that have a high potential for future growth, based on metrics such as earnings growth rates, revenue growth, or market share. Growth investors are willing to pay a premium for these stocks because they believe that the companies' growth potential justifies the higher price (Lee, 2014).

In the context of large acquisitions, Kaplan & Weisbach (1992) provide valuable insights into how investors evaluate and approach investments. The study analyzes a sample of large acquisitions and the subsequent divestitures, the paper provides insights on the success of acquisitions. The study challenges the commonly held view that divestitures represent failure and suggests that many divested acquisitions are not failures. Additionally, the authors examine the cross-sectional results and find that diversifying acquisitions are divested more often than related ones. Further, it is also shown that strategic fit, organizational fit and acquisition process itself plays a significant role in the outcome.

Investors' decision-making processes regarding organizational forms for investments are crucial in finance. Jensen and Fama (1983) contribute to this area by offering insights into how firms choose between debt and equity financing, and the factors influencing this decision. Their research emphasizes the importance of aligning the interests of investors and management, and how different organizational forms can lead to different outcomes in terms of risk and return. The study highlights that the market value rule is suitable for decision-making in open corporations, financial mutuals, and non-profits, while other forms such as proprietorships, partnerships, and closed corporations may not conform to the market value rule (Jensen & Fama, 1983).

2.2 Investor Behavior

2.2.1 Investment

The study of factors influencing investor behavior and investment decisions has received significant scholarly attention. Hellman (1996) explores the causes of investor actions through an examination of a large Swedish institutional investor, offering valuable insights into the role of accounting data in investment decision-making processes. There is no direct relationship between financial information and investment actions, instead the main factors that affect investment decisions are macro-economic information, private information, and different investor conditions. Thus, the role of accounting data in the investment decision process may not necessarily be as significant as suggested by previous studies (Hellman, 1996). Further, Gniewosz (2012) delves deeper into the process of share investment and examines the type of information that institutional investors consider. Utilizing a qualitative approach, the study revealed that annual reports held a noteworthy position as a source of information, with the manner in which it is used evolving over time. The reports could serve as a primary source of information or act as a tool for ensuring conformity (Gniewosz, 2012).

The field of behavioral finance holds significant importance in shaping investor behavior, particularly in the realm of investment decisions and strategies (Chaudhary, 2013). While investors typically have rational expectations of maximizing profits, human beings are prone to various behavioral anomalies that can hinder wealth maximization and lead to irrational behavior (Chaudhary, 2013). Chaudhary (2013) posits that behavioral finance provides an explanation for why investors make irrational decisions, demonstrating how emotions and cognitive biases, such as anchoring, overconfidence, and loss aversion, can influence behavior and decision-making. Through a systematic review done by Zahera and Bansal (2018), it could be added that disposition effect and herding are two biases that influence investment decision making. The disposition effect refers to the tendency among investors to hold onto losing investments for too long and sell winning investments too quickly. While herding is the behavior of investors who follow the actions of their peers, rather than conducting independent analysis (Zahera and Bansal, 2018). Additionally, Massa and Simonov (2005) have examined how investors respond to gains and losses in their investments. Their research reveals that investors' risk-taking behavior is influenced by prior gains and losses, with prior gains leading to increased risk-taking and prior losses resulting in reduced risk-taking (Massa and Simonov, 2005).

When examining the factors that drive investor behavior and lead to investment decisions, it is important to consider a broad range of criteria that influence individual investors. Nagy & Obenberger (1994) study reveals that classical wealth-maximization criteria are prioritized by investors, but they also employ diverse criteria such as environmental track record and ethical posture, which are given cursory consideration. Moreover, recommendations from brokerage houses, stock brokers, family members, and coworkers are not highly regarded, and many individual investors discount the benefits of valuation models when evaluating stocks. The authors identify at least seven relatively homogenous groups of variables that influence investor behavior, with each investor potentially viewing them differently in terms of importance. Psychological factors have a big role in the decision too. According to Sarwar and Afaf (2016), psychological factors contribute more to the decision than economic factors. They argue that psychological factors as compared to economic factors have more impact and effect on decision-making behavior.

2.2.2 Divestment

In the context of investor behavior and divestment decisions, it is important to consider the barriers that may hinder firms in mature industries from making timely and efficient exits. Strategic and economic exit barriers can impede divestment and have implications for maximizing investor returns. Harrigan (1982) emphasizes the importance for investors to understand the potential risks and challenges associated with divestment decisions, by taking into account the barriers to exit identified in the research. This is supported by research by Decker and Mellewigt (2007) that has further extended the foundation of exits. They have divided it into three different categories: actors promoting business exit, exit barriers, and exit outcomes. The key finding of the research is that in the past, companies would exit due to failure, but in recent years success has become an equally significant factor.

Further research examines the impact of capital structure and product market characteristics on the divestment decision. Kovenock & Philips (1997) study empirically analyzes factors such as firms' capital structure, plant-level efficiency, and industry capacity utilization and their influence on the divestment decision. Drummond's (2014) research delves into the intricate decision-making process of determining when to hold on to an investment versus selling it. While some investments may yield positive results, others may cause trouble, leading to uncertainty and doubt. To shed light on this complex issue, Drummond (2014) offers several key insights, highlighting the critical role played by factors such as doubts, second thoughts, overconfidence, and loss aversion. Educating management on these factors is paramount in making informed decisions that maximize the likelihood of long-term success. With regards to the PE industry, various factors have been identified as influencing the choice of exit strategy. These include the size and industry of the target company, the age and type of the fund, and prevailing market conditions (Schmidt et al., 2010).

2.3 Private Equity

2.3.1 Overview

PE is a form of investment that involves providing risk capital to businesses that are not publicly traded on stock exchanges. Unlike public markets, private transactions are regulated differently, and the protections afforded to individual investors in public markets do not apply. PE investors are usually sophisticated institutions or high net worth individuals. The term "equity" in this context refers to a bundle of financial instruments that are employed to share in the profits and losses of a business. PE investments typically involve a combination of ordinary shares, loans, and other financial instruments that collectively share in the potential returns and risks of the investment (Gilligan & Mike, 2008).

Kaplan and Strömberg (2009) provides a useful framework for understanding the multifaceted PE industry by dividing it into three subcategories: the firms, the funds, and the transactions, allowing for a more effective analysis of each participant's roles and responsibilities. The typical PE firm is organized as a partnership or limited liability corporation. PE firms typically raise capital through closed-end PE funds, which are organized as limited partnerships. Limited partners (hereafter LP), which include institutional investors and high net worth individuals, provide most of the capital, while the general partner manages the fund. The fund typically has a fixed life of ten years, during which the general partner invests in companies and earns an annual management fee (typically 2%), a share of the profits, and potentially deal and monitoring fees. PE firms typically have five years to invest the fund's capital and another five to eight years to return it to investors. LPs have little control over the investment process, as long as the fund agreement's basic covenants are met, including limits on the amount of investment in a single company, types of securities, and fund-level debt. The last decision is made by the Investment Committee (hereafter IC), which is the decision organ within a PE firm (Kaplan & Strömberg, 2009). When engaging in PE transactions, companies are often acquired by the PE firm at a premium of 15 to 50 percent, especially if the target company is public. The purchase is then typically funded with 60 to 90 percent debt, with the bank or investment bank usually responsible for arranging the debt (Kaplan & Strömberg, 2009).

2.3.2 Exit Strategies

As previously stated, PE firms rely on the return on their investments, which necessitates an exit strategy (Wennberg & DeTienne, 2013). Within the PE industry, there are four primary routes for exiting investments: initial public offerings (IPOs), financial sales, strategic sales, and buybacks. The key differentiator between an IPO and the other methods is that the former involves numerous, dispersed investors, whereas the latter three typically involve one or very few investors. Thus, these three categories are commonly grouped under a single heading of "acquisitions" (Chinchwadkar & Seth, 2018).

2.3.2.1 Types of Exits

To elaborate, an Initial Public Offering (hereafter IPO) is a process in which a privately held company becomes a publicly traded entity by offering its shares to institutional and retail investors for the first time. This allows the company to raise capital and expand its shareholder base beyond its initial founders, employees, and early investors (Ritter & Welch, 2002). The primary motivation for a company to go public through an IPO is to raise capital for various purposes such as financing expansion, paying off debt, or funding research and development. Furthermore, an IPO provides an opportunity for the company's founders and early investors to exit some of their ownership in the company and potentially make a profit. However, going public also entails additional regulatory and financial reporting requirements that can be costly and time-consuming. Public companies face greater scrutiny from investors and the media, and their stock price can be subject to greater volatility than that of a private company (Black & Gilson, 1998).

Financial sale, strategic sale, and buyback are categorized together as they all fall under the umbrella of acquisitions. A financial sale occurs when a PE firm sells its investment to another PE firm seeking to further develop the company. A strategic sale, on the other hand, involves a competitor in the same business seeking to expand its market share or obtain proprietary advantages. They may offer weaker valuations if they already possess industry connections and intellectual property, but may pay premium values for cumulative gain. These premium values reflect expected increases in revenues, savings from operation consolidation, or other synergistic benefits (Chinchwadkar & Seth, 2018). A buyback, also referred to as a share repurchase, involves a company purchasing its own shares from the market to reduce the number of outstanding shares. Typically, the company uses its profits or cash reserves to undertake this process (Kahle, 2002).

2.3.3 Factors Influencing The Choice of Exit Strategy

Brau et al. (2003) analyzed the decision-making process for selecting between an IPO and acquisition as the exit strategy. Their study focused on four categories of factors that impact the relative attractiveness of an IPO versus an acquisition: industry-related factors, market timing variables, deal-specific factors, and demand for funds factors. The study finds that several factors increase the likelihood of choosing an IPO, including industry concentration, affiliation with high-tech industries, low cost of debt, a favorable IPO market, larger firm size, and higher insider ownership. On the other hand, private companies in high market-to-book industries, financial service sectors and deals offering greater liquidity to selling insiders are more likely to be acquired. Additionally, the study suggests that takeovers are associated with a liquidity discount compared to IPOs (Brau et al., 2003).

Chinchwadka and Seth (2018) extends previous research with the aim to identify additional factors influencing the choice of exit route for PE firms. In addition to the existing categories of factors, they introduced a new category of "PE investor characteristics" and examined the impact of this category on the choice of exit method. Their findings suggest that PE investor characteristics play a crucial role in determining the exit method, where a large syndicate of PE investors in the same firm increases the likelihood of an IPO exit, while the presence of foreign PE investors decreases it. Furthermore, the study found that in buyout transactions, the probability of an IPO exit is lower than that of a strategic sale.

2.3.4 Exit Triggers

2.3.4.1 Holding Period

A holding period refers to the duration that a PE firm retains its investment before divesting it. During this phase, the PE firm engages in value creation by implementing strategic initiatives, such as operational enhancements, business expansion, or cost reductions

(Gompers et al., 2016). Joenväärä et al. (2022) report an increase in the average holding period, especially since the financial crisis of 2008. The study found that the average holding period after the crisis was 5.8 years, compared to 4.7 years before the crisis. The authors attribute this trend to a more challenging market environment and heightened competition within the PE industry. Additionally another study reveals that leveraged buyout transactions have distinct features that depend on the experience of the PE firm. Experienced PE firms tend to have shorter holding periods, are more inclined to pursue IPOs, and have lower rates of bankruptcy or financial restructuring (Strömberg, 2007).

2.3.4.2 Timing

According to Bayer (2007), timing refers to the act of carrying out an activity at the most opportune moment. In the context of PE, this involves obtaining the maximum amount of capital while simultaneously avoiding the inability to further develop investments. Brown et al. (2021) conducted an investigation into whether PE firms can strategically time their exit. The study revealed that the industry exhibits significant cyclical patterns, wherein periods of high fundraising are followed by low performance. Although PE firms are capable of timing their commitment to funds, they have little control over when investments are exited or commitments are called. Huang et al. (2021) further highlights that effective market timing may result in increased investment value, underscoring the importance of timing investment decisions for PE firms.

2.3.4.3 Returns

As previously stated, returns play a significant role in the business model of PE firms, thus it is imperative to gain a comprehensive understanding of the concept. Internal Rate of Return (hereafter IRR) is the preferred metric for calculating returns by the majority of PE firms (Cumming & Walz, 2010). IRR is a financial measure utilized to assess the potential profitability of an investment. It is the discount rate that equates the net present value of an investment's cash flows to zero, representing the rate at which the investment's cash inflows equal its outflows. A higher IRR signifies a more profitable investment, indicating that the investment is expected to generate higher returns relative to its cost of capital (Osborne, 2010). According to historical data, the average IRR of PE investments is 20%, with one out of ten investments not yielding any returns, and one out of four investments having an IRR exceeding 50% (Lopez-de-Silanes et al., 2015).

2.4 Theoretical Framework

2.4.1 The Theory of Planned Behavior

The Theory of Planned Behavior (hereafter TPB) (Ajzen, 1991), is a social psychology theory that explains how attitudes, subjective norms, and perceived behavioral control influence human behavior. These factors are assumed to operate through an individual's intention to engage in a specific behavior. It has its origins from previous work by Ajzen (1985 & 1987) and is a comprehensive extension of earlier ideas. The TPB is an extension of the theory of reasoned action (hereafter TRA) developed by Ajzen and Fishbein (1975). The TRA argued that human behavior is determined by an individual's attitudes towards the behavior and subjective norms, or social pressures to conform to the behavior. However, the TRA did not account for the influence of perceived behavioral control, or an individual's belief in their ability to perform the behavior. Ajzen (1991) added this third factor in the TPB, proposing that perceived behavioral control could have a direct effect on behavior, or could interact with attitudes and subjective norms to influence behavior.

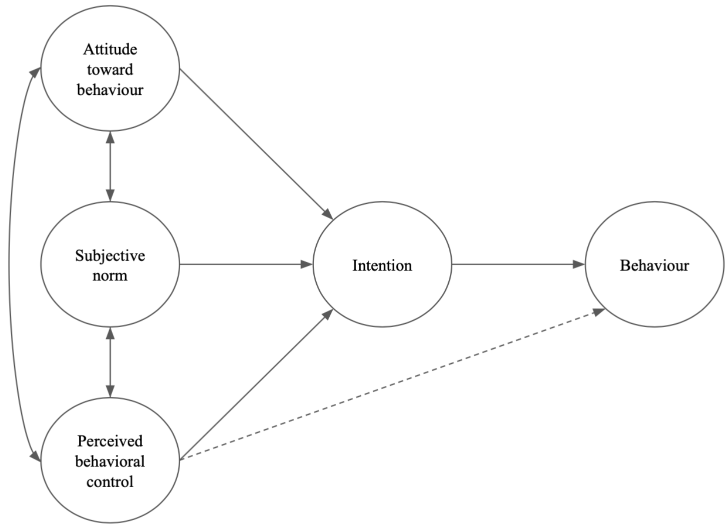
Attitude refers to the individual's evaluation of the behavior. It includes beliefs about the likely outcomes of the behavior and the value placed on these outcomes. Attitudes may be positive or negative, and they can vary in strength and importance. The affective component is the emotional response that a person has to the behavior, while the behavioral component refers to the person's beliefs about the behavior itself. The cognitive component is the person's beliefs about the outcomes of the behavior (Ajzen, 1991). For instance, an individual's positive attitude towards exercise, based on beliefs that it improves health, induces good feelings, and assists in weight management, can influence their intention to exercise regularly. Consequently, they are more likely to engage in exercise.

Subjective norm refers to the individual's perception of social pressure to engage or not engage in the behavior. It includes beliefs about what others think the individual should do and the motivation to comply with these beliefs. Social pressure can come from various sources, such as family, friends, or colleagues. Subjective norms are made up of two components, normative beliefs and motivation to comply. Normative beliefs refers to the person's beliefs about what others think they should do, while motivation to comply refers to the person's motivation to conform to the expectations of others (Ajzen, 1991). For instance, a person striving to eat less meat facing social pressure from meat-eating friends and family, potentially undermining their intention.

Perceived behavioral control refers to the individual's belief in their ability to perform the behavior. It includes beliefs about the presence or absence of factors that may facilitate or impede the behavior and the perceived ease or difficulty of performing the behavior. Perceived behavioral control is made up of two components: control beliefs and perceived power. Control beliefs refer to the person's beliefs about the factors that may facilitate or hinder their ability to perform the behavior. Perceived power refers to the person's confidence in their ability to overcome any barriers or obstacles to performing the behavior (Ajzen, 1991). For instance, an individual may want to start meditating to reduce stress and improve mental health but may feel that they lack the time or resources to practice regularly. These perceived barriers may weaken their intention to meditate, potentially preventing them from initiating or continuing the behavior.

As illustrated in the figure below, the TPB posits that attitudes, subjective norms, and perceived behavioral control are factors that collectively shape an individual's intentions and ultimately influence their behavior. Each factor is not independent of the others, but rather they interact with each other in complex ways. While each factor contributes to an individual's overall intention, which in turn influences their behavior, there is a particularly noteworthy arrow in the diagram from perceived behavioral control to actual behavior. This arrow suggests that perceived behavioral control can have a direct effect on behavior, as it reflects an individual's belief in their ability to perform a behavior (Ajzen, 1991).

Figure 1:Theory of Planned Behaviour



(Recreated from: Ajzen, 1991)

The most profound limitations are limits of its predictive validity, irrationality, affect and emotions (Ajzen, 2011). It is often criticized by its limits of predictive validity(Sheeran 2002; Armitage & Conner 2001). Irrationality is a frequent criticism and many have the impression that the model has become “too rational” (Ajzen, 2011). Affect and emotion is often an aspect that TPB is criticized to be missing, that the model again is too rational and is missing affect and emotion (Rapaport & Orbell 2000; Wolff et al., 2011).

2.4.2 Application of The Theory of Planned Behavior

The TPB is a commonly used theory when it comes to investor behavior and in understanding how investors take investment decisions, according to East (1993). Recent research conducted by Pilatin and Dilek (2023) explores the impact of the (TPB) on investor behavior in the context of crypto assets. Their findings highlight the significant influence of attitudes on both intention and behavior. In contrast, the effects of subjective norms and perceived behavioral control are comparatively less pronounced in shaping investor behavior (Pilatin & Dilek, 2023).

2.4.3 Our use of the Theory of Planned Behavior

Our research question centers around examining the factors that influence both the outcomes of the exit and the unfolding of the exit process. To gain a comprehensive understanding, it is crucial to delve into investor behavior, as it is ultimately individuals who make the decisions. Thus, employing the TPB is particularly relevant, as it provides a suitable framework for studying and analyzing investor decision-making processes. We believe that attitudes of the PE firms and portfolio companies towards the exit process could be influenced by their beliefs about the benefits and risks of exiting, as well as their perceptions of the exit market conditions. The subjective norms of the stakeholders could play a critical role in shaping the outcomes of the exit process. For instance, the norms and expectations of investors could influence the behavior of PE firms and portfolio companies in terms of their timing and approach to exit. The perceived behavioral control of the stakeholders could also be important. For example, the level of control that the PE firm has over the portfolio company's operations and decision-making could affect the timing and approach to exit, as well as the ultimate outcome of the exit.

Overall, the TPB provides a useful theoretical framework for examining the PE exit process and the factors that shape its outcomes. By understanding the attitudes, norms, and perceived control of the various stakeholders involved, we can gain insights into the decision-making processes and behaviors that ultimately determine the success or failure of the exit process.

3. Methodology

In this section, the methodology and execution of the empirical study are described. Initially, the selected research approach and its rationale are presented. Subsequently, a comprehensive account of the data collection and analysis methods is provided.

3.1 Choice of Method and Interviews

In order to achieve the aim of contributing with a qualitative perspective to the existing body of literature, the present study employs a qualitative approach. This approach is chosen in order to enrich the pluralism of research on the topic and to uncover aspects that may not be accessible through quantitative methods (Lee & Humphrey, 2006). To achieve this objective, a comparative approach has been adopted to collect and analyze data (Pickvance, 2001). Semi-structured interviews have been conducted to gather qualitative data. This method has been selected due to its potential to offer flexibility to the interview process and to avoid hastily closing off discussion, thus enabling interviewees to elaborate further on the topic (Alvesson & Deetz, 2000). However, it is important to acknowledge the limitations of semi-structured interviews, which can be time-consuming and make it challenging to compare responses from different interviewees (Alvesson & Deetz, 2000).

The objective in the beginning of the project was to conduct interviews with a range of distinct PE firms that maintain a presence in Stockholm. We conducted eight interviews with Partners and Directors of different PE firms to attain diverse perspectives (Kvale & Brinkmann, 2014). We aimed to conduct 30 interviews for a comprehensive analysis, due time restraints and practical reasons, we limited the number of interviews and focused on the Stockholm area (Vaivio, 2008). Lack of diversity in the larger firms is a major obstacle, with few female Partners (Mellqvist, 2023).

We sourced the interviews from the official websites of relevant PE firms and reached out to them via email, explaining our research idea and estimated time required for participation. Out of 20 firms contacted, eight agreed to participate, while twelve did not respond.

3.2 Data Collection

Table 1: Information about interviews

Firm	Title	Date	Length of interview	Place
Firm A	Partner	20/2 2023	59:21	Physical at office
Firm B	Partner	24/2 2023	1:13:39	Physical at office
Firm C	Director	8/3 2023	1:06:16	Physical at café
Firm D	Director	9/3 2023	1:07:12	Physical at café
Firm E	Partner	10/3 2023	1:15:39	Physical at office
Firm F	Partner	14/3 2023	56:57	Physical at office
Firm G	Partner	17/3 2023	1:22:21	Physical at office
Firm H	Partner	3/4 2023	1:01:45	Physical at office
Average duration: 1h 7 minutes				
Median duration: 1h 6 minutes				

We have conducted in total eight interviews with different PE firms, either with a Partner or Director, with a preference for conducting these interviews in person. Although we were open to conduct online interviews, in-person interviews are preferred given our aim to establish personal and deep connections with the interviewees. The rationale behind this preference for in-person interviews stems from the recommendation of prior research that physical interview contexts are conducive to personal and more profound discussions (Sturges & Hanrahan, 2004). Despite this, previous studies have demonstrated that respondents may perceive increased anonymity in telephone interviews (Greenfield et al., 2000). For this study, physical interviews are deemed more appropriate to enable interviewees to feel more comfortable discussing potentially sensitive topics. To address any concerns about anonymity perception, we have emphasized the interviewees' anonymity both during the initial contact and prior to the commencement of the interview. Both of us were present at all interviews, with one taking notes and the other conducting the interview. Additionally, we requested permission from the interviewee to record the interview to ensure that no crucial information is omitted.

At the outset of each interview, we reintroduced ourselves and articulated the aim of the project, in accordance with the recommendation by Kvale and Brinkmann (2014). We also reiterated the interviewees' anonymity. In addition, we seeked interviewees permission to record the audio to enable us to concentrate on the dialogue and the dynamics of the conversation, consistent with Kvale and Brinkmann's (2014) suggestion. Moreover, we inquired whether all interviewees grant consent to be quoted in the study and whether there is anything they do not wish to be mentioned or cited during the interview.

We developed a set of interview guidelines with the research question as the foundation. Initially, we asked questions that were more focused on the PE firms' operations and various aspects that they consider essential. As the interview progressed, we gradually shifted our focus towards the research question and asked more targeted questions, particularly concerning exit strategies. We applied a semi-structured interview approach, wherein the interview guide serves as a framework for the discussion, but additional follow-up questions were allowed to enable respondents to provide more detailed and thorough responses. In case a respondent brought up a fascinating topic during the interview, we explored it further by utilizing follow-up questions.

At the conclusion of each interview, we asked the respondent if there is anything they would like to add that has not been addressed during the interview. This provided the respondent with the opportunity to expand on topics that they believed were important, but were not covered in the interview (Kvale & Brinkmann, 2014).

3.3 Data Analysis

During the interviews, one of us was responsible for conducting the interview, actively listening, and asking follow-up questions, while the other took extensive notes. If time allowed, we reviewed the notes and added information from the audio recordings immediately after the interview. The transcripts included the respondent's spoken language expressions, for readability and ethical considerations, these were removed in the citations. This approach presents the respondent's statement in a more factual manner, which is considered ethically correct (Kvale & Brinkmann, 2014). Additionally, any specific personal or firm examples can be adjusted to protect the anonymity of the respondents. All interviewees were native Swedish speakers, and therefore all quotes used in the empirical findings are translated from Swedish to English. We put effort into translating the quotes as directly as possible, without distorting the meaning behind certain Swedish wording and expressions.

A thematic analysis has been employed to analyze the transcribed data in order to identify and group different themes related to the research focus (Bell et al., 2019). This method facilitates a comparison between answers that relate to the same theme, allowing for the identification of patterns, similarities, and differences in responses, which in turn facilitates the efficient presentation of qualitative data (Bell et al., 2019). The transcribed data have been carefully scrutinized to identify relevant quotes and experiences or statements of particular interest to the study. We have strived to maintain objectivity in the reproduction of the respondents' statements and experiences to provide a nuanced yet factual depiction. Moreover, to avoid "selective plausibility", where evidence is selected to fit the researcher's theory (Ryan et al., 2002), all empirical data presented have been selected prior to designing the theoretical framework.

Two test interviews were conducted to assess the viability of the questions as well as the research question. The purpose was to determine if the data gathered would be adequate. We obtained sufficient information to continue our research and gained valuable insights on which questions could lead to productive discussions and which were superficial. It is important to highlight that these interviews were not futile, as they contributed significantly to our research question by furnishing us with a plethora of relevant information.

Conclusively, we hold a shared perspective on all the interviewed firms. This consensus stems from the observation that these firms share a common modus operandi, despite differences in size. Consequently, we intend to analyze them uniformly, delving deeper when a firm stands out. This approach is not only aimed at avoiding redundancy but also at conducting a thorough and comprehensive analysis.

4. Empirical Findings

This section is devoted to presenting the empirical findings obtained from the conducted interviews, which explore how Private Equity firms handle the exit process and the key factors that drive their interest in it.

The following section has been partitioned due to various reasons, with one significant justification being to facilitate the reader's comprehension of the precise role played by the actual exit within the complete investment process. Additionally, the partitioning has been inspired by the literature review conducted by Decker and Mellewigt (2007), which is primarily concerned with three distinct categories, namely, actors promoting business exit, exit barriers, exit outcomes. In our thesis the corresponding sections are categorized as follows; before acquisition, during ownership, and exit outcomes. Although our structure differs somewhat from theirs, we acknowledge that their research and framework provide a valuable basis for our approach and serve as a source of inspiration.

4.1 Before Acquisition

During the interviews conducted with various companies, it was found that the majority of them expressed a clear intention to develop a detailed plan prior to the actual acquisition. This plan would outline their objectives and goals for the company during the period of their ownership. The plan created would encompass both financial and strategic objectives and goals for the company. Irrespective of the type of plan, growth was identified as a common denominator among all PE firms that we interviewed, whether through organic expansion, acquired growth or a combination of both. Firm A emphasized this sentiment:

"At the end of the day, what makes a PE investment successful is having a solid plan in place. We make sure to tailor our approach to each company's unique needs and goals, with a focus on driving growth - whether that means expanding organically, acquiring new businesses, or a little bit of both." (Firm A)

Firm C provided further detail on its approach, having a 5-year plan that is updated annually to account for external macro factors, emerging trends and firm-specific factors. Meanwhile, Firm E reported that it considers the potential exit path during the acquisition stage, which enhances the investment's appeal by uncovering hidden values through a broader perspective. Firm F underscored the importance of optimizing each strategic plan individually, emphasizing that a one-size-fits-all approach is not feasible for all investments. Finally, Firm B stressed the significance of developing an overall strategic plan at the onset of the journey, summed up by the following quote:

“What we know is that the outcome of the plan will never be what we initially thought, it can be either better or worse, but hopefully better of course.” (Firm B)

Firm D emphasized the importance of ensuring a strategic fit between the potential investment and the fund's structure, as it is crucial for the investment to align with the fund's objectives. They explained that in some instances, particularly towards the end of a fund's lifespan, they may have a predetermined investment type that will serve a specific purpose for the fund.

“We may opt for a more high-risk investment and establish an IPO target beforehand for various reasons, including the fund structure, which could be beneficial to other aspects such as carried interest.” (Firm D)

Firm A provided further insights into its investment strategy, which primarily involves purchasing companies from entrepreneurs and serving as the first financial buyer. The firm also clarified that it typically owns between 50% to 100% of the acquired company but always requires a mandate, which is one of the most crucial paragraphs in the shareholder agreement. The added paragraph provides the firm with the right to sell 100% of the shares, irrespective of the other owners' opinions.

“We want to be in the driver’s seat and be in control of the acquired company's destiny. The inclusion of the mandate in the shareholder agreement provides us with the necessary authority to make crucial decisions and ensure that we can steer the company in the right direction.” (Firm A)

Firm E shared similar views and added that they often have a predetermined exit strategy before making an investment, whether through an IPO or acquisition. For a newly acquired company that is in its early stages of development and considering an IPO as a potential exit strategy, it must have a valuation that exceeds two billion SEK. If its value falls below this threshold, it may not be financially viable for Firm E to pursue an IPO due to the high costs involved, and the company may be considered too small for public listing. Firm E further noted that it is already in the early stages, relatively easy to determine whether a potential investment will result in a strategic sale or not. For example, if the acquired company does not fit into the industry or is the largest company in the sector, no strategic buyer will be able to acquire them.

"Exiting an investment successfully requires strategic planning from day one, we are not afraid to walk away from an opportunity if we can not see a clear exit path already when making the decision to invest or not.” (Firm E)

4.2 During Ownership

According to the companies we interviewed, a prevalent and general approach to viewing an investment during ownership involves dividing it into two layers concerning the exit strategy. The first layer pertains to the specific investment or company, while the second layer pertains to the actual fund structure. Consequently, we will split this section into two parts for a comprehensive discussion.

4.2.1 The Portfolio Company

The majority of the companies we interviewed follow a five year investment horizon, which serves as a framework for the investment and provides guidelines. However, in reality, investments can perform better or worse during this period, leading to an earlier or later exit. According to Firm A, it can be generally stated that delivering on or exceeding the plan may result in achieving the goal sooner. If an investment is sold earlier, it is often because it has outperformed expectations. In summary, this can be encapsulated in the following quote:

"It is all about what we said we would do, how things have changed, and whether we are there operationally." (Firm A)

An exemplary case in point is a six year investment made by Firm A in the translation sector. During this period, they transformed the company from an interpretation agency to a translation agency and successfully established its leadership in the Nordics. Upon achieving their objectives and with the company performing exceptionally well, Firm A believed that they had accomplished all that they could and decided to divest. All criterias had been met, and they deemed it appropriate to sell the investment.

"One crucial factor is the successful completion of the five year plan, and that we feel that we have maximed the company's potential." (Firm A)

However, achieving this objective is easier said than done, as there are numerous challenges and variables that can impact the successful execution of the five year plan. Firm B asserts that timing is a straightforward matter.

"The right timing for an exit is when the company has achieved the objectives set out in its business plan and when there is substantial interest in the company, at a favorable valuation." (Firm B)

The IRR is often taken into account as a key factor, given that the PE model is designed to achieve a specific return. On the other hand, Firm D posits that IRR is not a primary concern for them. They believe that IRR is not something that should be explicitly focused on, but rather a result of the team's efforts. The IRR may be better or worse than a benchmark, but it does not dictate the exit strategy. Rather, it serves as an indicator of the team's performance. If the IRR is low before the exit, there are ways to improve it. Firm B reiterates the viewpoint of Firm D and summarizes it as such:

"It is complex, you can not just change some qualitative or quantitative requirements and then go for it, whoever says that is completely wrong." (Firm D)

The determination of the optimal timing for selling a company involves a multifaceted decision-making process, posing a challenge for investors. The interviewed companies encountered a similar predicament, contemplating whether to divest from a successful enterprise or prolong their ownership to potentially yield greater returns. Firm E discussed:

"Reaching the base case and how the outcome can always be increased. Given the unpredictable nature of the future, it is often more prudent to divest from a well-performing company within a time frame of six to eight years. Each investment requires significant attention and resources to ensure its success." (Firm E)

During our interview with Firm H, they emphasized the significance of managing the deal team's workload as a critical aspect of investment management. According to Firm H, this is essential to guarantee that the team can allocate sufficient time and effort to each investment, covering all stages ranging from initial due diligence to post-investment management and eventual exit.

"Right now we have to be net sellers in terms of the number of companies we hold, so that we can dedicate the necessary time and resources to each investment for it to be manageable for the deal team." (Firm H)

Firm F added that holding onto companies operating in illiquid markets poses risks. Meanwhile, Firm D referred to the strategic wave:

"The team considers a combination of capacity and risk. If there is more upside potential, they may continue to hold the investment for a few more years." (Firm D)

In addition to the aforementioned aspects, Firm G highlighted the importance of considering the opportunity cost of holding onto an investment that is not performing as planned. This is a factor that all the interviewed companies have emphasized as well. When an investment does not go as planned, it not only takes more time and resources, but also prevents the firm from pursuing other investment opportunities that may have higher potential for returns. Therefore, the decision to sell or hold onto an underperforming investment must take into account the potential opportunity cost. Firm B further noted that:

“There may be situations where it is more beneficial to invest more money and time into an underperforming investment rather than selling it, especially if the firm has a deep understanding of the industry and the potential for the investment to turn around. You cannot sell when things are going poorly, so you must turn it around. We have to fight for a graceful exit, even if it takes time.” (Firm B)

When an investment fails to meet expectations, maintaining exit discipline becomes crucial but also very challenging. Firm B and Firm H assert that it is relatively easy to maintain exit discipline and sell the company when it has met all the predetermined criteria. However, when the investment is not performing as expected, exit discipline becomes much harder to maintain. They further explained that exit discipline serves as a framework to ensure that emotions and other "soft" factors do not influence the decision-making process.

“The PE industry is primarily focused on generating profits, and if "soft" factors are valued in the exit decisions, then it is not a suitable place for investment.” (Firm H)

During the interviews, it was revealed that different perspectives exist on this matter. Firm E opined that it is not uncommon to become overly fixated on success and later realize that the company should have been sold earlier. Conversely, in situations where investments are not performing as expected, investors may become overly confident and develop a bias towards their investments. In light of these potential biases, Firm E recommended the following approach:

"To avoid making bad decisions because we are too confident or too fixated on success, it's a good idea to get an unbiased opinion. The IC can help with that by giving an objective and fair perspective. That way, we can make well-informed decisions without letting our biases get in the way." (Firm E)

When contemplating the sale of a company, there exist several hard and soft factors that require consideration. In addition to a ‘gut feeling’, there must be objective facts to support the decision. Firm B emphasizes the importance of having an “equity story”, which explains how to sell the company to the market and what the buyer can do with it. Firm F adds that the company should be well-positioned in a strong industry, supported by data and strong financial development. Both companies agree that it is important to consider all relevant factors before making a decision to sell.

“Ultimately, a highly sophisticated investor should think it is a good investment.” (Firm F)

Finally, In certain situations, it can be difficult to sell a company due to a strong attachment to the management team or specific key employees, which can impede the sale process. Firm E proposed an approach to mitigate this issue, which involves transferring key individuals.

"We often hire smart people from our portfolio companies to work for other projects, especially the CEO or CFO. It helps us know what we are getting from top management since we have worked with them before and witnessed their performance firsthand.” (Firm E)

Alternatively, Firm C recommends selling the company to another fund within the PE firm to retain it.

4.2.2 The Fund Structure

All the companies we interviewed emphasized the significance of the fund structure in making exit decisions. They explained that there are occasions when returning money to investors or demonstrating actual value, not just on paper, is necessary from a fund perspective. Such circumstances can trigger a desire to accelerate exit plans in specific cases. While individual returns and IRR are important factors, they are not the ultimate determining factors. The fund's overall performance takes precedence over individual cases. Firm B elucidated that they may be compelled to sell to avoid violating the fund structure.

“Generally, PE funds have a lifespan of 10-15 years, with investments made within the initial five years and realizations in the subsequent years. A company acquired early on can be held for up to ten years, while one acquired later may be held for five to seven years. The decision to initiate an exit is usually based on a significant strategic decision.” (Firm B)

When Firm B was asked about the importance of being able to realize your investments they said:

"Revenue speaks louder than promises - nail your exits, or kiss your future funding goodbye."

Firm D provided a more detailed explanation, stating that when a company demonstrates a blend of good and poor performance, the team may elect to retain it for a more extended period. The initial sale typically takes place within four to five years of the fund's inception, and the team usually adopts a sell-oriented approach for seven to eight years. Some companies are sold early to attain a 20% IRR, while others are retained for a longer duration in the pursuit of a 40% IRR. Investments that face challenges or difficulties are frequently held for a more extended period to optimize their value. To summarize, Firm B offered a concise statement:

"This is why PE people sometimes behave a bit oddly, because they have to sell sometimes. It is the "inherent" dynamics of PE." (Firm B)

Another aspect of the fund structure is to secure profits and mitigate the risk of the entire fund. Firm A explained that PE investment, in general, is about generating profits and achieving a targeted return. It is about maximizing returns while also reducing risk. If an investment is performing well, there may be a temptation to continue working on it for a further five years and double the returns, but there is also the risk that it may not go as planned. Therefore, from a fund perspective, it is often prudent to reduce that risk and take home the profits. Firm A further elucidated that:

"On an investor level, investors in the PE fund are professional and have invested in several different funds, often up to 100, to ensure a recurring cash flow from various funds. As a fund, it needs to send money back to run their business well, which may differ from maximizing the profit of a specific investment." (Firm A)

Firm F explained that they have adopted a new approach to the type of companies and how they should perform within the fund.

"We classify companies into three categories: some companies that should be secured to reduce risk, others that should ride the wave for longer and act as ROI builders, and some that should be somewhere in between." (Firm F)

Firm B provided insight into their investment approach, highlighting that they may occasionally deviate from the fund structure. This may occur in cases where investments do not proceed as planned or when external factors, such as the Covid-19 pandemic, negatively impact the investment. They clarify that the fund's investors do not consider market fluctuations, but instead, they have a predetermined number of years in their contract. While it may be possible to argue why an investment turned out a certain way, the fund structure has its rules. Firm D summarized how their investors often behave with the following quote:

"Rational investors may decide to extend the fund and wait for a better opportunity to exit." (Firm D)

Finally, it is advantageous for the subsequent fund to demonstrate the ability to realize profits from the investment. The PE firm's ability to generate satisfactory returns and distribute them on a regular basis creates strong incentives for the PE investors to reinvest in the next fund. Firm C has expressed that selling a company below its cost would be detrimental to the "metric" that investors utilize to evaluate PE funds. Firm D encapsulated this concept effectively with the following statement:

"If there are too many companies in the portfolio that are underperforming, it becomes difficult to raise another fund." (Firm D)

4.3 Execution

The actual execution of the exit is a complex and time-consuming process that requires a high level of preparation and organization. Firm G shared valuable insight into their approach towards executing an exit.

"Typically our process involves three months of preparation and three months of active marketing, with the help of investment banks and legal advisors, who assist with the vendor due diligence, financial and legal reports, and the gathering of documents for a data room, to prepare for commercial questions and market analysis." (Firm G)

In regards to the process of an IPO specifically, all interviewed companies raised the fact that the process is generally more complex requiring more preparation as the company must meet strict regulatory requirements. According to Firm D, the exit process for an IPO often involves preparing for a year in advance. However, due to market fluctuations and unforeseen circumstances, companies may need to revisit their plans and strategies for IPOs, as was the case in 2021 when several companies were unable to go public in 2022.

Based on the experiences of Firm D and Firm E, they tend to opt for strategic buyers when exiting if the company is not performing well and there is value for the strategy, or if the strategic buyer has better industry insights and is willing to pay a higher price for possible synergies. In a typical process for Firm D, one out of seven invited parties would be potential strategic buyers.

"In general, financial buyers are quicker in decision-making, have higher transaction security, are more debt-friendly, and have greater financial resources than strategic buyers." (Firm D)

Furthermore, Firm D also stated that portfolio company owners/CEOs generally prefer financial buyers, due to the fact that they often become division managers in the acquiring company, if it is a strategic buyer. It also implies a loss of control and influence over the direction of the business, as well as potentially limiting future growth opportunities. In contrast, financial buyers may offer the opportunity for the CEO to remain involved in the business and potentially invest in future rounds, allowing for continued control and ownership. When choosing the right buyer the companies that we interview all stressed the importance of the price in combination with the transaction security, Firm B stated that:

"The most important thing is valuation and transaction security. That always dictates and the goal is to get as much as possible while knowing the deal will go through." (Firm B)

Firm B continued by indicating that the primary goal for PE firms when selling a portfolio company is to prioritize returns for their investors and fund, which means that the highest bid and transaction security are the most significant factors. While creating relationships with other market actors, such as other PE companies, is important, it takes a back seat to financial considerations. Soft values can be an advantage but are not the deciding factor in the decision-making process. According to Firm D, similar to the perspective shared by Firm B, in cases where multiple bids are closely competitive, building a relationship with other market actors, such as other PE firms, becomes an important factor to consider.

"We always consider the long-term benefits of building relationships with other players in the market, especially in cases where bids are closely competitive. This can create opportunities for future collaborations and deals." (Firm D)

In addition, Firm F provided further insights on the significance of establishing a sense of confidence in the buyer during the exit process. This primarily entails verifying the credibility of the potential buyer and assessing the likelihood of a successful and complete transaction, where all agreed-upon terms are fulfilled.

"Given the limited number of slots available for allocation to interested parties, it is crucial to select actors who can effectively demonstrate their authentic interest in the deal." (Firm F)

According to several companies, the exit strategies in the PE market have expanded in recent years. Firm F explained that they previously have been relatively conservative in their exit strategies but are now embracing more trendy methods such as continuation vehicles, allowing investors to maintain exposure to successful investments and provide companies with continued access to capital and support from their existing investor base.

"Compared to others in the industry we have remained relatively conservative in our exit approach but I have always believed in the adage "Hold on to your winners" and continuation vehicle is one way to make it a bit more exciting." (Firm F)

Firm A, Firm C and Firm H have all observed a growing trend towards the use of continuation vehicles as an alternative exit method. Firm C described this strategy as selling a company from one fund to a separate entity, which is often a continuation fund created by the same PE firm. This approach allows the firm to retain exposure to the company, while also aligning its incentives with the management team. Firm H summarized it as:

"The PE firm can combine two to three companies in a separate fund, re-align interests with the companies, and focus on the team working with the company, rather than the fund's incentives. The exit is also a smaller process that does not require full due diligence, and leverage can be put on the fund level to get money out to investors." (Firm H)

Firm C highlighted the potential trade-offs associated with raising longer-duration funds, such as those with a 15-year lifespan as opposed to the traditional ten year structure. They cited an industry competitor who had sold off a portfolio company after only five years and achieved a decent return. However, when considering that same company a decade later, its value had increased by 500 times.

"On one hand, extending the fund life could have led to much better returns for that PE firm. But on the other hand, you have to consider the difficulty of communicating with investors

when raising longer and longer funds. It can come across as unprofessional and like you are just trying to milk more management fees out of them." (Firm C)

Firm A also highlighted the trend of minority selling to PE firms or LPs who desire direct exposure to a particular company. This approach is gaining popularity as it offers several benefits. Firm A explained that it allows companies to bring in minority investors, who typically hold a 25% stake, to secure the first investment and own the majority of the upside. Additionally, another party gets to share the upside and can help strategically, making it an ideal strategy for companies that are doing exceptionally well.

"I think this trend will gain even more traction in the future, as it offers companies an alternative path to exit while also retaining a degree of control over the business." (Firm A)

The trend of minority selling to PE firms or LPs is an interesting development as it offers companies a means to secure investment while also offering LPs distinct privileges.

5. Analysis

This section will analyze the empirical findings to answer the research question. It will follow our theoretical framework, comprising three parts. First, we will examine the attitude component, then the subjective norm component, and lastly, the perceived behavioral control component. Together, these components will shape the intentions and behaviors of investors.

5.1 Attitude

According to the TPB proposed by Ajzen (1991), *attitude* is a crucial determinant of an individual's behavior. Drummond's (2014) study provides a more in-depth analysis of this phenomenon. Our findings show that some of the firms interviewed may have fallen into one of Drummond's (2014) different factors when considering divestment. For instance, doubts and second thoughts may lead to a conservative evaluation of the investment, as the individual may perceive it as a risky decision that could potentially harm their financial situation. On the other hand, overconfidence may lead to an optimistic evaluation of continuing to hold onto the investment, as the individual may believe that they can weather any potential negative outcomes. Additionally, loss aversion can also play a role in the evaluation of divestment, as individuals may be more averse to losses than gains. This means that the potential losses associated with divestment may weigh more heavily on an individual's overall evaluation of the behavior than the potential gains. Overall, attitudes towards divestment can be influenced by a variety of factors, all of which can impact an individual's evaluation of the behavior and ultimately their decision to divest from a single investment.

Further research by Zahera and Bansal (2018) has been conducted, which incorporated various attitudes that can impact the decision-making process. Our empirical findings have revealed a proclivity among companies to retain entities that fail to perform in accordance with their initial expectations. An intriguing aspect arises when a company surpasses its expected performance. This is particularly interesting because it creates a situation where the decision to either divest or retain the investment becomes complex, deviating from the principles of both behavioral finance and the PE business model (Kaplan & Strömberg, 2009). According to the PE business model (Kaplan & Strömberg, 2009), investments should be sold once they reach a certain level. However, in some cases, investors may choose to retain the investment to further enhance profitability, as previously stated. Further it also shows that individuals do not have the same attitude to the same event. People will have different attitudes to the same things which then will lead to different behaviors.

PE firms' categorization of companies into different risk categories can impact their attitudes towards investment decisions and ultimately their behavior. When firms perceive a company as less risky and having a high potential for profit, they may categorize it as an ROI builder, leading to a more positive evaluation of the investment decision and a greater willingness to hold onto it. Conversely, if a company is deemed high-risk, firms may categorize it as one that should be secured to reduce risk and be more willing to exit the investment early. Massa and Simonov (2005) findings support this, as they suggest that prior gains and losses can influence firms' risk-taking behavior and affect their categorization of an investment as an ROI builder or high-risk.

5.2 Subjective Norms

Subjective norms, identified by Ajzen (1991), are a significant factor that influences an individual's behavior. Our interviews with various PE firms reveal that economic considerations hold the most significant influence on decision-making. This contradicts Sarwar and Afaf (2016), they claim that psychological factors have a more significant impact on decision-making behavior than economic factors. Societal norms play a crucial role in investment decisions as investors focus on economic success in financial sales of larger companies. Factors like investment size and the previous owners of the company reflect these societal norms. Our findings add a new dimension to Hellman's (1996) work by demonstrating the role of psychological factors in the divestment phase, in addition to financial information.

The interviews with PE firms yielded specific return, timing targets, and opportunity costs as significant factors in the divestment process, aligning with Brau et al's. (2003) study. However, Firm D takes a different approach by prioritizing a nuanced perspective instead of achieving set IRR targets. They prioritize achieving their goals, and if they have accomplished what they set out to do, the return will reflect that. This approach shifts the focus away from a single numerical value and towards a more comprehensive view. It can be assumed that other firms also follow this approach, but Firm D articulated it clearly, contradicting previous research on the subject (Cumming & Walz, 2010). Thus, illustrating that the exit strategy involves considering multiple metrics beyond just IRR and that and its effectiveness should be evaluated based on a range of factors that are not always clear-cut.

While the selection of an appropriate exit strategy involves several specific and numerical factors, it is imperative to acknowledge the influence of other pertinent elements. Chinchwadka and Seth (2018) assert that the "PE investor characteristics" represent a significant determinant in this regard. We concur with their viewpoint as our own findings substantiate the notion that the type and size of the PE firm have a bearing on their preferred choice of exit strategy. For instance, our interviews with smaller PE firms revealed a preference for strategic or financial sales over IPOs. This inclination stems from the prohibitively high costs associated with IPOs and the inadequate scale of the investee companies for stock exchange listings. Furthermore, it is worth noting that PE investor characteristics not only influence the selection of an appropriate exit strategy, we also suggest that it also plays a pivotal role in determining the optimal timing for such exits. Our investigation has revealed that certain PE firms exhibit a greater appetite for risk, while others adopt a more conservative approach. Consequently, these distinct characteristics significantly influence the duration of their investment, with some firms opting for longer holding periods and others seeking faster exits to secure their returns promptly.

The PE firms interviewed agreed that selling a company earlier than planned is often due to faster than expected achievement of set targets, while selling a company later than planned is often due to failure to meet these targets. This finding aligns with Decker and Mellewigt's (2007) view that success, rather than just failure, has become a significant factor in divestment decisions. Our study confirms this as the general trend among the firms interviewed, although some expressed a preference for retaining investments to maximize returns. These variations among interviewees demonstrate that some are willing to undertake additional risks to achieve higher profits, while others prioritize realizing profits. Our findings also highlight that interviewees possess an understanding of the potential risks and challenges involved in divestment decisions, as shown in Harrigan's (1982) study. However, our findings reveal that they engage in a thorough process of weighing the benefits and drawbacks against each other while considering opportunity costs. This process underscores the complexity of making informed decisions despite awareness of potential risks, as numerous important factors must be taken into account.

Chaudhary (2013) argues that, in accordance with the principles of behavioral finance, individuals should strive to make rational decisions aimed at maximizing their profits. This approach aligns with the PE model (Kaplan & Strömberg, 2009), which prioritizes financial gain above all else. However, our consultations with these firms have illuminated certain circumstances wherein such rational determinations are not invariably rendered, as some firms hold onto investments for longer than they should, believing they can generate even greater profits. This approach can result in either favorable or unfavorable outcomes.

According to Chaudhary (2013), individuals may not always make rational decisions due to multiple reasons. During our interviews with firms, we noticed two factors that impacted decision-making: anchoring and overconfidence. These firms were emotionally attached to their invested companies, leading to bias and anchoring. Additionally, each individual had a financial interest in the investments, through carried interest, potentially subconsciously influencing their decisions to hold onto investments for longer periods, despite the possibility of greater profits elsewhere.

Thus, the behavior of individuals within PE firms may not always align with the societal norms component of the TPB. Specifically, while societal norms may encourage individuals to prioritize financial gain and loyalty, the findings suggest that other factors, such as personal financial incentives and emotional attachment to investments, may sometimes take precedence over rational decision-making. In this sense, the behavior of individuals within PE firms may contradict the societal norms component of the TPB, highlighting the complex interplay between individual decision-making and broader societal norms and expectations.

Firm C's statement suggests that PE firms are influenced by the norms and expectations of their investors. In this case, the metric used to evaluate PE funds serves as a subjective norm that impacts their behavior. The norm is based on the expectation that PE firms should sell companies above their cost to generate satisfactory returns. While financial considerations are prioritized over soft values, such as relationships with market actors and building such relationships can become crucial when competing bids are closely matched. Nagy and Obenberger (1994) prioritize wealth-maximization criteria for investors, while Sarwar and Afaf (2016) suggest that psychological factors have a greater impact on decision-making behavior.

To maximize returns for investors, soft values like trust, relationship building, and credibility can be crucial. Due diligence and verification of the authenticity of potential buyers through researching their track record, financial stability, and past transactions can play a vital role in the final outcome of the exit process. Investors in the PE industry are typically sophisticated professionals who have invested in multiple funds, making their influence on PE firms strong. However, deviations from subjective norms can occur when external factors negatively impact the investment, as mentioned by Firm B. Thus, the behavior of PE firms may not always be influenced by subjective norms.

Portfolio company owners and CEOs often prefer financial buyers over strategic buyers, as they prioritize maintaining control and influence over the direction of the business. This underscores the need to consider the attitudes and convictions of stakeholders during the exit process, as their preferences may impact the behavior of PE firms when choosing a buyer. However, it is important to note that these preferences may not always align with the objectives of PE firms, which prioritize maximizing returns for their investors and fund. This indicates a potential contradiction with the TPB, as external stakeholders may not always align with the goals and behaviors of decision-makers.

Additionally, the preference for financial buyers among portfolio company owners/CEOs may be influenced by external factors, such as cultural and societal norms, as well as past experiences and biases. This highlights the complexity of decision-making processes and the potential influence of various factors beyond those captured by the TPB.

5.3 Perceived Behavioural Control

The third factor influencing the behavior is *perceived behavioral control* according to Ajzen (1991). Our empirical findings demonstrate that all PE firms have a clear plan to achieve future objectives for the company, with a focus on diverse ways to promote growth. This is a natural characteristic of the PE business model (Kaplan & Strömberg, 2009). Which is supported by Lee's (2014) report, asserting that companies investing in growth firms are capable of offering a premium and concentrate on metrics. Our findings suggest that certain PE firms can identify hidden values in investments by considering the prospective exit path during the acquisition phase. Moreover, different PE firms develop a clear strategic plan before the actual investment and ensure strategic alignment between the potential investment and the fund's framework. This is consistent with Kaplan and Weisbach (1992) recommendation for making a successful investment, and it may be one reason why the PE industry has experienced tremendous growth in recent decades (Kaplan & Strömberg, 2009).

By developing a clear strategic plan and ensuring strategic alignment between potential investments and the fund's framework, PE firms can enhance their level of control over the investment process and increase the likelihood of achieving their growth objectives. This has implications for other industries and organizations, as it highlights the importance of having a clear plan and proactively managing investments to achieve success.

According to the majority of the interviewed firms, the key to successful divestment lies in having a clear exit discipline process. This allows for rational decision-making even when other factors may be at play. This is also supported by Drummond (2014), who explains that educating management about the different issues can help mitigate the aforementioned factors. In the context of PE, the IC and the exit discipline guidelines are the two primary factors that can prevent these factors from impacting divestment decisions. However, it is essential to note that while it is easier said than done, having a clear process in place can help make rational decisions and avoid the potential pitfalls associated with divestment.

Moreover, this emphasizes the crucial importance of perceived behavioral control in decision-making. Individuals' beliefs about their control over a behavior can influence their intentions and subsequent behavior. In the context of divestment decisions, this means that having a clear process in place can increase individuals' perceived control over the decision-making process, making it more likely that they will engage in rational decision-making. Having a well-defined process in place can enhance the sense of control and increase individuals' perceived control over the decision-making process. This can be especially important in high-pressure situations, such as divestment decisions, where emotional attachment and external pressures may impact rational decision-making. By implementing clear guidelines and educating management, individuals can feel more in control of the decision-making process and make more rational decisions.

From the interviews all firms perceived their ability to initiate an exit as being influenced by the fund structure. For example, if the fund has a set lifespan of 10-15 years, the PE firm may feel compelled to sell an investment to avoid violating the fund structure, even if individual returns are not optimal. This implies that the perceived behavioral control of the PE firms in initiating an exit may be influenced by factors outside of their control, such as the fund structure. This finding is in line with earlier studies by Strömberg and Kaplan (2009), as well as Kovenock and Phillips (1997), which emphasize the primacy of the fund over individual cases. The coherence in the exit strategies of the PE firms is evident, as the structure and performance of the fund are generally the primary determinants of the exit decision.

External market conditions play a crucial role in the decision-making process of PE firms when initiating an exit strategy. Schmidt et al. (2010) stress the importance of considering external factors that influence the choice of exit strategy, and our findings confirm their significance. Flexibility and adaptability are crucial for PE firms when considering the exit process, as market conditions may impact their ability to exit. Black and Gilson's (1998) literature stresses the importance of extensive preparation, organization, and regulatory compliance for successful IPOs. If market conditions are unfavorable, a PE firm may need to consider alternative exit strategies such as selling to a strategic buyer or another PE firm. Firm E identified the dual-track approach as a promising trend within exit flexibility, providing greater control over the timing and method of exit. This approach maximizes valuation while mitigating the risk of market fluctuations or the loss of a potential buyer, making it an attractive exit strategy for PE firms.

Furthermore, Firm F’s approach to categorizing companies into three different categories illustrate how they actively take steps to manage their perceived level of control over their investment decisions. By categorizing companies, they are effectively creating a framework to guide their investment decisions, which gives them a sense of control over the outcome of the investment.

From our interviews it became evident that the PE firms attempt to reduce the complexity and uncertainty associated with the exit process, and increase their perceived control over the exit process. Firm G illuminated this when explaining their exit process. By engaging investment banks, legal- and technical advisors etc, they suggest that they believe that the resources and expertise provided by the investment banks and legal advisors will increase their ability to execute the exit successfully. This is consistent with the TPB, which suggests that individuals are more likely to engage in a behavior if they believe that they have the necessary skills, resources, and support to do so.

Using TPB, it can be argued that the perceived behavioral control of PE firms in the exit process may be limited, as they rely heavily on the guidance and expertise of others. This raises questions about the true extent of their control and the influence of investment banks and legal advisors on their decisions. It is noteworthy that significant fees are often paid to these parties for their services. Therefore, the focus of PE firms may be on fulfilling contractual obligations rather than making the best possible decision for their business. These dynamics also raise ethical concerns regarding the role of investment banks and legal advisors in the exit process and potential conflicts of interest that may arise.

5.4 Summary

In summary, the TPB proposed by Ajzen (1991) has shed light on the crucial role of attitude in determining an individual's behavior, in the context of divestment. Our findings suggest that some firms interviewed have been influenced by the factors explored by Drummond's (2014), when considering divestment. Doubts and second thoughts may lead to a conservative evaluation of divestment whilst overconfidence may lead to an optimistic evaluation of the investment. Additionally loss aversion plays a significant role in the evaluation of divestment. Although the disposition effect observed by Zahera and Bansal (2018) remains evident in investments that have experienced a decline in value, there is a tendency to deviate from the theory when investments perform above expectation.

The firms interviewed indicated that divesting a company earlier than planned is typically due to the company achieving set targets faster than expected, while divesting later than planned is often due to the failure to meet these targets. This aligns with the findings of Decker and Mellewigt (2007), who note that success has become an increasingly significant factor in divestment decisions in recent times. However, some PE firms preferred to retain investments despite the perceived risk, indicating a deviation from societal norms in decision-making. Personal financial incentives and emotional attachment may influence behavior more than rational decision-making, leading to overconfidence and anchoring biases.

PE firms prioritize wealth-maximization criteria, as found by Nagy and Obenberger (1994), but decision-making is also influenced by external factors. Our analysis suggests that contextual factors, such as societal and cultural norms, past experiences, and biases, can impact decision-making. For instance, portfolio company owners/CEOs may prefer financial buyers due to concerns about losing control over the business. Understanding the needs and desires of stakeholders is crucial in decision-making processes and these may not always align with the goals and objectives of PE firms.

Having a clear strategic plan and exit discipline process is crucial for successful divestment in PE. Certain firms can identify hidden values by considering the prospective exit path during acquisition. Ajzen (1991) suggests that having a well-defined process can enhance individuals' sense of control and increase their perceived control over the decision-making process, which can be important in high-pressure situations.

Additionally, our analysis highlights the importance of flexibility and adaptability in the approach to the exit process, considering alternative strategies to mitigate risks. They must also proactively manage their perceived level of control over investment decisions which is in line with the literature by Black and Gilson (1998). Investment banks and legal advisors play a significant role in the exit process, but PE firms must be mindful of potential conflicts of interest and make decisions based on what's best for their business. Preparation, organization, and regulatory compliance are also crucial for successful exits.

6. Conclusion

This section will commence with a conclusion and discussion of the main findings of the thesis. Followed by potential directions for future research.

6.1 Unfolding of The Exit Process

Firstly, PE firms mainly have a shared attitude towards the exit process itself. They view the exit process as a necessary step in their investment strategy and as a means of achieving their desired returns for their investors. This shared attitude stems from the overarching goal of PE firms, which is to maximize returns for their investors. Additionally, PE firms may share attitudes towards certain factors that impact the exit process, such as market conditions, industry trends, and the performance of the investment. However, PE firms' attitudes towards divestment can vary based on their past gains and losses, investment strategies, risk tolerance, and risk perceptions, which can lead to differences in how they categorize companies according to their perceived risk level, and thus, influence their attitudes towards divestment.

Secondly, the subjective norms of the PE firm may influence how they approach the exit process. The subjective norm in the industry is that exiting portfolio companies is a standard practice that is expected of all PE firms. This norm is reinforced by industry benchmarks, peer pressure, and investor expectations. Therefore, the process of exiting portfolio companies tends to follow a similar pattern across firms. However there are differences in the approach such as whether they prioritize maximizing financial returns or also consider non-financial factors. The investment size and previous owners of a company can influence the behavior of investors in PE firms, as they may adhere to societal norms that dictate investment decisions in different contexts. Additionally, individual decision-making within PE firms may not always align with these norms, resulting in longer holding periods for investments. The metrics used to evaluate PE funds can also act as a subjective norm that influences the behavior of PE firms during the exit process, as they strive to sell companies above their cost to generate satisfactory returns for their investors.

Thirdly, there are several similarities among PE firms when it comes to reducing the complexity and uncertainty of the exit process and enhancing their perceived control over it. One of the ways they achieve this is by formulating a clear strategic plan before investing to ensure that the potential investment aligns with the fund's framework. However, certain factors that are beyond their control, such as the fund structure and external market conditions, can affect the perceived behavioral control of PE firms when it comes to initiating an exit.

6.2 Factors Shaping The Outcome of The Exit

Firstly, the fund structure can be seen as a form of perceived behavioral control that has a critical role in shaping the behavior of PE firms, as it establishes the parameters within which the firm operates and influences its investment decisions, risk appetite, and exit strategies. Furthermore, it influences the attitude of the PE firm towards risk-taking and value creation and shapes the firm's ability to invest in and exit portfolio companies in a manner that aligns with its investment objectives. The fund structure sets investment and exit criteria, including a target ROI for the entire fund. The firm's risk appetite and value creation approach are shaped by these criteria. Investment decisions and exit strategies for each portfolio company are guided by the fund's objectives and norms, which influence the investment team's decisions. Some PE firms may sell a company to avoid violating the fund structure and generate returns for investors, given the fund's typical lifespan of 10-15 years. This ability to realize profits is advantageous for future funds and incentivizes reinvestment.

Secondly, the performance of a portfolio company remains a key determinant of an investor's attitude towards a potential exit, as it can influence their beliefs about the likely outcomes of that action. The better the performance of the company, the higher the potential valuation and the more attractive it becomes to potential buyers or investors.

Thirdly, the market conditions play an essential role in shaping the outcome of the exit. In unfavorable market conditions, PE firms may perceive their ability to initiate an exit as being limited. This can lead to a shift in their investment strategy and a greater focus on value creation, rather than a timely exit. The use of continuation vehicles identified as an alternative method and one of the upcoming trends within exit flexibility, provide PE firms with greater control over the timing and method of exit, mitigating the risk of market fluctuations or the loss of a potential buyer. In the end, whilst the TPB emphasizes the importance of individual agency and motivation in achieving desired outcomes, it is important to recognize that luck and external factors beyond their control can interact with these individual factors to shape the final outcome.

6.3 Future Research

Two significant areas requiring further investigation in the field have been identified. Firstly, it is believed that the divestment aspect of an investment deserves more attention in the context of behavioral finance, given the extensive research conducted on the investment side. In future research, it is recommended to extend the scope beyond PE and explore other industries, such as venture capital, business angels, or investment companies. This approach would offer a broader perspective on the subject matter, potentially uncovering new insights and enhancing the existing body of knowledge. Secondly, the PE industry and its business model have evolved significantly from its origins, as observed during our research. Therefore, it would be valuable to comprehend the underlying reasons for this transformation and its resulting implications.

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8. Appendix

8.1 The Interview Guide

Introduction questions:

- What is your title and for how long have you been working within the industry and this firm?
- What are your main job tasks?
- What is most fun with your job?
- Can you tell more about your firm? Size, strategy etc

In-depth questions:

- What different exit strategies do you usually use?
- What factors do you consider when choosing an exit strategy for a portfolio company?
- How do you determine the right timing to sell a portfolio company?
- What role do stakeholders (such as investors, management, employees) play in the exit process?
- Do you think it depends on different stakeholders on how and why to sell a company?
- Do personal preferences influence more than what the numbers say?
- How does the process work when selling a company? From the moment you think of selling to actually disposing of the company.
- When you sell a company to another company, is it often to another private equity actor or is it a different type of company?
- When choosing to sell to another company, what do you consider? The one who pays the most or the one you think is best suited?
- Can you go through a recently successful exit that you have been involved in?
- Were there any underlying aspects that made you choose this exit strategy?
- Were there any underlying aspects that made you choose to sell this portfolio company?
- Can you go through a recently less successful exit that you have been involved in?
- How do you handle any challenges or obstacles that may arise during the exit process? And what is a typical problem that can arise?

Concluding questions:

- How do you stay updated on the latest trends and developments in private equity exits?
- What advice would you give to other private equity firms looking to improve their exit strategies?
- Is there anything else you would like to add?