STOCKHOLM SCHOOL OF ECONOMICS

Master Thesis in Finance

Who's in Control?

– A Comparative Case Study on Private Equity and Shareholder Activism–

David Blomberg[α] David Olerup[Ω]

Abstract

This thesis aims to evaluate the role of the Board of Directors as a governance tool in companies invested into by either a Private Equity or Shareholder Activist investor. In order to do this, we perform a comparative case study on Private Equity investor Segulah's engagement in marine technology company Callenberg and Shareholder Activist investor Cevian Capital's engagement in fashion retailer Lindex. Our main finding is that the Board serves an important role for the investor to overcome agency problems and the costs associated with them. These problems include managers not exerting enough effort (*the effort problem*), misusing company resources to build inefficiently large companies (*empire building* or *the asset use problem*) and Board members having a time horizon that differs from investors (*the horizon problem*). The most important factor brought by both investors is that they increase the flow of information and thereby reduce the information asymmetries that are the source of agency costs.

Keywords: Private Equity, Shareholder Activism, Board of Directors, Agency Costs, Corporate Governance

Tutor: Stefano Rossi, Assistant Professor
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[α] 20715@student.hhs.se
[Ω] 20509@student.hhs.se

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1. INTRODUCTION

For many years, Private Equity has been an important part of the capital markets. Institutional, alongside private investors, anticipate large returns on their committed capital. Also the companies targeted by Private Equity investors rely on them to provide capital as well as focus and strategy. What Private Equity investors bring to these targeted companies that creates the rapid increase in value often experienced is not wholly understood. Most of the existing literature regarding Private Equity concerns Venture Capital rather than investments in mature businesses.[1] However, the majority of the Private Equity market is made up of investments in established companies.[2]

While Private Equity has attracted much interest and capital for a longer period of time, Shareholder Activism is a phenomenon of the 21st century. By pursuing a specific agenda, Shareholder Activists aim to create value in Publicly Listed Companies (PLCs) and ultimately increase the share price. In contrast to Private Equity investors, Shareholder Activists hold a minority stake in the businesses into which they invest. They provide operational focus and help poorly performing companies to improve.[3] However, critique has been put forth, accusing Shareholder Activists of being corporate raiders with the sole goal of increasing the targeted company's cash flow to shareholders.[4]

We have gained unrestricted access to data regarding two investments, one made by Private Equity investor Segulah and one made by Activist investor Cevian Capital (Cevian). The former investment was in the privately owned marine technology company Callenberg while the latter was in the publicly listed fashion retailer Lindex.

Private Equity investors and Shareholder Activists use a number of different governance tools to control and influence the firms into which they invest. One of the tools used is the Board of Directors (the Board).[5] The Board serves an important role insofar that the members contribute with a network and work to align manager's interests with shareholders'.[6] The main difference in Private Equity investors' and Shareholder Activists' ability to use the Board as a governance tool is that Private Equity investors often have complete ownership, as opposed to Shareholder Activists, allowing them to shape the Board according to their agenda.[7] Other differences include that Boards controlled by Private Equity investors are more likely than their PLC counterparts to

[1] Bierman (2003).
[2] Lerner et al. (2009), pp. 1-13.
[3] Becht et al. (2008).
[4] Tornwall, *Cevians intåg väcker blandade känslor*, Dagens Industri, 2006-10-10.
[5] Byrd et al. (1998).
[6] Nisar (2005).
[7] Acharya et al. (2009).

be leading in the formulation of strategy as well as having a clearer focus on performance management.[8]

We believe that the Board is the most important governance tool used in both cases. Thereby:

The purpose of this thesis is to evaluate what role the Board served as a governance tool for the investors in the two cases studied.

We have chosen to use the below definition of corporate governance in the context of our thesis since it clearly explains the role of the Board.

"The owners (shareholders) elect directors as their representatives to manage the affairs of the business. The directors, who as a group are referred to as the Board of directors, then delegate responsibility for actual operations to the Chief Executive Officer (CEO), whom they hire. The CEO is accountable to the shareholders. In addition to its role in selecting the CEO, the Board also advises on and consents to the selection of businesses and strategies of the firm as well as oversees results. In sum, this system of authoritative direction, or government, is known as *corporate governance.*"[9]

We fulfill our purpose by highlighting Segulah and Cevian's work with the Board as a governance tool as well as connecting it to agency theories. By doing so, we find that the Board serves several important purposes, such as providing market knowledge, strategic focus and management control. The shared value creation between Activists and other shareholders forces Activists to be more decisive than their Private Equity counterparts. Common among the two is the importance of increased information flows in order to minimize the information asymmetries that are the source of agency costs.

1.2 Overview of studied companies

In this section we provide the reader with an overview of the companies examined in the study.

1.2.1 Segulah[10]

Segulah is a Swedish Private Equity firm with a mid-cap focus. They invest in profitable, stable companies with a seasoned executive team. Their business model consists of bringing three elements to the investments:

1. *Focus* on core operations.
2. *Competence* among the Board members.

[8] Acharya et al. (2009).
[9] Colley et al. (2004), p.3.
[10] www.segulah.se, 2009-03-20.

3. *Capital* to finance organic and acquired growth.

As of 2009, Segulah have closed their fourth fund for investments. The capital committed amounts to SEK 5.2 billion. The acquisition of Callenberg that we are evaluating was, however, done through fund Segulah II, a fund that attracted SEK 850 million. Segulah relies heavily on their network of industry and finance professionals. The Boards of the acquired companies are often comprised of people from this network.

1.2.2 CALLENBERG

Callenberg is one of the leading Scandinavian suppliers within the fields of marine electrical engineering, automation and HVAC (Heating, Ventilation and Air-Condition). Their business is, however, geographically diversified across three continents including Europe, North America and Asia.[11]

The company was founded in 1951 in Uddevalla, Sweden. Its major customer at the time was the local shipyard. During the expansive years for the Swedish shipping industry in the late 1960s and early 1970s, Callenberg strengthened its position domestically. However, with the death of the Swedish shipping industry, Callenberg had to broaden their market. The eye fell upon Miami where the cruise industry had started to attract new customers and thus begun to grow. Callenberg set up a business there that has come to be one of the most important parts of the group. In relation to a contract in Indonesia, Callenberg set up a branch in Singapore in the late 1990s. The expansion eastward was initially crippled by force majeure events such as 9/11 and the outbreak of SARS.[12, 13]

At the point of Segulah's entry in 2001, Lars Marcusson was CEO of the company and Thomas Forsström was CFO. They were both represented on the Board and stayed in the company during the entire holding period. Lars Marcusson started as an engineer at the company and has worked his way to the top. He has been complimented by Segulah for knowing every aspect of the business and for never taking unnecessary risks. Thomas Forsström had a passive role in the company in 2001. This changed during Segulah's holding period; he came to be faced with more complex tasks and greater responsibilities. A common feature among the two is that they have both been described as frugal, careful and risk-averse.[14]

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[11] Investment paper stage III, 2001-05-02.
[12] Ibid.
[13] Marcusson, Interview, 2009-03-31.
[14] Ehrnrooth, Interview, 2009-03-20.

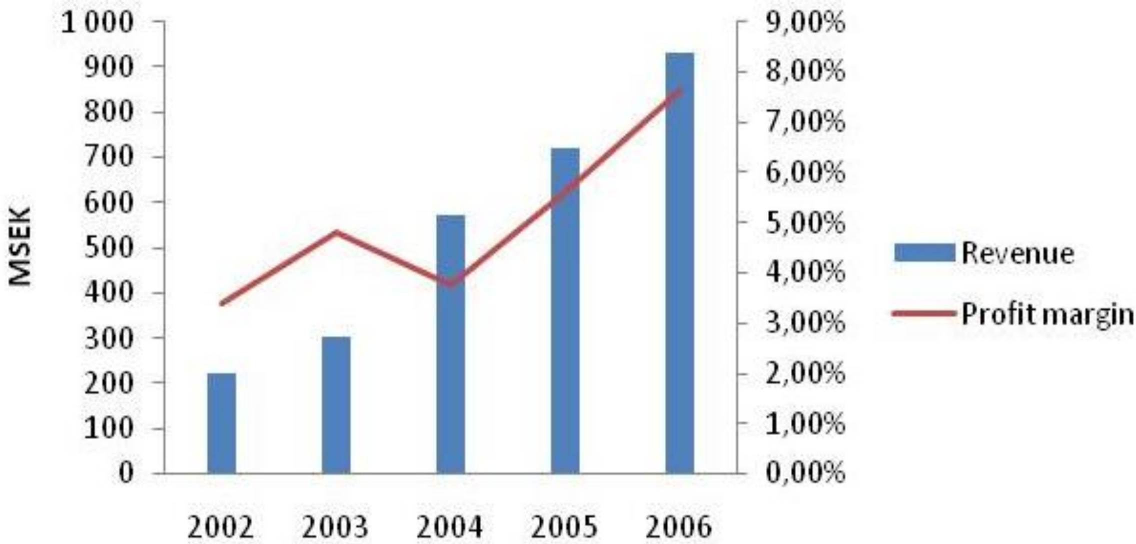
Callenberg was wholly owned by the publicly listed company Expanda in 2001. Expanda's business centered on furniture and design and their commitment and strategic contribution to Callenberg was virtually non-existent according to CEO Lars Marcusson.[15]

In May of 2001, Segulah acquired 80 percent of the shares in Callenberg from Expanda for a total consideration of SEK 95 million. The remaining 20 percent were acquired almost a year later in April of 2002.[16]

During Segulah's time as owner, three acquisitions were made by Callenberg. In 2003, Semco Marine A/S and ABB HVAC Oslo were acquired. These deals strengthened Callenberg's Nordic position in the service, repair and marine offshore market. The addition of ABB HVAC Gothenburg in 2005 provided Callenberg with an increased capability to take on larger projects, especially in the HVAC sector.[17]

Turnover in 2000 was SEK 232 million for Callenberg. When Segulah left the company late in the year 2007, turnover had risen to over a billion.[18, 19] Please see Figure 1 for information on Callenberg's revenue growth and increased margins during Segulah's holding period.

Figure 1 Callenberg Revenue and profit margin



[15] Marcusson, Interview, 2009-03-31.
[16] Investment paper stage III, 2001-05-02.
[17] Investment paper HVAC Oslo, 2002-11-10.
[18] Investment paper stage III, 2001-05-02.
[19] Ehrnrooth, Interview, 2009-03-20.

1.2.3 Cevian Capital

Activist investor Cevian, originally named Amaranth Capital, was established in 2002. Cevian was founded by Christer Gardell and Lars Förberg who had prior experience from performing Activist investments through AB Custos. As of spring 2009, Cevian has raised capital for two funds, Cevian I and Cevian II and manage assets of a total value of about SEK 35 billion.[20]

Cevian's first fund, Cevian I, invested in Swedish, Norwegian and Finnish exchange listed companies. Apart from Lindex, the fund also held a substantial amount of shares in Intrum Justitia, Skandia, Metso and Visma. A total value of SEK 4.5 billion was realized by the fund and an average internal rate of return (IRR) of 90 percent was accomplished.[21]

Today, Cevian is Europe's largest Activist investor[22] and although investments are performed in open markets, management describes Cevian's methods to be very similar to those of Private Equity investors' insofar that they work actively with operational improvements and have the ambition to be represented on the Board, preferably through the Chairman.[23]

1.2.4 Lindex

Lindex is a Swedish fashion retailer with roots in the Gothenburg area. The company's core customer group is middle-aged women in mid-sized towns. Today, Lindex is wholly owned by the listed Finnish retail corporation Stockmann.[24]

In 2003, Lindex was a listed company on the Stockholm Stock Exchange and had operations in Sweden, Norway, Finland and Germany. Running approximately 350 stores, Lindex was one of the leading fashion chains in the Nordic region but had accumulated significant losses in their German operations.[25] The Lindex group had a strong position in lingerie and women's wear and had acquired Twilfit in 2002, a small retail chain focused solely on lingerie. At the time of Cevian's entry, Jörgen Johansson was CEO of Lindex. He came from food retailer Saba Trading AB during the summer of 2001[26] and had a successful start of his career at Lindex according to Swedish newspapers.[27] It was Jörgen Johansson who initiated the acquisition of Twilfit.

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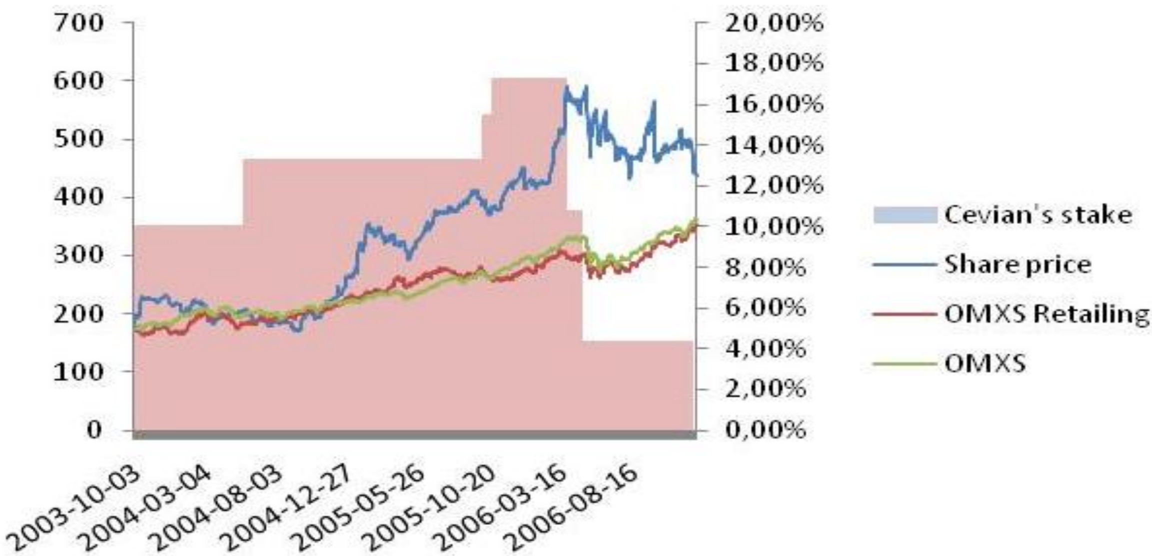
[20] http://www.ceviancapital.com/history.php, 2009-03-27.
[21] Cevian Capital information package for investors, January 2009.
[22] Ibid.
[23] Alexanderson, Interview, 2009-03-26.
[24] http://www.stockmann.fi, 2009-05-13.
[25] Lindex Case Study, Appendix, Cevian Capital.
[26] Press release, Jörgen Johansson ny vd i Lindex, 2001-03-09.
[27] Andersson*, Lindex kelgris efter lyckad sparnit*, Dagens Industri, 2002-07-27.

Figure 2 Lindex share performance and Cevian's ownership

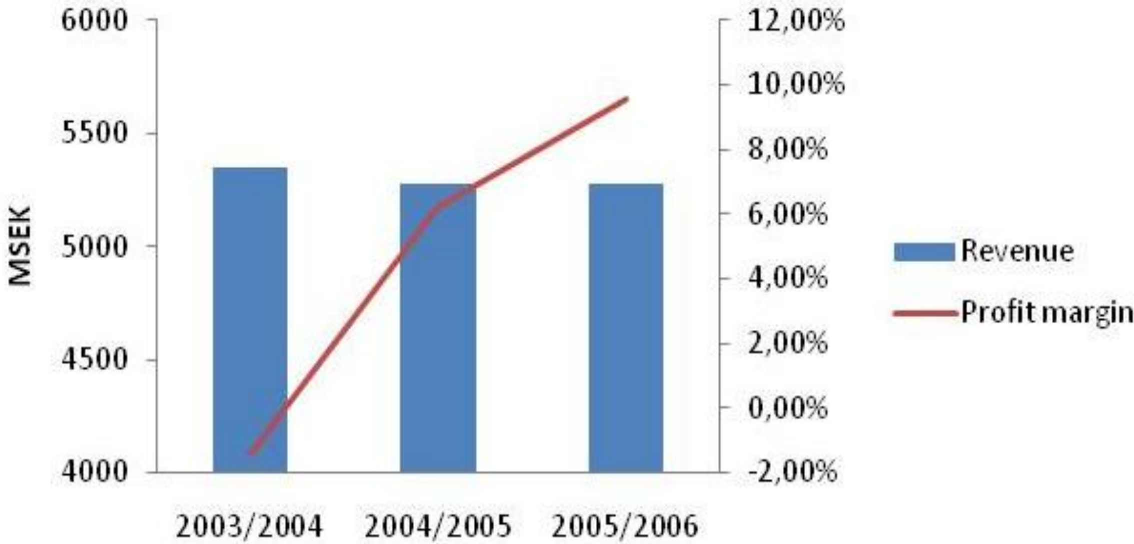


Above, we present the performance of the Lindex stock in relation to the OMXS and the OMXS Retailing indices as well as Cevian's ownership as a percentage of the total number of shares.

A few months after Cevian's first acquisition of Lindex shares, Cevian partner Christer Gardell was elected onto the Board. Furthermore, Jörgen Johansson resigned from his position as CEO and was succeeded by former Hennes & Mauritz (H&M) executive Göran Bille. Less than a year later, in December 2004, the Board was changed substantially as Christer Gardell was elected Chairman of the Board and a number of other persons with relation to Cevian became Board members. Between 2004 and 2006, Lindex closed their German operations stepwise and Twilfit was sold in 2005, although a few stores were kept and changed to Lindex stores. Cevian sold their last Lindex shares in October 2006 but their holdings had peaked already in December 2005 at a level of 17 percent.

Please see Figure 3 below for information on Lindex' revenue development and increased margins during Cevian's holding period.

Figure 3 Lindex Revenue and profit margin



2. METHODOLOGY

In this section we outline the methodology and present the materials used in the study.

2.1 DATA

Please note that we have signed Non Disclosure Agreements with both Segulah and Cevian. This means that non-public data that has been used may not be available from the respective companies even on request. Finally, the reader should note that the information we obtained about Callenberg through Segulah may be the property of Callenberg's current owner, Wilhelm Wilhelmsen Group. Any such information was obtained under their acceptance as asked for by Segulah partner Sebastian Ehrnrooth.

2.1.1 WRITTEN MATERIALS

2.1.1.1 Segulah

- The most important source of information we have obtained from Segulah is minutes from all of the Board meetings held in Callenberg during Segulah's holding period. The minutes are unusually thorough and exhaustive.
- Investment paper for the initial acquisition of Callenberg with information about what Segulah believed was possible to improve in the company.
- Investment papers for the add-on acquisitions that Callenberg did during Segulah's holding period. All these papers were produced by Segulah.
- Financial reports from Callenberg

2.1.1.2 Cevian

The amount of written information about Cevian's investments in Lindex is very large and we have evaluated more sources than the ones listed below. The listed materials were those that we found to be the most important ones and they are the materials we base our major discussions on. They are not listed in order of importance.

- Minutes from Board meetings in Lindex and minutes from meetings in subcommittees such as the accounting committee.
- Investment committee memorandums. The first investment committee memorandum that discusses Lindex is from September 10th, 2003 and describes Cevian's agenda and possible points where Cevian could help Lindex create value; "The value enhancement program" as well as strengths and weaknesses of the company. Later memorandums discuss the rationale behind further investments and divestments in Lindex and also

provides insight into what parts of the value enhancement program Cevian succeeded to implement or not.

- Investor materials such as case studies of Cevian's investment in Lindex and general overviews of both the Cevian I fund and Cevian in general.
- Memos from Board workshops with topics such as general strategy and strategy for the German subsidiaries.
- Reports on how Lindex should handle the Twilfit case and the divestment in Germany.
- Internal e-mail conversations about Lindex as well as reports from visits, mails and minutes from telephone meetings.
- Historical financial statements of Lindex from Cevian's holding period.

2.1.2 INTERVIEWS

In order to get a deeper understanding about what happened on the Boards of the targeted firms, we have filled the gaps in the written information through interviews. These interviews were held with different stakeholders on the Boards to get a picture as broad as possible. The people we have interviewed and their respective role in each organization are presented below. The templates/questions used in different interviews have been similar in order to minimize noise in the sample, but the questions have been modified to provide as exhaustive information as possible. This way, we have been able to extract each interviewee's individual knowledge. In order to gain as much insight as possible from our interviews, we did not decide who we would interview until we had thoroughly examined the written materials. The interviewees were contacted and the group consists of the persons that we believe had the most important roles in each company Board and in each investment firm. We may note that no one declined our request to interview them, thus not skewing our perspective. The people we have interviewed are:

2.1.2.1 Segulah/Callenberg

- Sebastian Ehrnrooth – Partner at Segulah, Board member in Callenberg and responsible at Segulah for the Callenberg investment.
- Lars Marcusson – CEO and Board member of Callenberg before and during Segulah's holding period.
- Jan Norell – Chairman of the Board during Segulah's holding period. Previously head of Alfa Laval Marine & Power and member of Alfa Laval's Board. Member of Segulah's Industrial Advisory network.

2.1.2.2 Cevian/Lindex

- Christer Gardell – Founding partner of Cevian Capital, member of Lindex' Board January-December 2004, Chairman of Lindex' Board December 2004-2007.

- Marcus Alexanderson – Investment manager at Cevian.
- Lars Otterbeck – Member of Lindex's Board both prior to, during and after Cevian's engagement. Previously Chairman of the Board in Skandia, Hakon Invest and Näringslivets Börskommitté. CEO of Alecta.

2.2 The approach

In order to fulfill our purpose, we have performed a qualitative, comparative case study of the two engagements in Callenberg and Lindex. The choice to perform a case study is directly derived from the attributes of the data obtained. A quantitative study would have been less feasible. Furthermore, the Board focus stems from the fact that the data pointed in the direction that almost all communication between the investor and the target company took place through the Board. By letting the attributes of the data decide the focus of the thesis, the risk of fitting data to theory was reduced. According to Ghauri and Grønhaug, this is a preferable approach when dealing with complex qualitative data.[28]

By dividing our empirical findings into the nine categories outlined below, we were able to analyze similarities and differences between Callenberg and Lindex and the way that Segulah and Cevian worked with their respective targets, primarily through the Board. These nine categories were deemed to be representative of the major events that took place in both Callenberg and Lindex. Some deviations from the Board's work are made in order to provide the reader with an as complete picture as possible. The nine categories are presented below;

[28] Ghauri and Grønhaug (2005), pp.16-19.

Entry
Previous owners
Agenda at entry
Board composition and competencies
Degree of influence
Changes made
Requested competences
Reporting standards
Level of detail
Management cooperation
Consolidation and strategic focus
Consolidation of business entities
Realizing synergies
Core business focus and divestitures
Incentives program
Program structure
Reception by management
Outcome
Human resources
Level of investor participation
Approach to dismissals
Operational improvements
Level of involvement
Actual improvements
Provision of advanced financial function
Mergers and acquisitions
Strategy
Provision of network
Investor participation
Geographical expansion/contraction
Strategy
Process
Conflicting interests
Exit
Reasons behind exit
Characteristics of exit

3. Theoretical Framework

In this part we present the prior research that we will use in order to provide a theoretical framework for our thesis. The different theories are presented below under general headings where theories from different authors and researchers in associated fields are discussed. An exception is the article "Private Equity Boards vs. Publicly Listed Company Boards" by Acharya, Kehoe and Reyner that is presented separately due to the fact that it does not sort under any of the major headings.

3.1 Agency theory

A broad array of economical and financial literature covers the field of agency theory and the problems associated with principal/agent relations. A large part of the theory is developed in the frame of Economics and Corporate Finance and describes how power is delegated and why agents make suboptimal choices on behalf of their principals. The principal is often the owner of a company and the agents the managers of that company. The problematic issues stems from the fact that there is asymmetric information between the agent and the principal since the principal can not control the agent at all times. Jensen and Meckling define an agency relation as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent".[29] Since both parties are utility maximizing, it is likely that they will have different objectives and that the agent might not act in the best interest of the principal since the agent's utility is most likely not maximized by hard work, low salary and no perk-consumption.[30]

Many of the agency theories are concerned with management in general rather than the Board in particular, but there are features of the Board that has enabled us to use the theories in this setting as well. First and foremost, each of the Boards we have examined contained executive directors as well as non-executives. Secondly, the Boards of both companies examined were highly involved in the management and the companies did not employ a large amount of mid-level managers that need to be controlled.

Jensen and Meckling discuss agency costs and who has to carry them. Generally, the owners of a company will have to carry the cost of aligning managers' objectives with their own through "auditing, formal control systems, budget restrictions, and the establishment of incentive compensation systems which serve to more closely identify the manager's interests with those

[29] Jensen and Meckling (1976).
[30] Ibid.

of the outside equity holders”[31]. The authors also state that the price of monitoring and alignment is included in the price owners pay for the shares in a company that they buy.[32]

What happens in the Board room of a company where not all directors represent the owners of the business is affected by agency issues. It is in the owner’s interest to maximize the value of the company but it might not be in the interest of the Board members to maximize the same value; they rather want to maximize their own utility. The maximization of the utility of the members of the Board might be done through consummation of perks or by building too large corporations. According to Jensen, the power of the manager increases as the company grows larger since he or she controls more resources. Moreover, managers of large firms tend to get more compensation for their work.[33] Analogously, members of the Board should also gain from increasing the size of the company beyond the optimal level.

Jensen argues that managers prefer to finance projects internally to avoid monitoring. He further discusses the issue of distribution of free cash flows to owners of a company. When free cash flows are high, managers are likely to destroy value by investing in non-profitable projects. Jensen’s main finding is that debt can help aligning managers’ motives with those of owners; “by issuing debt in exchange for stock, managers are bonding their promise to pay out future cash flows”[34]. The author argues that simply promising to raise dividends will never lead to the same effect since managers are not forced to keep dividends high. One of the possible ways to spend capital is by diversification, a process that generally destroys value according to Jensen. Diversification is most likely to occur in companies with high free cash flows or with large, promised, borrowing space left to use.[35]

Byrd, Parrino and Pritsch argue that the performance of a firm depends not only on the quality of the management team but also the incentives that they face. The authors discuss four types of agency problems, outlined below:[36]

- *The effort problem* - Agents do not work hard enough and therefore do not create as much value as possible. The authors cite another study that showed that the share price of companies examined went down when Board members announced that they had accepted to work on another company’s Board as well.
- *The horizon problem* – Companies are most often expected to have infinite lives and they are therefore expected to continue business for a long time after their managers have

[31] Jensen and Meckling (1976).
[32] Ibid.
[33] Jensen (1986).
[34] Ibid.
[35] Ibid.
[36] Byrd et al. (1998).

stopped working. That is what investors take into account when valuing firms. Managers, however, weight cash flows with a different hurdle rate since their time in the company is finite. They may therefore make suboptimal choices from a long-term perspective.

- *The differential risk preference problem* – Managers have undiversified total portfolios since a substantial part of their earnings are tied to the company where they are employed. Therefore, they might be too risk averse in order to defend their jobs. As a consequence, managers do not want to take on debt and prefer self-financing.
- *The asset use problem* – Managers consume perks instead of distributing earnings to the owners. Moreover, they may increase the size of the firm beyond the optimal level, often referred to as *empire building*.

Another feature of the effort problem is that managers set low targets in order to be able to reach them. By doing so, they can enjoy what has been described as *the quiet life* since owners do not become suspicious of and question managers who always reach targets.[37]

Byrd et al. discuss how owners can go about to align manager's objectives with their own. The different measures or markets that can be used are presented below:[38]

- *Stock ownership* – If managers are owners as well, they will be more inclined to work for value maximization.
- *Compensation contracts* – When it is hard to monitor managers, it might be possible to control them through contracts that compensate them on basis of their results. Bonus programs and stock options are two possible compensation based solutions.
- *Board of directors* – The Board's legal obligation to hire, fire and set compensation for managers makes it a good tool for controlling management.
- *The managerial labour market* – According to studies, managers that have been dismissed often experience problems finding new jobs.
- *The market for corporate control* – Takeovers and the risk of takeovers forces managers to work more efficiently.
- *Large block holders and Activist investors* – Mitigates agency problems since they have incentives to change underperforming managers.
- *Debt and dividends* – If capital is paid out to investors it is impossible for management to consume the same capital.

[37] Bertrand and Mullainathan (2003).
[38] Ibid.

3.2 PRIVATE EQUITY

Private Equity is a method of investing into privately owned companies or to perform buy-outs of publicly listed companies. Private Equity firms set up funds into which mainly institutional investors commit capital, either up-front or as the fund makes investments. These funds are typically closed for a predetermined number of years.[39]

Institutional investors choose to invest into funds set up by Private Equity firms since they believe that the managers of those funds posses' skills and resources necessary to improve the businesses into which they invest. Those skills include screening of investment projects, providing strategic and operational know-how as well as improving the capital structure of the investments.[40]

The way in which Private Equity companies make investments differ among three categories. These are:

1. *Venture Capital (VC)* – Young, unestablished companies are supported financially, strategically and operationally in exchange for a large equity stake.
2. *Leveraged Buy Out (LBO)* – Debt financed acquisition of established companies. Typically, the Private Equity firm ends up owning 100 percent of the equity.
3. *Spin-off* – A part of a company is divested into a separate company and bought from the company it was spun off from.

The most common of these three is the LBO.[41]

Sweden is the third largest market for Private Equity in the European Union and the country with the highest proportion of investments to GDP. European Private Equity firms focus more on LBO's than their American counterparts who finance a substantial number of new ventures.[42] The Private Equity business grew almost exponentially during the 1980s. This growth has continued in recent years.[43]

According to Nisar, investors can obtain significant returns from being engaged in the businesses that they own. Especially so if the investor has got considerable expertise in the area in which they are investing.[44]

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[39] Segulah, Lecture notes, Course 4112 Corporate Valuation, 2008-11-21.
[40] Briggs (2008).
[41] Lerner et al. (2009), pp. 1-13, 279-292.
[42] Ibid.
[43] Briggs (2008).
[44] Nisar (2005).

Citing prior research from Kaplan and Strömberg (2000) and Goodstein, Gautam and Boeker (1994), Nisar concludes that Private Equity firm's right to nominate Board members is an important control tool. The Board members, however, serve other roles as well; they provide a network for the company to secure important resources through and they monitor the internal governance to align manager's goals with shareholder's interests. Also, the Board engages in strategy-shaping activities.[45]

3.3 SHAREHOLDER ACTIVISM

In this thesis, shareholder Activism is defined as the activity through which a financial investor seeks to pursue his or her agenda in a publicly listed company. This financial investor is likely to be a fund and the agenda will have the goal of improving the business in a number of different ways to ultimately increase the share price.

Shareholder Activism is closely related to *the free rider problem*, a well documented phenomenon within agency theory. The reason why many institutional investors do not engage in Activist activities is that the costs exceed the benefits. The investor will have to carry the costs associated with changing underperforming management and suboptimal operations alone and share the benefits with all other shareholders. Hedge funds have sought to overcome this problem by being unrestricted in their investment objectives. By using derivatives and leverage, they have been able to make Activist activities worthwhile. The managers of Activist hedge funds differ from those of institutional investors insofar that they are highly incentivized. The abovementioned reasons all help mitigating *the free rider problem*.[46]

The companies targeted by Activist hedge funds have a number of common features:[47]

- They are "value" firms, demonstrated by low market-to-book ratio.
- They are profitable with sound cash flows and return on assets.
- They have low payout ratios and highly compensated CEOs compared to peers.
- They have substantial takeover defenses in place.
- They are liquid mid-cap stocks.

The agendas of Activist hedge funds display some similarities and can be broken down into the following categories:[48]

[45] Nisar (2005).
[46] Brav et al. (2008).
[47] Ibid.
[48] Klein and Zur (2006).

- They aim to be represented on the Board, a safe way to ensure access to the forum where decisions are made. Therefore, Activists will generally propose a well experienced individual to speak for them on the Board.
- If a merger is imminent or if a company faces liquidation, Activists will oppose these actions if they believe them to be wrong.
- If there are operating improvements to be made, these will most often be related to IT, logistics and distribution
- Activists will not work actively with long term strategy unless it is thought to increase the share price.
- If the Activist believes that another CEO could do a better job than the current one, they will propose a candidate to replace him or her.
- Since the targets of shareholder Activism generally are profitable and conservative when it comes to paying dividends, Activists often seek to increase the payout ratio.

Activist hedge funds have experienced substantial growth in recent years. They have been accused of being corporate raiders with the sole goal of draining companies of their cash reserves. Academic research has yet to conclude whether shareholder Activism creates value.[49]

According to previous research on Activist fund Hermes UK Focus Fund, the Activist is likely to intervene in corporations that are performing poorly. This stands in contrast to the findings of Brav et al. who characterize targets as being profitable with sound cash flows. The way that the fund cooperates with the target is mainly through meetings with Board members and not through campaigns at general shareholder meetings. Sometimes, the fund also uses the press to get more leverage in discussions with the Board. Moreover, the Hermes UK Focus Fund often sought support among other institutional owners. In contrast to Karpoff (see above), the authors, Becht, Franks, Mayer and Rossi, found clear evidence that the Activist actions undertaken by the fund created shareholder value. The value created often stemmed from changes in Board composition and from restructurings. Other common ways through which the fund engaged its targets was by demanding restructuring of corporate policies, but also changes in the financial policy, often proposing higher dividends.[50]

3.4 Private Equity vs. Publicly Listed Company Boards[51]

There are substantial differences in the way that Boards of Publicly Listed Companies (PLCs) and Boards of companies owned by Private Equity investors operate. An interview study conducted in the UK concludes that while Private Equity controlled Boards are more effective

[49] Karpoff (2001).
[50] Becht et al. (2008).
[51] Acharya et al. (2009).

and better at strategic leadership and performance management, PLC Boards are characterized by better governing skills as well as being better at developing top management. The rationales behind these results highlight the important differences that exist between the two ownership structures.

Strategic leadership – Private Equity controlled Boards are described in the study as leading the strategy formulation process. The Private Equity investors are likely to have an agenda ready at entry. PLC Boards, on the other hand, are not as involved in the formulation of strategy. The management team typically formulates the strategic agenda. The Board's role is then to challenge and mould it. This more passive role stems from the less involved role of the PLC Board members.

Performance management – Boards controlled by Private Equity investors employ aggressive performance measures. These are monitored actively on each Board meeting with extra attention given to the underperforming areas of the business. PLC Boards on the other hand generally focus on aggregate control and decisions. The reason why they do not focus as intensively on managing performance might be that they have a longer time horizon and do not see the long term benefits of their short term focus.

Management development/succession – Private Equity controlled Boards are characterized by their relentless desire to have the right people in the right places. If top management do not live up to expectations, they are likely to be replaced swiftly. This pressure goes hand-in-hand with the highly geared incentive programs put in place to motivate these managers. Furthermore, Private Equity Boards are described as working with managers existing knowledge and skills rather than helping them improve. PLC Boards on the other hand are described as being much more committed to their managers and their development. They have routines in place to assist in the process of personal development. Overall, PLC Boards are characterized by their greater focus on people.

Stakeholder management – Due to the diverse interests of the broad investor base of PLCs, managers spend a substantial amount of time communicating information and rationale behind decisions to these different investors. Conversely, Private Equity owned companies do not face these problems thanks to their aligned owner interests. Their Boards do, however, have to struggle with e.g. the media and unions, areas where PLC Boards are more experienced.

Governance/Risk management – There are substantial differences in how PLCs and Private Equity controlled Boards work with governance and risk management. PLCs have well established routines in place to identify risks. These routines are described as being hugely time-

consuming with little value being added. Private Equity controlled Boards do not work with as thorough governance systems. They are, however, better than PLC Boards at *managing* risks as opposed to avoiding them.

4. EMPIRICAL FINDINGS

In this section we present the empirical materials that we have developed through our research. The presentation is outlined as presented in section 2.2.

4.1 ENTRY

4.1.1 CALLENBERG

As mentioned in the section on Callenberg, the company was owned by listed company Expanda in 2001. The owner's commitment and contribution was negligible. One of Expanda's largest owners contacted Segulah with the idea to divest Callenberg. The process was initiated and Segulah brought in a consultancy firm to evaluate the proposal. However, Segulah were not thoroughly interested until they had evaluated the company's US operations. They were impressed by the company's ability to grow and manage costs. The overall impression of Callenberg was that of a company characterized by frugal and competent management that lacked long term strategic focus. The acquisition process has been described by Segulah as successful insofar that it resulted in a purchase at a multiple of 5-6 times the profit, which was regarded as a low valuation.[52]

Segulah did not have a structured agenda at the point of entry. They knew the main things they wanted to do, but lacked a detailed plan. The main goal was to get an advantage over competitors by consolidating in a typically fragmented industry.[53] Since Callenberg neither had any proprietary technology, nor any products, the operational focus had to be on improving the service offer.[54] In order to be able to do this, it was crucial to get industry competence onto the Board.[55]

As the deal closed in May of 2001, Segulah made a big mistake; they had overlooked the part of the contract that allowed Expanda to take Callenberg's liquid funds with them.[56] While this did not threaten operations, CEO Lars Marcusson was furious and his relationship with Segulah got off to a bad start. It did not help that while Segulah had declared that their investment horizon was 3-7 years, he still viewed them as short term investors who were just interested in making a quick return on their invested capital.[57, 58]

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[52] Interview, Ehrnrooth, 2009-03-20.
[53] Investment paper stage III, Segulah, 2001-05-02.
[54] Interview, Ehrnrooth, 2009-03-20.
[55] Interview, Norell, 2009-04-02.
[56] Board minute, Callenberg, 2001-06-26.
[57] Interview, Ehrnrooth, 2009-03-20.
[58] Interview, Marcusson, 2009-03-31.

4.1.2 Lindex

Cevian acquired a 10 percent stake in Lindex from a large block holder on the 3rd of October 2003.[59] Over the course of the following two years, Cevian acquired more shares and their stake in the business peaked around 17 percent.[60] The ownership of Lindex was dispersed with no strong owners. At entry, Cevian had a detailed and structured agenda ready. See more on this in section 4.7.2.

4.2 Board Composition and Competencies

4.2.1 Callenberg

When Segulah formed Callenberg's Board, they began by replacing the incumbent Chairman, Rolf Karlsson. The new Board was instead formed around the retired Vice President of the Alfa Laval Group, Jan Norell. His experience from the marine engineering business was considered invaluable, especially after he played a major role in the due diligence process, meeting with all key employees as well as investing money of his own.[61, 62]

Former Bofors CEO Per Ove Morberg was recruited to the Board to bring in a project and financing perspective, along with a strong track record in large M&A deals. During the time Segulah stood as owners of Callenberg, Per Ove Morberg passed away. In September of 2002, the Board was complemented by the appointment of Norwegian Knut Arnesen who brought in up-to-date knowledge about the marine engineering business as well as a customer focus.[63, 64]

CEO, Lars Marcusson and CFO, Thomas Forsström were both represented on the Board. Lars Marcusson had the role of briefing the Board on current business as well as giving input on the practical feasibility of different projects and changes. He has been described as having trouble verbalizing his ideas, something that Jan Norell often helped with. Thomas Forsström had a more passive role in the beginning. However, he came to be an important part of the Board, especially around and after the add-on acquisitions in 2003.[65] As Sebastian Ehrnrooth said; "We planned to expand his role once we had realized his potential"[66] (translated freely).

[59] Lindex Case Study, Cevian.
[60] Investment Committee Memorandum, Cevian, 2005-10-06.
[61] Interview, Ehrnrooth, 2009-03-20.
[62] Investment paper stage III, Segulah, 2001-05-02.
[63] Ibid.
[64] Board minute, Callenberg, 2002-09-24.
[65] Interview, Norell, 2009-04-02.
[66] Interview, Ehrnrooth, 2009-03-20.

Segulah were represented on the Board by partners Sebastian Ehrnrooth and Anders Claesson.[67] Their roles on the Board were quite different. Anders Claesson had an aggregated perspective on the business while Sebastian Ehrnrooth became deeply involved in everything from operational issues to scouting for possible acquisitions. This involvement was a source of conflict on a few instances but has also been described as a major part of the success.[68] Both Jan Norell and Per-Ove Morberg were recruited from Segulah's large industrial network.[69]

The provision of a network was one of the most important features of Segulah's engagement and value creation in Callenberg according to both Chairman Jan Norell and CEO Lars Marcusson.[70, 71] Especially Sebastian Ehrnrooth conducted extensive research and acquired relationships to a substantial number of important industrial experts and owners of businesses related to Callenberg's. Lars Marcusson did not have a very good overview of Callenberg's competitors in the Nordic region but Sebastian Ehrnrooth's contacts helped substantially to overcome that problem as new acquisitions were to be made.[72]

4.2.2 Lindex

Cevian ran a campaign at the Annual General Meeting in January 2004 to get Christer Gardell and Conny Karlsson elected onto the Board.[73] Once they had managed to get represented on the Board, they were able to influence the replacement of all but two Board members by presenting viable alternatives. Lindex had a history of changing owners, with inactive Board members left on the Board as a consequence. Cevian's criteria for the new members were that they had to have a general management competence along with a good understanding of the business. [74] Cevian brought in well needed competence from the fashion industry and kept the Board members with the most management experience, like Lars Otterbeck.[75]

As outlined below in Figure 4, Callenberg had a relatively consistent number of Board meetings each year while Cevian influenced the Lindex Board to meet more often in the beginning of the investment.

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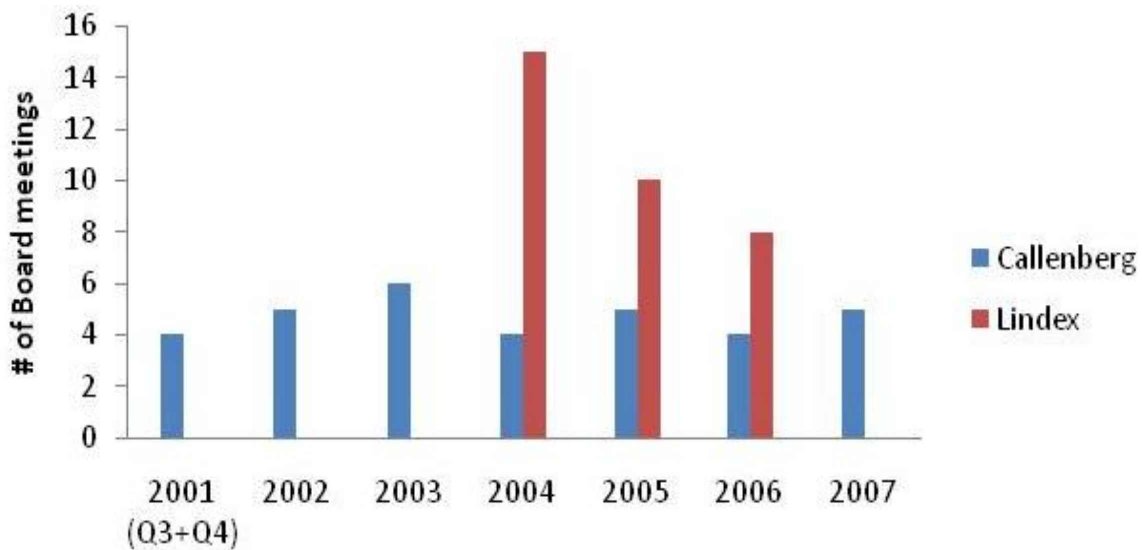
67 Board minute, Callenberg, 2001-05-18.
68 Interview, Norell, 2009-04-02.
69 Interview, Ehrnrooth, 2009-03-20.
70 Interview, Marcusson, 2009-03-31.
71 Interview, Norell, 2009-04-02.
72 Interview, Norell, 2009-04-02.
73 Lindex case study, Cevian.
74 Interview, Gardell, 2009-04-14.
75 Lindex case study, Cevian.

Figure 4 Number of Board meetings during the owning periods of Segulah and Cevian



4.3 REPORTING STANDARDS

4.3.1 CALLENBERG

As previously mentioned, Callenberg was owned by listed company Expanda before Segulah bought them. Therefore, Callenberg CEO Lars Marcusson thought that the reports produced for the Board were sufficiently detailed and exhaustive.[76] Segulah, however, were of a different opinion. They demanded extensive reports on how the different business units were doing as well as updates about ongoing projects.[77] Their motivation for this was firstly that they demanded it from all their companies and secondly they argued that it would be a good way to prepare the company for a possible Initial Public Offering (IPO).[78] Lars Marcusson was furious with this and in combination with Segulah's liquid funds blunder discussed above, this did little to improve relations.[79]

Stuck in the middle between Segulah and Lars Marcusson was Chairman of the Board, Jan Norell. It was only through his diplomatic skills that the issues were resolved. Sebastian Ehrnrooth of Segulah explains that had it not been for Jan Norell, Lars Marcusson's role as CEO would have become increasingly difficult and there was a possibility that he would have had to be replaced

[76] Interview, Marcusson, 2009-03-31.
[77] Interview, Ehrnrooth, 2009-03-20.
[78] Investment paper stage III, Segulah, 2001-05-02.
[79] Interview, Norell, 2009-04-02.

by a more cooperative CEO.[80] Jan Norell did however express a view that Segulah's demands were too extensive for a company of Callenberg's size.[81]

Jan Norell explained that Lars Marcusson was used to the ignorance of passive owners and the chock of increased owner involvement was overwhelming.[82] Sebastian Ehrnrooth further explained that he felt that Segulah did not earn the trust of Lars Marcusson until 2003 when Callenberg and Segulah made their first add-on acquisition. That was two years into the holding period and up until this point in time, Segulah felt that their long term commitment to improve the business had not been accepted.[83]

Furthermore, Segulah's representatives on the Board were pointing out overly cautious and low budgets in Callenberg's operations.[84] The executives and managers of Callenberg frequently set low targets for the operations, something that was not accepted by Segulah who, through the Board, declared that such budgets would not be accepted.[85] In this way, Segulah were able to control subsidiaries' budgets and ambitions straight from the Board.

4.3.2 Lindex

Cevian were even more discontent with the reports produced internally in Lindex. However, they did not have to force any changes onto the incumbent management team. During the first six months of Cevian's investment period, all executives and most of the Board members were replaced due to their lack of motivation and skill. The people brought in were as keen as Cevian to make changes and therefore embraced the demand for increased reporting wholeheartedly.[86, 87] It may also be noted that Cevian produced a large amount of this material themselves, performing analyses and evaluating different operational improvement plans.

4.4 Consolidation and strategic focus

4.4.1 Callenberg

Already prior to entry, Segulah recognized that Callenberg lacked strategic focus. At this time, Callenberg was a loosely held group containing 5 different operating entities:[88]

80 Interview, Ehrnrooth, 2009-03-20.
81 Interview, Norell, 2009-04-02.
82 Interview, Norell, 2009-04-02.
83 Interview, Ehrnrooth, 2009-03-20.
84 Board minute, Callenberg, 2004-09-21.
85 Ibid.
86 Interview, Gardell, 2009-04-14.
87 Interview, Alexanderson, 2009-03-26.
88 Investment paper stage III, Segulah, 2001-05-02.

- *Callenberg Engineering AB, Uddevalla* – The core business where most people were employed and a significant part of the Callenberg Group's revenues were produced. CEO of Callenberg Engineering AB was Lars Marcusson.
- *El-Marine AB, Gothenburg* – Acquired from Danish marine technology company Semco in 1997. El-Marine also had operations in the harbor of Landskrona and has been described as a pet-project of the prior CEO and Chairman of the Board, Rolf Karlsson.[89]
- *Andersson & Callenberg El AB, Uddevalla* – Land based firm performing installations mainly for the Uddevalla Municipality, enjoying an almost monopolistic position in the Municipality.[90] Believed to be of great importance for Lars Marcusson to foster his local network.[91]
- *Callenberg Engineering Inc., Miami (USA)* – Developed by two Callenberg employees who left Sweden for the United States to profit from the emerging cruise market. The Miami subsidiary stood out as innovative and competent when it came to finding new sources of income when the cruise market changed.[92]
- *Callenberg Engineering Pte Ltd., Singapore City (Singapore)* – A small subsidiary started on request by a large US-based costumer.[93]

There was no explicit intention to consolidate the Callenberg Group in Segulah's initial investment paper, but an intention to merge the Swedish entities seems to have been present from the outset, judging from our interviews.[94] The consolidation was proposed officially at the first Board meeting taking place after Segulah's entry in May of 2001. The Board decided that the three Swedish companies should become divisions in one legal entity and that a new CEO was to be appointed to that entity while Lars Marcusson would act as CEO of the whole Callenberg Group[95]. The consolidation process continued throughout the whole year of 2001 but in December of the same year, Segulah's representatives demanded that the pace of the process had to improve since the "unification had not been started" (translated freely).[96] From the end of the first quarter, the companies should act as if the consolidation was legally completed.[97]

After Segulah's demand in December of 2001, the Swedish Callenberg subsidiaries were consolidated in the first quarter of 2002. As Callenberg acquired HVAC Gothenburg from ABB, the company also became a part of the consolidated Swedish Callenberg group. Callenberg was,

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[89] Interview, Norell, 2009-04-02.
[90] Interview, Ehrnrooth, 2009-03-20.
[91] Interview, Norell, 2009-04-02.
[92] Interview, Ehrnrooth, 2009-03-20.
[93] Interview, Norell, 2009-04-02.
[94] Interview, Ehrnrooth, 2009-03-20.
[95] Board minute, Callenberg, 2001-05-18.
[96] Board minute, Callenberg, 2001-12-07.
[97] Ibid.

however, experiencing severe problems finding a new CEO for the Swedish entity. Please see more on this in section 4.6.1.

Closely connected to consolidation lies the issue of strategic focus. Callenberg, being a company operating both land and marine based businesses was not totally focused and Segulah was in great favor of abandoning the land based part of operations. Originally, Callenberg was a land based electrics company and CEO Lars Marcusson was not prepared to focus solely on marine technology. Segulah representative Sebastian Ehrnrooth claims that it would not have been possible to keep Lars Marcusson at Callenberg if Segulah had gone through with their demand to divest the land based division “Andersson & Callenberg”.[98] Chairman of the Board, Jan Norell, believes that Lars Marcusson could have remained in the business but that he would have lost his spirit and ambition.[99] Lars Marcusson wanted to invest more in land based companies as Segulah and Callenberg evaluated potential acquisition targets but was not able to convince Segulah to finance any such acquisitions, even though an agreement to keep the ratio of land to marine constant was reached.[100]

According to the minutes from the Board meetings in April and December of 2002, Callenberg seriously considered a bid on a local West Swedish electrics company.[101] However, judging from the interviews we have conducted, another picture emerges; Segulah just let Lars Marcusson believe that land based acquisitions were a possibility while not seriously considering it an option.[102] One should, however, note that the land based division of Callenberg produced very good results, probably because of their rather monopolistic position in the Municipality of Uddevalla.

4.4.2 LINDEX

A few years prior to Cevian’s entry in Lindex, the company bought the Swedish lingerie chain Twilfit. The intention to buy Twilfit came from CEO Jörgen Johansson. Originally, Twilfit was acquired in order to minimize the risk of some other larger fashion retailer buying the company to establish themselves in the lingerie market, the market in which Lindex was earning most of its profits.[103] Twilfit’s headquarters were situated in Stockholm when Cevian started acquiring Lindex shares while Lindex’ own headquarters were situated in Gothenburg. Cevian recognized that the headquarters could be merged in order to save overhead costs. Already prior to entry, in the improvement plan, Cevian recognized that Twilfit’s operating costs could be streamlined and

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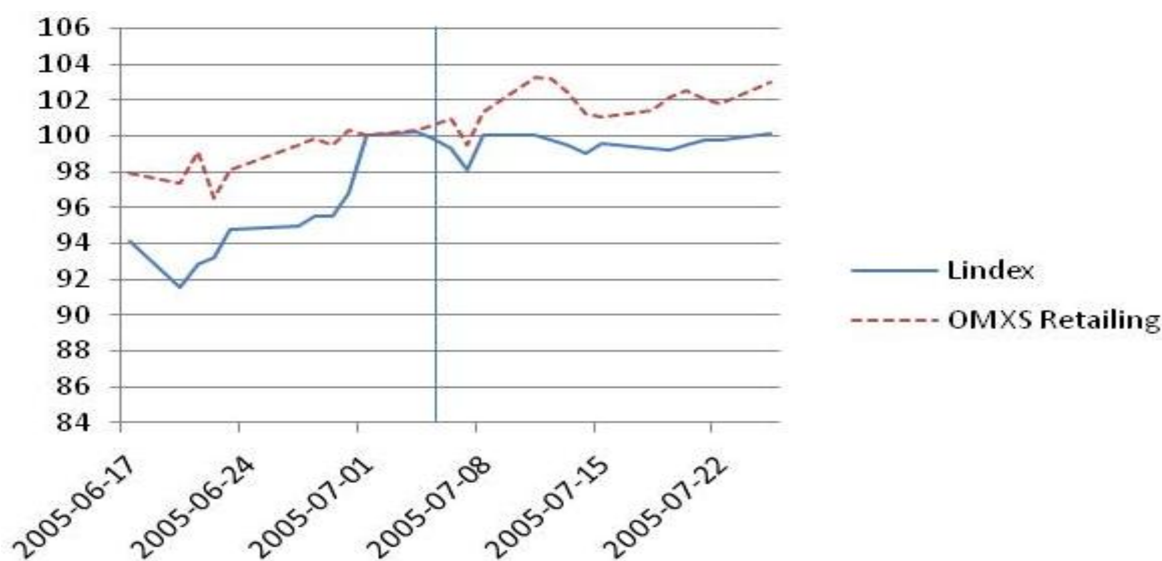
98 Interview, Ehrnrooth, 2009-03-20.
99 Interview, Norell, 2009-04-02.
100 Interview, Marcusson, 2009-03-31.
101 Board minutes, Callenberg, 2002-04-22 and 2002-12-12.
102 Interview, Norell, 2009-04-02.
103 Interview, Gardell, 2009-04-14.

that the company could share headquarters with Lindex.[104] The merger of the two headquarters took place not long after Cevian proposed it.[105] Later, in July of 2005, Lindex streamlined and focused even further when they sold 38 out of 44 Twilfit stores; the remainder was changed to Lindex stores.[106] Cevian did not see any risk that another fashion retailer would acquire Twilfit to enter into Lindex' market.[107]

As can be seen in Figure 5, the stock market reacted positively to the news of the sale that was announced on the 4th of July 2005.[108] The cumulative abnormal return in comparison to the OMXS Retailing Index for an event window stretching from ten days prior to the announcement to fifteen days after was 1.7 percent. The OMXS Retailing Index consists of all listed fashion retailers in Sweden and should therefore act as a valid benchmark.

Figure 5 Divestment of Twilfit: Lindex share price plotted against OMXS Retailing Index (2005-07-03=100)



Cevian had the opportunity to start buying Lindex shares at the same time as Lindex had just launched a new system for internal deliveries. The possibility to profit from this system was one of the reasons that Cevian saw potential in the Lindex share.[109] Cevian got involved with the logistics system after a major break-down in the operations 2003/2004. After the problems emerged, Cevian put in a substantial amount of work to implement the system further and to bring different parts of the company, such as the stores and the purchase function, closer

[104] Investment Committee Memorandum, Cevian, 2003-09-10.
[105] Portfolio review memorandum, Cevian, 2004-10-06.
[106] Andersson, Lindex, E-mail to the Board of directors of Lindex, 2005-07-01.
[107] Interview, Gardell, 2009-04-14.
[108] *Lindex säljer Twilfit*, Nyhetsbyrån Direkt, 2005-07-04.
[109] Investment Committee Memorandum, Cevian, 2003-09-10.

together. Cevian also pushed Lindex to cut costs in the merged headquarters by consolidating different overstaffed functions and work more intensively with IT.

Furthermore, Cevian believed that Lindex held to much cash. They worked for both share redemption and increased dividends. Cevian succeeded in their intention and increased the dividend pay-outs, they also performed a 1:6 split with compulsory redemption of one of the new shares.

4.5 Incentives Program

4.5.1 Callenberg

Soon after Segulah had purchased the majority of the shares in Callenberg, they tried to launch an incentives program to align the goals of managers with those of Segulah.[110] However, due to poor relations with CEO Lars Marcusson, the program was never implemented.[111] As he chose to not partake, none of his colleagues did either. The reason given by everyone but the CEO for not partaking was the weak economic climate in the wake of the terror attacks in the US on the 9th of September 2001.[112]

It took almost two years until Segulah tried to launch another incentives program. Around the time of the add-on acquisitions in 2003, Lars Marcusson and his colleagues, as well as some members of the Board, were offered to participate in a heavily geared ownership program that would make them a substantial return in the case that Segulah sold Callenberg with a profit. This time around, there were no objections and all accepted the proposal.[113] The crucial factor for making this possible was the improved relations with Lars Marcusson. At this point, he understood Segulah's agenda and had to a large extent aligned his own to it.[114]

Apart from the abovementioned ownership program, Segulah introduced more traditional bonuses that were tied to tough financial targets. These bonuses could maximally reach three extra months pay. Segulah did not believe that these bonuses were as good at motivating management as ownership.[115] Chairman of the Board, Jan Norell, did not see any change in the motivation of management caused by either the traditional bonuses or the ownership program.[116]

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110 Investment paper stage III, Segulah, 2001-05-02.
111 Board minute, Callenberg, 2001-12-07.
112 Board minute, Callenberg, 2002-02-19.
113 Interview, Ehrnrooth, 2009-03-20.
114 Interview, Norell, 2009-04-02.
115 Interview, Ehrnrooth, 2009-03-20.
116 Interview, Norell, 2009-04-02.

4.5.2 *Lindex*

Cevian believes in creating financial incentives for top management to align their agendas with Cevian's. As Lindex was a public company with stocks traded on an exchange, Cevian saw the opportunity to offer to sell call options, primarily to the CEO. He then got to decide whom to include in the program. The main advantages with using options, as Marcus Alexanderson at Cevian puts it, is that people do not have to tie up a lot of capital to purchase stocks and that there is a positive signalling effect.[117] Cevian issued the call options themselves, valuing them according to the Black and Scholes formula.[118]

All managers that were offered options bought them and later made a return of between five and ten times their invested capital.[119] Apart from the option based incentive program, Lindex also employed a bonus system similar to that of Callenberg with bonuses of maximally three to four months pay tied to tough financial targets. These programs were individually designed for each executive person at Lindex in order to be as concrete as possible.[120]

4.6 Human resources

4.6.1 *Callenberg*

Segulah believed that CEO Lars Marcusson was too involved in the daily routines and management of Callenberg Engineering in Uddevalla. They wanted him to act more as CEO of the whole group of divisions and companies across all regions and believed that his skills would fit such a role. In order to facilitate the transition of his role, Segulah wanted a new CEO of the Swedish business entity to be appointed.[121] The appointment of the CEO did, however, become problematic.

Segulah's representatives on the Board wanted to have a CEO of the Swedish operations who was market focused. The CEO would, according to Segulah's demands, not have to be an expert in the electrics field but rather needed to have experience from managing a company and to be focused on customers and suppliers. The group CEO, Lars Marcusson, was concerned and wanted the new CEO of the Swedish Callenberg branch to know "...everything about electricity, have been a sailor and have a relationship to all of the customers"[122] (translated freely). Even though the search for a new CEO began already in the summer of 2001[123], a new CEO was not

[117] Interview, Alexanderson, 2009-03-26.
[118] Internal Memo on Incentives Program, Cevian, 2004.
[119] Interview, Alexanderson, 2009-03-26.
[120] Interview, Alexanderson, 2009-03-26.
[121] Interview, Ehrnrooth, 2009-03-20.
[122] Interview, Norell, 2009-04-02.
[123] Board minute, Callenberg, 2002-05-18.

appointed until two years later, in August of 2003.[124] During the search for a CEO, Segulah carefully examined the few potential candidates that emerged. The different candidates met with Segulah and were all evaluated. According to Chairman of the Board, Jan Norell, the management issues in Callenberg shifted rapidly as it was transformed from a small to a large company. The need of a candidate to fit the demands specified by Lars Marcusson was small, but Segulah's representatives on the Board did not step in to redefine those demands. Moreover, Segulah did not provide any candidate of their own despite having access to a large network of industrial advisors.[125]

4.6.2 LINDEX

Without it being mentioned explicitly in the investment committee memorandums, Cevian had a hypothesis about the incumbent CEO Jörgen Johansson as not being the right person to lead Lindex. He had been employed as CEO just a couple of years prior to Cevian's entry and was at that time celebrated for his successful cost savings plan implemented in 2002.[126] He came from a different part of the retailing industry, having made his career in a food retailer, and Cevian did not believe that he had the competence needed to make Lindex as profitable as the company had potential to be.[127]

Jörgen Johansson got to stay in the business for some time after Cevian's entry but as Lindex presented a warning about low earnings in the second quarter of 2004, he left the company. According to Marcus Alexanderson at Cevian, Jörgen Johansson understood that he would not be able to lead the company after this and stepped down on his own behalf.[128] Another picture emerged in the Swedish newspapers. Dagens Nyheter's headline on the 9th of March was (translated freely): "Lindex losing money – CEO sacked"[129]. Member of the Lindex Board, Lars Otterbeck, describes how the Board was chocked by the news that Cevian wanted to replace Jörgen Johansson. The majority of the Board wanted to give him another year to fully implement his agenda. Cevian explained that they did not have time to wait and that Lindex was heading in the wrong direction. The Board complied and Jörgen Johansson left.[130]

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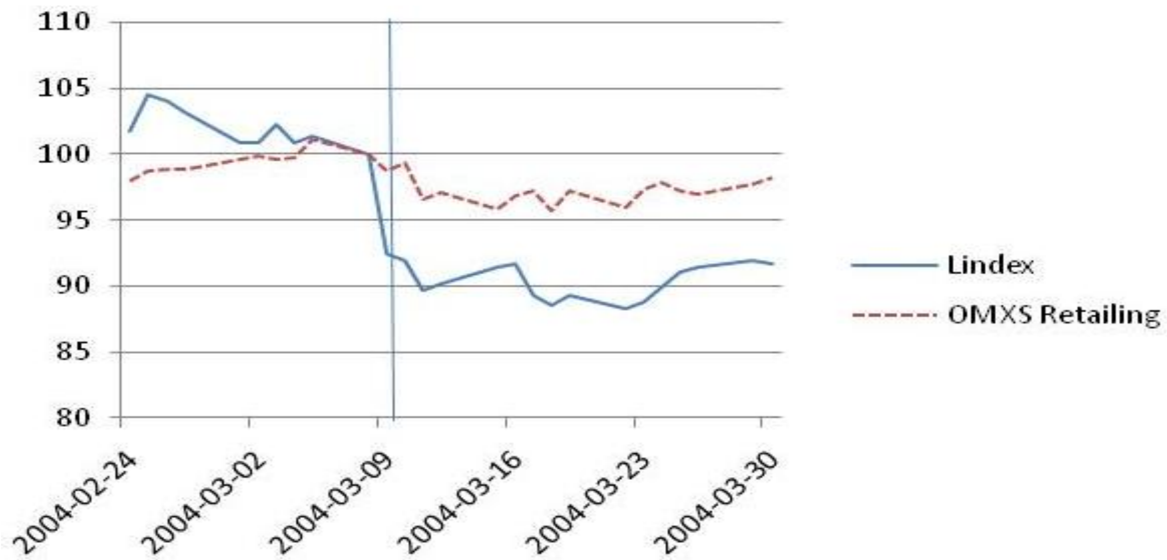
[124] Board minute, Callenberg, 2002-04-25.
[125] Interview, Norell, 2009-04-02.
[126] Andersson, Lindex, E-mail to the Board of directors of Lindex, 2005-07-01.
[127] Interview, Alexanderson, 2009-03-26.
[128] Interview, Alexanderson, 2009-03-26.
[129] Gripenberg, *Lindex går back – VD sparkad*, Dagens Nyheter, 2004-03-09.
[130] Interview, Otterbeck, 2009-04-29.

Figure 6 Dismissal of Jörgen Johansson: Lindex share price plotted against OMXS Retailing Index (2004-03-08=100)

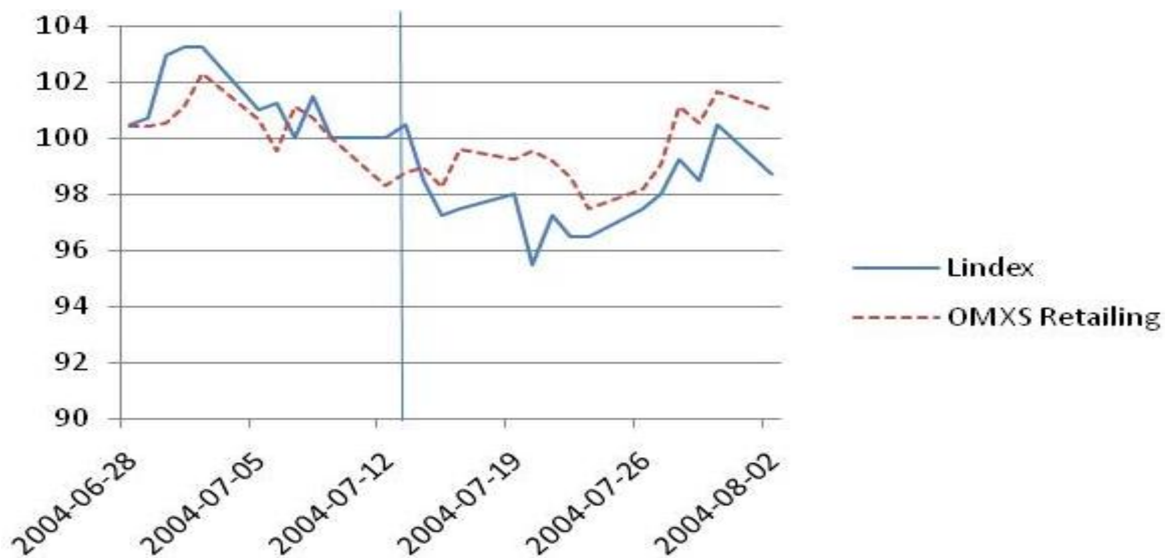


As the news about Jörgen Johansson's dismissal and a profit warning reached the market on the 9th of March 2004, the share price of Lindex declined.[131] Using an event window starting ten days prior to and ending fifteen days after the dismissal of Jörgen Johansson, we find that the Lindex share price experienced a cumulative abnormal return of -9.1 percent in relation to the OMXS Retailing Index.

After Jörgen Johansson's dismissal, Cevian contributed substantially to find a new CEO with more relevant experience from the fashion retail industry. Christer Gardell was one out of three members in the committee that was set to find a new CEO and during the transition period, Cevian-related Board member Conny Karlsson acted as interim CEO. With help from Cevian's Board representatives and a recruitment firm, Lindex came in contact with Göran Bille, former executive at Hennes & Mauritz (H&M) who was still CEO of Lindex at the time this paper was written, in spring 2009.

[131] *Lindex resultat för andra kvartalet kraftigt försämrat - VD avgår*, Press release, AB Lindex, 2004-03-09.

Figure 7 Appointment of Göran Bille: Lindex share price plotted against OMXS Retailing Index (2004-07-11=100)



As the news of Göran Bille's appointment as CEO reached the market through a press release on the 12th of July 2004, Lindex outperformed the OMXS Retailing Index for a few days but soon the share price declined. Using the OMXS Retailing Index as comparative, the Lindex share experienced a the cumulative average return of -3.89 percent for the period starting ten days before and ending fifteen days after the event.

4.7 Operational improvements

4.7.1 Callenberg

Segulah and especially Sebastian Ehrnrooth were deeply involved in how Callenberg was managed. Segulah also provided a context in which the existing staff and managers of Callenberg were able to grow and improve the business but they never changed the operations of the company. Segulah did however bring in one competence of their own to the Board by providing a financial function in excess of the CFO that was important for Callenberg's ability to grow through acquisitions and to strike better deals with financial counterparts, especially banks.

We have identified a number of improvements in Callenberg's ability to profit from the company's existing operations attributable to Segulah's work on the Board, but no direct changes of operations. The work that Segulah's representatives on the Board contributed with in order to facilitate Callenberg's operations can be categorized into the following:

- Cost savings and working capital improvements.
- Increased focus on marketing and after-sales.

- Enhanced financial function.
- More demanding goals and budgets.

Below follows information and discussion on what happened on Callenberg's Board in connection to each of the points above.

There were no other issues that Segulah worked as intensively with through the Board as improving margins and saving costs. According to former Chairman of the Board, Jan Norell, the marine industry is characterized by strong and large customers and smaller, less powerful suppliers. The structure of the market makes the fleets powerful so they are able to profit on companies such as Callenberg.[132] Therefore, Callenberg tied up substantial amounts of working capital in their operations. Segulah had a hard time accepting this as a state of nature and therefore worked intensively to get their customers to pay earlier. For a period in 2002, Sebastian Ehrnrooth actually went through each and every unpaid invoice to be able to question the CEO and CFO on what was happening with each customer.[133]

Segulah wanted to bring in more marketing skills to Callenberg's top management and Board, since they already from the outset of the investment found this to be a neglected area. Segulah's representatives on the Board mostly worked to bring in more marketing to the operations through two different channels. Firstly, they were very clear that they wanted the new CEO of, first, the Swedish, and later, the US-subsidiary, to be market focused.[134] They were partially successful in doing this, both Thomas Roos and Avi Tal, the two CEO's appointed in Sweden and the US, have been described as market focused and competent[135] but their appointment took very long time, especially Thomas Roos's. Secondly, Segulah enforced a new strategic plan that was accepted by the Board in 2002.[136]

Segulah enhanced the financial function in more than one way. First and foremost, they enhanced the role of the incumbent CFO that prior to Segulah's takeover was just responsible for the bookkeeping.[137] The role of the CFO seems to have changed judging from the minutes from the Board meetings, since the CFO clearly got more involved in advanced financial issues. However, according to CEO Lars Marcusson, the role did not really change.[138] Segulah also provided financial expertise from the company's Stockholm office. It was Segulah that made the calculations and provided investment papers for all add-on acquisitions Callenberg did during

[132] Interview, Norell, 2009-04-02.
[133] Board minute, Callenberg, 2002-04-22.
[134] Board minute, Callenberg, 2004-12-14.
[135] Interview, Norell, 2009-04-02.
[136] Board minute, Callenberg, 2002-02-19.
[137] Interview, Ehrnrooth, 2009-03-20.
[138] Interview, Marcusson, 2009-03-31.

Segulah's holding period. According to CEO Lars Marcusson, Segulah's knowledge in financial engineering was very helpful for him since that kind of knowledge had not been available during the holding period of the former owners Expanda. The improved knowledge made it possible to get better financing for the company, something that was exemplified by Segulah closing Callenberg's account at the local bank, Bohusbanken (a part of Danske Bank), and instead got better financing from the much larger Swedish bank SEB.[139] Segulah also had a leading role when Callenberg's Board decided to take internal loans between the US and the Swedish subsidiaries to pay off more expensive Swedish loans.

4.7.2 LINDEX

In Cevian's improvement plan for Lindex we found the following operationally linked improvement points:[140]

- A general tightening of costs and capital management.
- Streamlining of the operating costs in subsidiary Twilfit.
- Capitalize on the new purchasing/logistics platform.
- Lower personnel and consultancy costs.
- Restructuring of the Board to bring in more market knowledge.
- Shift focus from large to small and mid-sized cities.
- Enhance top management.

Cevian recognized that Lindex' economical performance had been good, as accounted for by the gross margin, but operating costs had increased as a percentage of sales for a long time.[141]

One year into the engagement, in October of 2004, Cevian summarized the different measures they had taken through the Board in order to improve the operations of Lindex. Firstly, the Lindex stores in Germany that were not producing profits had been closed. Secondly, the number of working hours in Lindex stores all around the Nordic region had been lowered, but the efficiency gain that Cevian was hoping for was not fully realized. Already prior to Cevian's entry, a new supply, logistics and business system had been decided upon. It was still not fully implemented, and therefore margins had not reached the potential levels.[142]

Although Cevian was not able to extract all efficiency gains from Lindex by 2004, the company was able to change the operations to be more efficient during Cevian's time as owners. Cevian's representatives on the Board secured the profits from ongoing structural changes, increased the

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[139] Interview, Ehrnrooth, 2009-03-20.
[140] Investment Committee Memorandum, Cevian, 2003-09-10.
[141] Telephone minute, Gardell, Förberg, and Alexanderson, 2003-09-12.
[142] Portfolio review memorandum, Cevian, 2004-10-06.

demands on the budget and helped Lindex optimize taxes and cut personnel costs in both the headquarters and in the stores. The management of Lindex was motivated by Cevian's higher demands. According to Investment Manager Marcus Alexanderson, many of the Board members and managers had been under-stimulated.[143] Connected to the operational improvements was also the issue of redemption and dividends. As more money was paid out from Lindex, the managers had to engage themselves more and were able to extract more from their time and devotion.

4.8 MERGERS AND ACQUISITIONS

4.8.1 CALLENBERG

Segulah had an initial plan to enhance the value of Callenberg through add-on acquisitions. Segulah saw a fractionalized market and believed that they could profit from creating a larger business with skills in a substantial number of fields. Therefore Segulah employed a "buy and build case"[144]. During the time of Segulah's holding, Callenberg performed a number of acquisitions:

- *2003* – Norwegian ABB HVAC Oslo.[145]
- *2003* – Two divisions (SwitchBoards and Maritime Service) from Danish Semco Maritime.[146]
- *2005* – Swedish ABB HVAC Gothenburg.[147]

The work with finding, screening and acquiring other businesses was done in cooperation between Segulah's main office in Stockholm and the Board of Callenberg. The decisions about what companies to evaluate and what deals to go through with was a matter for the Board in Callenberg and all final decisions were unanimous.

Connected to the acquisitions made by Callenberg is also a joint venture in China. Callenberg had a brief session on the Chinese market with a project done there on behalf of the Swedish fleet operator Gotlandsbolaget and saw potential in the market.[148] Callenberg also had special knowledge of the market through Chairman of the Board, Jan Norell, who had been responsible for Alfa Laval's operations in Asia.[149] The Segulah representatives Sebastian Ehrnrooth and Anders Claesson were in favor of doing a green field investment in China but the Board decided

[143] Interview, Alexanderson, 2009-03-26.
[144] Investment paper stage III, Segulah, 2001-05-02.
[145] Board minute, Callenberg, 2003-09-23.
[146] Ibid.
[147] Board minute, Callenberg, 2005-06-16.
[148] Interview, Marcusson, 2009-03-31.
[149] Interview, Norell, 2009-04-02.

to do a joint venture instead.[150] According to Jan Norell, this was much due to the fact that Lars Marcusson was concerned about taking too large risks.[151] The joint venture partner was, however, not performing as well as Callenberg demanded, and after six months, Callenberg's Board decided to make a green field investment of their own.[152]

4.8.2 Lindex

Cevian analyzed a possible acquisition of KappAhl and recommended the Board to go through with a bid on the company when Konsument Föreningen (KF) announced that KappAhl was for sale.[153] KappAhl was however sold to Swedish Private Equity firm Nordic Capital at a much higher price than Cevian wanted Lindex to pay. Nordic Capital was, however, able to sell off KappAhl just one year later at a very substantial profit.[154] Also Swedish women and children's wear retailer Polarn & Pyret was mentioned as a potential target in the Investment Committee Memorandum prior to the first acquisition of Lindex shares.[155]

Apart from the evaluation of KappAhl and the outspoken intention to evaluate Polarn & Pyret, Lindex did not screen any potential acquisition targets, as far as our research has shown.

4.9 Geographic expansion/contraction

4.9.1 Callenberg

As from the outset of Segulah's investment, Callenberg had subsidiaries in Sweden, the US and Singapore. Except from acquiring other companies, Callenberg expanded geographically by joint ventures and green field investments. Generally, the geographic expansion seems to have been a matter handled much through the Board but also by management. Segulah's office in Stockholm did not interfere with the expansion but Segulah's representatives on the Board took part in the discussions and decisions made. Of special importance was also the Chairman of the Board, Jan Norell, whom Segulah had recruited. A special case is the Singapore branch that one time was set to be closed down but later expanded again.

During Segulah's ownership, the following geographical expansions were strongly endorsed and later realized by the Board:

- *2002* – Bahamas, green-field investment.

[150] Board minute, Callenberg, 2005-06-16.
[151] Interview, Norell, 2009-04-02.
[152] Interview, Norell, 2009-04-02.
[153] Interview, Alexanderson, 2009-03-26.
[154] Interview, Alexanderson, 2009-03-26.
[155] Investment Committee Memorandum, Cevian, 2003-09-10.

- *2003* – Norway, acquisition.
- *2003* – Denmark, acquisition.
- *2004* – Singapore, re-establishment.
- *2005* – Latvia, green-field.
- *2005* – China, first joint venture, later green-field.
- *2007* – Russia, green-field.

The add-on acquisitions in Norway and Denmark are discussed in section 4.7.1. Establishment in Brazil, Vietnam and India was also considered but Callenberg never went through with either one of them.[156] The reason that the establishment in India was not initiated was much due to Chairman Jan Norell's prior experiences from that market.[157]

As mentioned above, Callenberg also performed a geographical contraction, minimizing the Singaporean subsidiary for about one year during 2003-2004. The Board did see potential in the subsidiary but the operations lacked the skills needed to perform well. When Danish Semco was acquired and integrated into Callenberg's operations it became clear that there were synergies to be realized and knowledge to be transferred between the different subsidiaries.

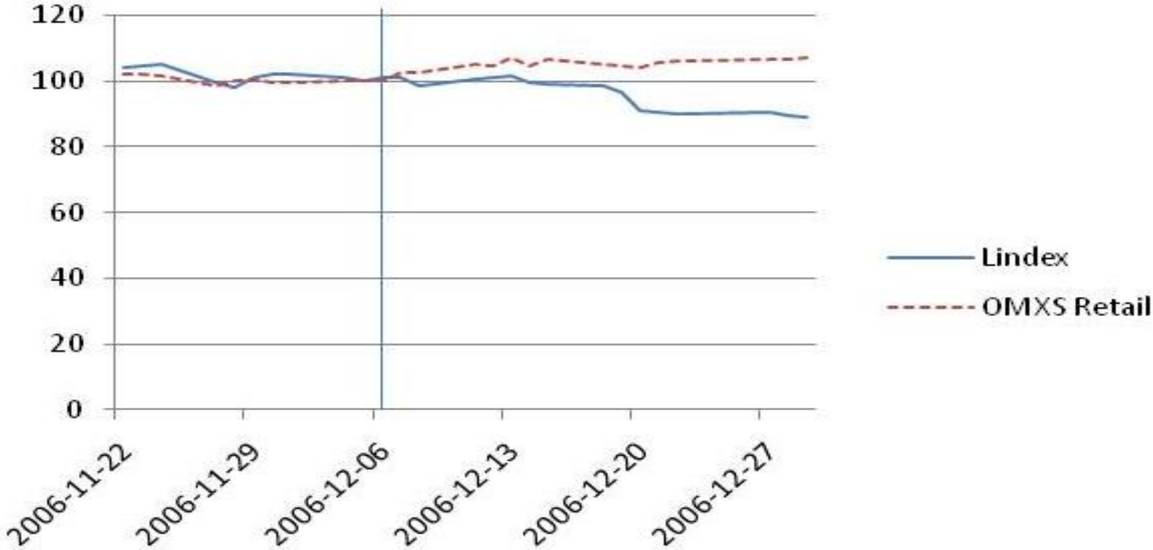
4.9.2 LINDEX

For Cevian, it was important to get control over Lindex' loss-making stores in Germany. The stores had made substantial losses since the beginning and most of them held expensive long term rental agreements, paying well over market price for their locations.[158] This means that Cevian argued for a geographical contraction rather than an expansion. The closing down of the German stores was done in two stages. First, all unprofitable stores were closed during 2004, and later in 2006 the remainder was closed after a Board decision.[159]

The divestment of the German stores was announced on the 6th of December 2006[160] and the stock market reacted negatively to the news. The cumulative abnormal return as compared to the OMXS Retailing Index starting ten days prior to and ending fifteen days after the announcement was -21.08 percent.

[156] Board minute, Callenberg, 2005-04-20.
[157] Interview, Norell, 2009-04-02.
[158] Interview, Alexanderson, 2009-03-26.
[159] Investment Committee Memorandum, Cevian, 2006-09-29 .
[160] *Lindex förhandlar om försäljning av butikerna i Tyskland,* Press Release, AB Lindex 2006-12-06.

Figure 8 Divestment of German stores: Lindex share price plotted against OMXS Retailing Index (2006-12-05=100)



As far as our research has shown, Cevian did not take direct action through the Board to increase the geographical coverage of Lindex but they did take an active role in the closing of the German stores. From the outset of Cevian's investment, Lindex was already running stores in Norway and Finland.

4.10 Exit

4.10.1 Callenberg

After having completed the third and final add-on acquisition in 2005, Segulah initiated the sale of Callenberg. This proved to be too soon. Potential buyers did not have access to consolidated financial statements due to the acquisitions that had been made. Nevertheless, the process went along with a potential financial buyer. They did however pull out at just before completing the deal.[161]

The reason for initiating the sales process was, according to Sebastian Ehrnrooth at Segulah, that he felt that they had achieved their goals with Callenberg. In retrospect, however, he concluded that the decision to sell came too quickly after the add-on acquisitions.[162]

During large parts of 2005 and 2006, Segulah worked with CEO Lars Marcusson and CFO Thomas Forsström to produce the material needed for the sales prospect. Marcusson has

[161] Board minute, Callenberg, 2006-12-20.
[162] Interview, Ehrnrooth, 2009-03-20.

described this as being highly time consuming as well as disrupting focus.[163] Also Chairman of the Board, Jan Norell, agrees that the strategic focus of the Board was lost once the sales process had been initiated. He describes the management of Callenberg as being under a substantial amount of stress during this time.[164]

The sale of Callenberg to Norwegian company Wilhelm Wilhelmsen Group was not completed until November 2007. Segulah had accepted that Callenberg would not be sold in the near future when they failed to complete the deal in 2005. All parties agreed that the sales process stole focus and should be put on hold. When Segulah were approached by Wilhelmsen in 2007, they were not sure if they dared to try and sell the company again. They did and the sale was completed in late 2007.[165]

4.10.2 Lindex

In September of 2005, Cevian felt that they had successfully realized the main part of their value creating agenda. The decision to start divesting shares was taken.[166] During the following 14 months, Cevian sold all of their shares in portions.[167]

[163] Interview, Marcusson, 2009-03-31.
[164] Interview, Norell, 2009-04-02.
[165] Österlind, *Segulah säljer marin jätte*, Dagens Industri, 2007-11-02.
[166] Investment Committee Memorandum, Cevian, 2005-09-21.
[167] Ibid.

5. Analysis

Below, we present our analysis of the above empirical findings, sorted under the same headings.

5.1 Entry

The main difference that stands out when placing Segulah in relation to Cevian is the degree of certainty with regard to what needed to be improved upon in order to enhance the value of their respective targets. Cevian had their agenda set at the point of entry and supported it with massive amounts of data and research while Segulah adopted more of an ad hoc approach. This stands in contrast to the findings of Acharya et al. who found that Private Equity investors generally have a detailed agenda ready at entry. The amount of time and research spent on evaluating the companies differ due to two reasons; different markets and different access to information. By investing into a public company, Cevian had access to financial statements that were more exhaustive than those of their private counterpart. This increased the possibility to perform analysis and gave ideas about where to dig deeper.

Segulah did not have the opportunity to make as thorough investigations, for good and for bad. There are not as many investors evaluating private companies as there are those evaluating public, hence increasing the possibility of finding undervalued targets. However, the analyses that Segulah performed could never have been as detailed and thorough as Cevian's. This might have been the reason why Segulah were not able to secure Callenberg's liquid funds from previous owner Expanda.

Furthermore, it was crucial for Segulah not to have a rigid agenda when working with Callenberg since it would have crippled their agility to be responsive to changing market conditions. There is an inherent element of uncertainty that was incorporated by Segulah already from the outset when they decided to rapidly expand Callenberg's operations. Cevian on the other hand were forced to have a definitive plan in order to get sympathies among other owners as well as on the Board.

5.2 Board Composition and Competencies

Segulah began by replacing the entrenched Chairman of the Board, Rolf Karlsson. He was responsible for having expanded the company in an unfocused fashion when acquiring El-Marine as well as for not realizing apparent synergies between different branches of the business. His actions were in line with the theories of *empire building* and the *effort problem* outlined in section 3.2. By replacing him, Segulah was able to reduce the agency costs associated with those problems.

According to Briggs, investors fund Private Equity because they bring operational and strategic know-how to their targets. When shaping the new Board, Segulah did that. By appointing primarily Jan Norell and Per-Ove Morberg, the industrial competence of Callenberg reached the level needed to expand and improve the business. Nisar argues that Private Equity firms' right to nominate Board members is an important governance tool. By appointing Sebastian Ehrnrooth and Anders Claesson to the Callenberg Board, Segulah was able to use the Board as such a tool.

By using Activist methods, as outlined in section 3.4, Cevian was able to shape the entire Board in less than a year as well as getting Christer Gardell elected as Chairman and Conny Karlsson as interim CEO during the spring and summer of 2004. They were able to inject both competence and commitment despite a relatively small stake in the business. This is well in line with the goals of Activist funds.

Due to the fact that the ownership of Lindex was dispersed and that the Board contained passive members that had remained after large, prior, owners had left the company; it was possible for Cevian to get their will through even with a smaller share of ownership. Furthermore, by substantially increasing the number of Board meetings, Cevian made sure that the activity of the Board increased. After using the unfocused Board as a vehicle to get some control over Lindex and to get representation on the Board, Cevian quickly replaced most of the Board members who were not exerting enough effort. By doing so, and by bringing in more dedicated Board members, Cevian minimized agency costs stemming from *the effort problem* described in section 3.2. The increased number of Board meetings helped mitigating *the effort problem* in a similar fashion as Board members had to work harder and accomplish more.

While Segulah saw the value creation that took place as being attributable to the competencies of the Board members, Cevian rather saw the Board as an instrument through which they could implement their pre-determined agenda. Segulah nominated Jan Norell as Chairman of the Board since they believed that his competence would create value. In contrast, Cevian made sure that they themselves were in control of the Board by securing Christer Gardell's position as Chairman of the Lindex Board.

5.3 Reporting standards

While the reports that Segulah demanded of Callenberg may have been detailed and exhaustive, the size factor demonstrates itself clearly here. The material produced for the Lindex Board was less to the point and far more voluminous. To some extent, it had to be, due to the scale of the business and the capital involved. Acharya et al. describe PLC Boards as generally working more

intensively with aggregate control and management. It is interesting to note how Cevian worked with these issues in a manner similar to the Private Equity approach.

The focus on having sufficient materials to make informed decisions was as relentless with Segulah as with Cevian. Both their business models are driven by thorough analyses and there is no reason why they would not demand equally extensive information.

As the two investors demanded more extensive information, the Boards of their respective targets reacted differently. Lars Marcusson, CEO of Callenberg, reacted negatively to the demands, something that we deem to be an effect of the agency problem known as *the quiet life*. Also Lindex' Board exhibited features of *the quiet life problem* prior to the changes in its composition driven by Cevian. As Cevian replaced entrenched managers and Board members, they effectively eliminated the problem. The conflicts in Callenberg dimmed the focus of the Board, rendering it less able to work constructively, ultimately leading to forgone value creation.

5.4 CONSOLIDATION AND STRATEGIC FOCUS

Both Segulah and Cevian saw opportunities to realize synergies internally in their respective engagements by consolidating separated entities within each company. Synergies that could be realized included merging Callenberg's Swedish operations and combining Lindex' and Twilfit's headquarters. These rather obvious synergies had been left unrealized by previous Boards, a typical example of *the effort problem* that the investors overcame by making the changes.

By not letting Callenberg's management use company resources in order to secure the diversification of their own income, Segulah corrected *the differential risk preference problem*. Callenberg had for a long time suffered from a management that wanted to differentiate the business of the company. Callenberg's CEO Lars Marcusson desperately wanted to invest in land based companies but due to Segulah's strong emphasizes on marine technology, management could not use valuable resources to benefit from a differentiated asset portfolio. This increased the value for Callenberg's owner, Segulah.

Also Cevian played an important role in overcoming *the differential risk preference problem*. Cevian distributed the free cash flows of Lindex and thereby effectively made it impossible for Lindex' management to use those cash flows in a non-productive way. Cevian also overcame the problem by exiting from deals that had been struck with an obvious goal of differentiation, like the acquisition of Twilfit. As outlined in Figure 5, there are signs that the divestiture created value in Lindex, at least in the short run, as exhibited by a positive cumulative abnormal return of the share.

5.5 INCENTIVES PROGRAM

The core problem in agency theory is how to align the interests of managers with those of owners. Both Segulah and Cevian are strong believers in creating monetary incentives for managers and Board members. However, their views on how this should be done differs somewhat. While Segulah are strong advocates of ownership, Cevian are positive to using options, much due to their lower required investment as well as the simple fact that there is a publicly traded stock to act as underlying. The fact, however, that both of them used a combination of regular bonuses and other incentives is well in line with how to best mitigate *the effort problem* according to Byrd et al.

The fact that Chairman Jan Norell did not see any changes in the motivation of either managers or Board members after Segulah created monetary incentives indicates that the incentives program was not as important as suggested by theory or that it was not extensive enough. Rather, the increased information flow and provision of new competencies could have been the crucial factors behind the successful Board work.

5.6 HUMAN RESOURCES

There was a significant difference between how Segulah and Cevian worked when it came to employing top managers. Cevian was determined and did not accept any lack of competence or cooperation while Segulah accepted Lars Marcusson's sometimes less cooperative sides. The reason to this might be that there are fewer experienced and competent managers in the field of electrics and marine technology in Sweden as compared to the fashion retail industry. It is, however, hard to believe that the skills of Callenberg's CEO were impossible to find somewhere in Sweden or the Nordic region. It seems as though CEO Lars Marcusson had skills and experiences that were truly valuable to Callenberg, but the problems with aligning his objectives and goals with those of Segulah was a source of conflict and value destruction during the first two to three years of Segulah's ownership.

The owners of a company can provide their target firm with valuable networks as discussed by Nisar, but only Cevian worked intensively with recruitments. As soon as Jörgen Johansson left Lindex, Cevian had a candidate who could take immediate responsibility of the operations and then Cevian followed up through Christer Gardell's partaking in the CEO recruitment committee of Lindex.

In the short term, Lindex' share price declined on the news of Jörgen Johansson's dismissal as well as Göran Bille's appointment as CEO. The declines are probably attributable to the uncertainty created when changing top management. The long term outcome of the change in

management composition is more difficult to examine econometrically, but it is likely that Cevian helped increasing Lindex' value through the hiring of a more devoted and competent management team. We believe that Göran Bille was the right person for the position and that Cevian contributed substantially to increase the value of Lindex through helping the company find him. Bille has stayed in Lindex and the company has been able to produce better margins than his predecessor, as displayed in Figure 3.

Acharya et al. claim that PLC Boards are more committed to their managers and their development while Private Equity controlled Boards are relentless in their focus to recruit the right people. Our results point in the opposite direction, namely that Segulah were slow and committed while Cevian brought in the Private Equity approach to the Lindex Board.

Jan Norell of Callenberg has described the recruitments of top managers as being the most neglected aspect by Segulah and the whole Board of Callenberg. Through neglecting this area, Segulah was responsible of value destruction caused by more than one source. Firstly, Lars Marcusson, who should have been CEO for the whole group, was not able to concentrate on that issue for two whole years while the Swedish divisions did not have a CEO. Secondly, the Swedish divisions were not able to produce as good results as they could have since they lacked focused leadership. Thirdly, the long time that the recruitment issue was on the schedule of each Board meeting might very well have disrupted the strategic focus and work of the Board. The same reasoning goes for the problems finding a CEO for the US division, although it took less time. There are no reasons to believe that Segulah could not have been as agile as Cevian in finding new talent for Callenberg's top management.

5.7 Operational improvements

Cevian had a much more specific agenda upon entry than Segulah. But just as Segulah did not provide new ways to produce the final goods and services, Cevian did not work with Lindex's clothing lines. While Segulah's improvements were of a sort providing a context to work within, Cevian's were more precise and direct.

Klein and Zur describe Activists as primarily working with the IT, logistics and distribution parts of the business. This holds true for Cevian who devoted much time to IT and logistics. Cevian can also be seen as taking a Private Equity approach to operational performance management. The reason why they worked intensively with these issues is probably that they wanted to create possibilities to influence operational issues. Segulah worked with every aspect of the business and tried hard to mitigate agency problems such as *the quiet life*, a phenomenon that demonstrated itself when managers set too low targets in order to be able to meet them.

In contrast to the findings of Acharya et al., who claim that Boards in Private Equity owned companies work more intensively with performance management than PLC Boards, Cevian influenced the Board of Lindex to work with these issues in a manner similar to what is normal for Private Equity controlled Boards. The reason for this work is that by putting focus on short term metrics, Cevian aimed to create long term value that would be reflected in an increased share price.

5.8 Mergers and Acquisitions

There are striking differences between how Segulah and Cevian worked with the Board to evaluate add-on acquisitions. Both Segulah and Cevian had an outspoken will to evaluate and perform add-on acquisitions but only Segulah made these acquisitions an integral part of the work on the Board. Segulah involved the Board heavily and gave them room to decide what different targets to pursue. The fact that Segulah's representatives worked so intensively with acquisitions created value for the company they invested in. Segulah used the market knowledge and the skills in Callenberg's Board to find the right acquisitions and they were dedicated to perform deals that could earn them synergies.

The reason for Cevian's unwillingness to have acquisitions as an important part of the agenda could be due to the fact that there were internal problems to be corrected and that an acquisition would have created even greater uncertainty in the business.

Cevian involved the Board to a much lesser extent than Segulah. Instead, they focused on operational improvements and strategies to enhance the performance of the existing company. Cevian did not use the full potential of the Board and all the market knowledge that was present in it after the changes in the composition initiated by Cevian, at least not when it came to making acquisitions. The fashion retail market might be far from as fractionalized as the market for marine technology and electricity solutions but we see substantial possibility for efficiency gains and synergies for Lindex if they would have acquired another retailer. Lindex would have gotten a very strong position when negotiating contracts with both its suppliers in the Far East and the landlords in the Nordic region. As Nordic Capital were able to buy and sell Lindex' competitor KappAhl within a year, with a return of about 100 percent, it seems obvious that a company like Lindex could have realized operational synergies that Nordic Capital could not and thereby have profited even more.

Due to the apparently different business models, Segulah and Cevian had very different focus. While Cevian did not see the need for long term strategic work, the success of the Callenberg investment depended upon Segulah's ability to provide acquired growth and long term strategy. This difference can be derived from the sizes of the different investments. While Lindex was a

large publicly traded company with a well-defined business model, Callenberg did not have the tools to grow organically, albeit that they were profitable.

5.9 Geographic expansion/contraction

Both Segulah and Cevian worked intensively with the issue of geographical coverage even though Segulah's agenda was more focused on adding new markets and Cevian's on cutting costs. They both focused on the Nordic market, Segulah by extending their operations through acquisitions in Denmark and Norway and Cevian through divestiture in Germany. This divestiture was a correction of earlier management's *empire building* activities. When those managers had left the business, it was easier to correct this problem.

In the short run, the divestment of the German operations might have been conceived by the market as a sign of weakness as exhibited by the decline of the share price. However, in the long run, we share Cevian's view that had the divestment not been made, the German operations would have consumed cash flows and destroyed value. There is a possibility that the market failed to incorporate this in the stock price in the short run.

5.10 Exit

The most striking difference between the ways in which Segulah and Cevian exited their companies is the degree to which they let it affect their investments. While Segulah had to sell a whole company to a strategic buyer, all Cevian had to do was to sell their shares on the stock market. Due to these differences, Callenberg was seriously affected by Segulah's ineffective sales process while Lindex did not experience much interruption.

Private Equity and Activist investors align the Board's and executive management's horizon to the shareholder horizon. The horizon might, however, not be the same as concluded by prior research. Both Private Equity and Activist investors effectively create two horizons at the same time.

The investor creates a long term horizon for management by providing them with the tools necessary to continue working in a productive fashion after the investor leaves the company. The investor does, however, also create a common horizon between the investor and the Board that is much shorter. The high probability of a trade sale to a larger company when a Private Equity investor divests also implies a high probability of substantial changes on the Board. Because of that, the Board in a Private Equity owned company will work for value maximization in the same, shorter, time horizon as the Private Equity owner.

The above is well in line with what actually happened in Callenberg. At the same time as a context for long term value creation was brought to the company, the Board worked with a common, shorter horizon as well.

When there is a large possibility that a company in which an Activist investor has invested will be sold as a whole entity at exit, the same argument holds for the Board of an Activist controlled firm. This might, however, also imply a different horizon between the Activist and other shareholders.

6. Conclusions

In this study, we have aimed to evaluate the role of the Board as a governance tool in two companies targeted by either a Private Equity investor or a Shareholder Activist. From studying Segulah's investment in Callenberg and Cevian's investment in Lindex, we have drawn the following conclusions.

The Board sets strategic goals and takes the most important decisions concerning the business, so if the investor is able to bring in enough competence, the Board can create shareholder value both in the short and in the long run. In the two cases studied, the investor seldom intervened in the business in any other way than through the Board. This clearly demonstrates the importance of the Board's role as a governance tool.

By clearly conveying their time horizon to the Board, a Private Equity investor, as well as a Shareholder Activist, can align interests and create value in the short run and at the same time create a context within which value can be created also in the long run.

Agency theory suggests that agents may not exert as much effort as possible to maximize the utility of the principal. Dispersed or unfocused ownership allows for unfocused work on the Board, a problem associated to *the effort problem*, best exemplified by Lindex' Board prior to Cevian's entry. The sole provision of focus can allow a targeted firm's Board to reach its inherent potential. Board members that have not exerted enough effort in the past might need to be replaced in order to overcome *the effort problem*.

According to theory, Private Equity investors enter their targets with a clear agenda of how to improve upon the business. The ability of a Private Equity firm to not always use the traditional Private Equity approach to Board work in targeted firms allows for a greater agility in response to changing market conditions. This may be of crucial importance if there is inherent uncertainty in the business, exemplified by Segulah's intention to grow Callenberg aggressively. This reasoning is analogous to how Activist investor Cevian used the public market and adopted a Private Equity approach to change the course of Lindex' stagnated business.

The complete ownership that Private Equity firms enjoy in their target companies does not mean that they completely control the Board. Even if the investor has the possibility to dismiss all members of the Board, the Board members can entrench themselves by conveying a picture of themselves as indispensible. Activist investors share the ownership of the targeted company with other investors and the fact that they can not keep all the value created for themselves forces them to be more comprehensive and extract all value that there is to be extracted. It is thereby more difficult for Board members to entrench themselves in Activist controlled

companies than in Private Equity controlled peers. Instead of swiftly replacing non-cooperative managers, Private Equity investor's representatives on the Board can consume private perks in the form of not dealing with difficult decisions, e.g. not letting incumbent managers leave the business if they are uncooperative or do not contribute to successful Board work. We find that the shared value creation of Activists do not allow for such behavior.

As shown in out study, apart from overcoming the costs attributable to agency problems, the Private Equity investor as well as the Activist investor also contributes to value creation in the target company by providing its Board with a network. The network provided by the investor is a way through which competence to the Board is attracted but also an important link to acquisition targets and financial counterparts.

We conclude that information flows are essential to minimizing agency costs. When Private Equity and Activist investors increase the demand for reporting materials from managers in the businesses that they invest in, they effectively increase the information flow. The investors create value by transferring control costs from themselves to the management of the controlled business.

7. FURTHER RESEARCH

We have provided insight into how not only a Private Equity firm, but also a Shareholder Activist, use the Board of directors as a governance tool in order to control and develop their target companies. The approach has been to perform a comparative case study concerning two investors and two targets. In order to reach more general conclusions, it would be interesting to conduct a similar study, but to include more companies, both investors and targets.

Even though research has been done on the subject and recent studies have explored the question of whether or not Activist Investors create value in their targets, more research needs to be done. Our findings point in the direction that the agenda that Activists bring to targeted Boards creates focus and helps the companies to overcome agency issues but, our findings are not conclusive.

Generally, the amount of studies conducted on mid-market Private Equity transactions is very limited. The amount of Venture Capital literature, on the other hand, is quite extensive. Making up a vast majority of the Private Equity deals struck in Europe, investments in seasoned businesses are contributing not only with return for investors but, as importantly, with capital for the base of the European industrial society. More information benefits all participants in the market and we are therefore hoping that a general interest in the mid-market Private Equity business soon will be awakened among scholars.

Another interesting extension would be to evaluate the Private Equity and Activist investors' roles as agents rather that principals and the implications this has on the Board work of targeted companies.

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Appendix 1 Guidelines for successful Board work

Based on our findings in this thesis we have developed some guidelines for Private Equity investors to use as a checklist in order to minimize agency-problems and maximize shareholder value through the Board of directors.