

# Private equity as a form of active and professional ownership

An analysis of value-adding mechanisms of private equity in Finland

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Maija Järvenpää

# Agenda

## Executive summary

**Background**

**Key findings**

**Conclusions**

# Executive summary

## Background and motivation

- Private equity has been shown to accelerate growth; What is the role of the private equity investor?

## Key themes

- Two different perspectives on value-added by private equity
  - Activities performed by PE investors
  - Intangible resources provided by PE investors

## Key findings

- Successful PE investors
  - are adaptively involved in their portfolio companies, taking into account the background of the portfolio company and industry characteristics
  - provide their own expertise and acquire complementary expertise through networks

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# Background

## Research questions

- 1) **What** are value-adding mechanisms of private equity?
- 2) **How** have Finnish PE investors used these mechanisms in order to contribute to the performance of their portfolio companies?
- 3) What is the role of **industry characteristics** on value added by private equity?
- 4) How do **investor characteristics** affect value added by private equity?

## Research design

- Multiple-case study supported by a fsQCA method
- 15 cases of which 9 buyout and 6 VC cases, various industries
- Case companies received the first round of PE funding during 2007-2011
- In total 23 interviews of which 15 with investor representatives and 8 with CEOs/key managers
- Interview data supported by secondary data sources

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## Data revealed two key themes

**Activities performed by PE investors**



**Intangible resources provided by PE  
investors**

# The list of activities performed by Finnish PE investors is extensive

Activity	Potential objectives
Change the composition board of directors and develop board work practices	Improve accountability Provide support for the top-management team
Systematize performance monitoring and set performance targets	Improve accountability
Participate in the development of the top-management team	Revitalize the company Professionalize the company
Participate in strategic planning	Create a new strategic direction (Re)focus or refine the strategy
Participate in decision-making and execution of significant investments such as acquisitions or investments in production capacity	Mitigate risks Enable risk-taking Provide support for the top-management team
Act as a sounding board, spar and mentor the CEO	Provide support in day-to-day problems Provide support during intensive strategic changes
Represent the company together with the top-management team	Provide legitimacy in the eyes of external stakeholders such as debt and equity providers and potential customers

**Question 1:**

**The set of value-adding activities of private equity is diverse - However, the purpose to perform a certain activity seems to be more important than the activity itself**

## Investor involvement has two, partly contradictory goals

Activities that promote **entrepreneurial behavior**, e.g.:

- A new strategic direction
- Development of the top-management team in order to revitalize the company

Activities that promote **professionalization**, e.g.:

- Improved monitoring and corporate governance
- Development of the management team in order to professionalize the company

## Case companies form four groups in terms of the focus of investor involvement

	Investor focus on promoting entrepreneurial behavior	Investor focus on promoting professionalization
Buyout	<p>Group 1: Buyout investor as an engine of growth</p> <p>Example case: A</p>	<p>Group 2: Buyout investor as a growth facilitator</p> <p>Example case: G</p>
VC	<p>Group 4: VC investor as an engine of growth</p> <p>Example case: J</p>	<p>Group 3: VC investor as a growth facilitator</p> <p>Example case: M</p>

**Questions 2 & 3:  
Successful PE investors use tools of active  
ownership adaptively taking the current  
development stage and industry characteristics into  
account**

## Finding a balanced mix of experience

PE investors provide portfolio companies with their own expertise and contacts...

Expertise and networks accumulated through:

- PE experience
- Other business experience
  
- Direct industry experience
  - as an entrepreneur or manager
  - as an investor

... and recruit outside board members with relevant backgrounds

## Three 'experience portfolios' were associated with positive portfolio company performance

	Group 1: "Industry experts"	Group 2: "Diversified professionals"	Group 3: "Networkers"
<b>Investor experience</b>			
PE experience	✓	✓	
Other business experience		✓	✗
Direct industry experience	✓	✗	✗
<b>Outside expertise</b>			
Share of outside board members large	✗		✓

Note: ✓ means that the condition is present while ✗ means that the condition is absent in the given group. The size of the symbol indicates the relative importance of the condition. An empty cell means that the condition can be either present or absent i.e. the condition is insignificant in the given group.

**Question 4:**  
**Successful PE investors identify their own areas of expertise and acquire complementary expertise through their networks**

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# Private equity investors are active and professional owners

## Successful PE investors:

1

Promote **opportunity-seeking behavior** and risk-taking in their portfolio companies when it is justified and controllable

3

Adaptively use tools of **active ownership**, taking into account portfolio company and industry characteristics

2

Facilitate growth by providing non-financial services that **mitigate risks** related to high growth

4

Offer portfolio companies not only their own **expertise and networks** but also that of external industry experts

# Appendix

# Focus of investor involvement

## Group 1: Buyout investor as an engine of growth

### Group summary

- Portfolio companies typically established and in relatively stable industries
- PE investor promotes entrepreneurial behavior by creating a new strategic vision and a value creation plan together with the top-management team
- Often a new CEO is recruited to lead the strategic transformation/to revitalize the company

### Example case: A

"What [PE investor] brought was the industrial vision to build this type of an entity. [PE investor] supported the management, together with the management scouted and found good acquisition targets and acquired financing for acquisitions. [PE investor] acted as a growth engine."

-CEO

# Focus of investor involvement

## Group 2: Buyout investor as a growth facilitator

### Group summary

- Portfolio companies typically at a phase of fast growth at the time of the investment
- Industry changes may be rapid yet relatively predictable
- Similarly to Group 1, focus of strategic planning is on a medium-term value-creation plan
- PE investor promotes professionalization by improving monitoring practices, challenging views of the management and formalizing board work

### Example case: G

"I would say that after our investment the company had a real board of directors for which the management had to report. ... We had once a month a board meeting for which the management prepared reports and presentations. I feel that this kind of shape up was the foundation for everything. Now [The company] was managed like a real company. And this does not mean that it had not been managed well before us, but I guess it became more conceptualized, more focused"  
-Investment partner

# Focus of investor involvement

## Group 3: VC investor as a growth facilitator

### Group summary

- Companies in this group are young fast-growing ventures at the time of the investment
- In most cases in this group, industry changes are rapid and somewhat unpredictable
- PE investor promotes professionalization by improving monitoring practices, challenging views of the management and formalizing board work
- Often a new CEO is recruited to professionalize the company
- PE investor provides credibility

### Example case: M

"In the beginning, they (investors) were exceptionally active in aspects related to running the business. They clearly saw that we understood and still understand our market and market dynamics better than anyone in the world. ... We had just entered the market and probably our greatest weaknesses were related to governance structures and basic corporate infrastructure. So, [the VC] as an active guy took quite an active role in these things - both in good and bad. Afterwards, it was definitely a good thing, but at that time it did not always feel like that."

-CEO

# Focus of investor involvement

## Group 4: VC investor as an engine of growth

### Group summary

- This group is a hybrid of Group 1 and Group 3
- In Case J, PE investor is also a co-founder of the company and hence has a more entrepreneurial approach on investor involvement
- E.g. initial funding enabled the company to have an organization of 20 employees from day one
- A new CEO was recruited to revitalize the company
- PE investor provides credibility

### Example case: J

”In order to launch the business, an initial funding of just over million euros was needed. ... It (funding) enabled us to have about 20 employees from day one. Without the initial funding, it (the business) would have been quite impossible to launch because our customers are quite demanding. They demand credibility, best sponsors and (best) people. ... Otherwise, they don't trust that they will get all the required help and hence, they will not be willing to pay for it (the service).”  
-Investment partner & co-founder

# Intangible resources provided by PE investors

## Related quotes

### Group 1: “Industry experts”

“Through us (PE company), some new discussions can be started. Or then it can be the other way around; when the organization faces some challenges they ask us 'hey who could help us, who knows something'. ... This, quite logically, is related to our long industry experience of 10-15 years”  
-Investment partner & co-founder of Case J

### Group 2: “Diversified professionals”

“We used to think that we lack good, experienced entrepreneurs. I think that nowadays we have quite many so called serial entrepreneurs in Finland and entrepreneurship is highly valued. Currently, in my opinion, it is difficult find outside board members.”  
-Investment partner of Case L

### Group 3: “Networkers”

“(When building the board of directors), we considered what types of backgrounds would be beneficial. And after that we recruited the board. ... We noted that we should put more focus on Sweden and hence we recruited [the new chairman of the board] who is a former member of the management group of [large Swedish company].”  
-Investment partner of Case E