Management control system change in buyouts

A multiple case study on management control system change in private equity performed buyout transactions

John Tore Aas

Supervisors:
Associate Professor Daniel Johanson (NHH)
Dr. Roberto Jaoquín Santillán Salgado (EGADE)

Master thesis in Business Analysis and Performance Management (BUS) and International Business (MIB)

This thesis was written as a part of the Master of Science in Economics and Business Administration program - Major in Business Analysis and Performance Management (BUS) at NHH and as a part of the Master in International Business (MIB) at EGADE. Neither the institutions, nor the advisors are responsible for the theories and methods used, or the results and conclusions drawn, through the approval of this thesis.
ABSTRACT

This empirical study investigates how the control package change in private equity performed buyout transactions. The overall research question is:

**How does the control package change following a buyout transaction performed by a private equity firm?**

The method applied is the multiple case study design with six buyout cases in the Scandinavian private equity industry. For each case there is conducted one interview with a private equity professional. The study applies the theoretical frame suggested by Malmi and Brown of management control system as a package and is based on prior research on buyouts and changes in the management control system.

The study suggests that following a buyout transaction there exist a major opportunity to change and alter the use of the management control systems. There are not necessarily introduced new control tools, but the existing ones are developed to better fit the operating environment and an altered strategy. The use of the systems is in general intensified, and control is centralized. After buyout there appears to be a clear initiative of aligning the interests of the new owners with those of the management and employees, by connecting reward and compensation closer to company performance.

The private equity firms appear to have an important role in the development of the management control systems after buyout. In the position as a majority owner the private equity firms take board position and play an active role, directing their investment. In changing the system the role of the private equity firms is foremost seen as an initiator. Nevertheless, when needed the private equity firms also assist in the implementation of changes.
# TABLE OF CONTENTS

ABSTRACT ................................................................................................................. I
TABLE OF CONTENTS ............................................................................................... II
TABLE OF FIGURES ...................................................................................................... IV
TABLE OF TABLES ....................................................................................................... V
PREFACE ..................................................................................................................... VI

## PART 1. INTRODUCTION ......................................................................................... I

1.1 Background and motivation for topic .................................................................. 1
1.2 Research questions ............................................................................................ 2
1.3 Aims .................................................................................................................... 4
1.4 Structure ............................................................................................................ 5

## PART 2. PRIOR RESEARCH AND THEORETICAL FRAME ..................................... 6

2.1 Private equity – business, firms and funds ......................................................... 6
2.2 Private equity performed buyout ....................................................................... 9
   2.2.1 Types of buyouts ......................................................................................... 9
   2.2.2 Understanding buyouts ............................................................................... 9
   2.2.3 The appearance and cycles of buyouts ....................................................... 10
   2.2.4 Performance in buyouts ............................................................................. 11
   2.2.5 Changes and actions performed in buyouts .............................................. 12
   2.2.6 Corporate governance ............................................................................... 14
   2.2.7 Agency costs ............................................................................................. 15
   2.2.8 Categories of buyout opportunities .......................................................... 15
   2.2.9 Conclusion on buyout ............................................................................... 17
2.3 Management control systems (MCSs) ............................................................... 18
   2.3.1 Defining management control systems ...................................................... 18
   2.3.2 Concepts of systems and management control .......................................... 19
   2.3.3 Approaches to management control system ............................................. 21
   2.3.4 Conclusion on management control systems ............................................. 27
2.4 Prior research on changes and effect on MCSs ............................................... 28
   2.4.1 Contextual factors and studies on changes and effect on MCSs ............... 28
   2.4.2 Studies on buyouts´ effect on strategy and goals ...................................... 31
   2.4.3 Studies on buyouts´ effect on MCSs ......................................................... 31
   2.4.4 Conclusion on changes and effect on MCSs ............................................. 33
2.5 Research framework ......................................................................................... 34
III

PART 3. RESEARCH METHODOLOGY

3.1 Field of study

3.2 Research design

3.3 Data collection

3.4 Evaluation of research design

PART 4. EMPIRICAL DATA AND ANALYSIS

4.1 Introduction to cases

4.2 Changes in strategy and goals

4.3 Changes in the various components of the MCS

4.3.1 Planning controls

4.3.2 Cybernetic controls

4.3.3 Reward and compensation controls

4.3.4 Administrative controls

4.3.5 Cultural controls

4.3.6 The package of controls – a summary of changes

4.4 The role of the private equity firm

4.5 Summary of analysis

PART 5. CONCLUSION AND FURTHER RESEARCH

5.1 Conclusion

5.1.1 How do the various components of Malmi & Brown’s (2008) control package change following a buyout transaction?

5.1.2 What is the role of the private equity firm in initiating and implementing changes in the control package?

5.1.3 How does the control package change following a buyout transaction performed by a private equity firm?

5.2 Suggestions for further research

REFERENCES

APPENDIX

Appendix 1: Structured interview guide
**TABLE OF FIGURES**

Figure 2-1: PE funds according to portfolio company maturity (model after Bance (2007))... 7

Figure 2-2: Private Equity Fund Structure (model after Berg-Utby (2007)) ......................... 8

Figure 2-3: Buyout categories ........................................................................................................ 16

Figure 2-4: Relationship between planning and control functions ............................................ 20

Figure 2-5 Management Control Systems Package (Malmi and Brown, 2008) ...................... 23

Figure 2-6: Research model ............................................................................................................ 35

Figure 3-1: Types of designs for case studies ............................................................................... 42
TABLE OF TABLES

Table 3-1: Interview overview ........................................................................................................... 44
Table 4-1: Case overview .................................................................................................................. 54
Table 4-2: Findings changes strategy and goals ............................................................................... 56
Table 4-3: Findings changes planning controls .................................................................................. 59
Table 4-4: Findings changes cybernetic controls ............................................................................. 65
Table 4-5: Findings changes reward & compensation controls ....................................................... 68
Table 4-6: Findings changes governance structure .......................................................................... 73
Table 4-7: Findings changes organization structure ........................................................................ 75
Table 4-8: Findings changes policies and procedures ...................................................................... 77
Table 4-9: Findings changes cultural controls .................................................................................. 79
Table 4-10: Summary findings changes in MCS ............................................................................ 82
PREFACE

This thesis is written as a part of the Master of Science in Economics and Business Administration program at the Norwegian School of Economics (NHH) and as a part of the Master in International Business program at EGADE Business School, Tecnológico de Monterrey.

Performing a qualitative study on the private equity industry requires extensive use of sensitive, not readily available, information. Studying the field of private equity has been an inspiring and rewarding process. However, without the help of the private equity firms this study would never have been possible. I would like to express my gratitude to the private equity professionals that have given me insights to their interesting cases and provided me with extensive information.

This paper has partly been written at Norwegian School of Economics in Bergen, supervised by Associate Professor Daniel Johanson, and partly at EGADE Business School, Tecnológico De Monterrey, supervised by Dr. Roberto Jaoquín Santillán Salgado. I would like to express my gratitude to Professor Johanson for extensive guidance and constructive suggestions during the whole process. Furthermore, my sincere thanks go to Dr. Santillan, for assisting me in the second half of this process, providing me with challenging questions and helpful feedback.

Oslo, Norway, May 2012

John Tore Aas
PART 1. INTRODUCTION

1.1 Background and motivation for topic

Among professional investors today, private equity (PE) is a highly respected asset class. Since the beginning of the 1980s PE firms have performed buyout transactions. They have invested in companies, which they have held on to for a couple of years, and then exited, often with a substantial profit. In the past 30 years the “business” of PE has been studied by academics.

Researchers seem to agree that PE on average creates economic value and that a buyout leads to performance gains (Kaplan and Strömberg, 2009; Wright et al., 2009). Studies also show that buyouts enhance financial performance (Cumming et al., 2007). The approach in most research conducted on PE and buyouts has brought attention to the economic perspective. Focus has primarily been on effects on performance, efficiency, governance and value creation for shareholders. There have been several studies on whether or not buyouts lead to enhanced performance and what changes that are done in the case of financial, governance and operational engineering. These changes seem well supported and understood. Less understood is what happens to the management control and the systems of control used by managers, following a buyout.

In controlling and managing a company, management control systems (MCSs) are of high importance. As a company grows the need for appropriate MCSs increase, as the managers are not able to keep direct control and supervision on the employees. There is a need to employ certain systems to monitor and give incentives to the employees, to make sure they behave in consistence with the firm’s strategy and goals. These systems should give managers feedback on how the company performs and give the ability to alter the direction if necessary.

Little research attention has been given to what happens to the MCSs following a buyout. Otley (1999) argues that it is important to study the MCSs in organizations that are changing, in particular when managers have responsibility for strategy, management control and operational control. Although this is most common in management buyouts (MBOs), many of the same features appear in buyouts performed by PE firms. Even if the managers in a PE
performed buyout do not own the firm themselves, they often obtain an equity stake, which most likely will align their interests with those of the owners.

As pointed out above, little research on how MCSs change in buyouts has been conducted. A paper by Bruining et al. (2004) is one of the few on this subject. Bruining et al. studies the impact on strategy and MCSs, which management buy-outs (MBO) might have, by employing the levers of control framework by Simons (1995). This is basically the only study on changes in control systems in buyouts, where a framework for MCSs has been applied.

Other relating studies have more or less focused on separate parts of what constitutes MCSs. Jones (1992) has studied changes in accounting control systems following MBOs. Other studies have looked more on the case of venture capital and changes in parts of the MCS (Davila and Foster, 2007; Mitchell et al., 1997; Silvola, 2008).

It is surprising that the case of changes in MCSs following a PE buyout is so little studied, especially when taking into account that emphasize on changes in MCSs have been stressed by academics like Otley (1999) and Chenhall (2003). Even more surprising is the lack of interest on this field when Phan and Hill (1995) report that “the change in governance structure that occurs with an LBO [leveraged buyout] does affect firm goals, strategy, and structure” (p.730). Strategy and goals are most often seen as contingent variables of the management control systems (Otley, 1999; Simons, 1995). When strategy and goals change, theory then suggests that MCSs would change too. Instead of focusing on what kind of “engineering” (Kaplan and Strömberg, 2009), or focusing solely on which incentive and control devices (Meuleman et al., 2009) are most important in determining efficiency and productivity gains in buyouts, it would be interesting to study the MCSs in a more or less holistic approach, to get an understanding of what happens to the MCSs in a buyout. Today too little is understood about the effects of a buyout on MCSs.

1.2 Research questions

Overall research question:

How does the control package change following a buyout transaction performed by a private equity firm?
Specific research questions, derived from the above:

How do the various components of Malmi & Brown’s (2008) control package change following a buyout transaction?

What is the role of the private equity firm in initiating and implementing changes in the control package?

The control package refers to the set of controls management uses to monitor the performance and direct behavior of the employees, with the aim to employ a strategy to reach given goals. As a package it is understood that management controls operate together and are interrelated (Malmi and Brown, 2008). From a contingency-based perspective there are no MCSs applicable for all organizations (Otley, 1999), meaning that appropriate systems for control for an organization depends on the specifics of the organization and the environment that it operates within. Different organizations will necessarily have a different control package, and also the control package will evolve as the specifics of the organization and its surroundings change.

A buyout transaction typically appears when a PE firm acquires a significant portion or majority control of a mature business with established plans (Bance, 2007). A buyout transaction is normally performed as an investment in a PE fund, which usually has a limited lifetime, and which is managed by a PE firm. It has been argued that buyouts resolve some of the conflict between owners and managers, by better aligning the interest of the owners and managers (Jensen, 1989). Agency theory deals with this type of conflicting interest that can exist between owners and managers, and the inherent cost of this (Jensen and Meckling, 1976). By introducing a new form of corporate governance and active involvement, PE firms seek to reduce this cost and develop the firms to increase the value. In doing so the contextual variables of a company’s control systems are likely to change. For example ownership, leverage, strategy and goals are in earlier research shown to change in buyout transaction (Gilligan and Wright, 2010; Phan and Hill, 1995).

As the research on how MCSs change in buyouts is limited, and it seems to be support in the literature that the MCSs will change in a buyout transaction, it is interesting to study this area closer. The overall research question seeks to get an overall understanding of how the MCSs change. Accordingly the focus is on the control package, and not on separate systems. A
study on separate systems might be more precise, but could risk neglecting the fact that the different systems are interrelated and work in cohesion.

The two specific research questions will be investigated to understand and answer the overall research question. To get an understanding of how the control package changes it is necessary to first investigate the various components of the control package, and how they change. As a typology the framework suggested by Malmi and Brown (2008) will be applied. The second specific research question aims to understand the role of the PE firm, as an active owner, in changing these systems. How the PE firm participates in a process of changing the control package can explain and provide understanding of how the overall control package is changing.

Addressing the research questions will been done in mainly three steps. First the nature of PE and buyouts will be examined. Together with a theoretical study of frameworks for studying MCSs and practical presentation of prior studies, this will lay the foundation for the research. Second, changes in the systems, and the nature of the changes, will be examined. Third, and last, the research findings with implications for buyouts will be identified and discussed.

## 1.3 Aims

This paper aims to contribute to the rapid building research being done on the PE industry, more specifically PE performed buyouts. The view applied in this study makes it a novel study and will hopefully lay the foundation for further research. The primarily aim is to understand how MCSs change following a buyout. Further, the thesis aims to understand how these changes are initiated, and how the PE firm involves, as an active owner, in these changes.

Since there has been done little research on buyouts with this approach, it would be necessary to first get an impression on what changes happens to the MCSs following a buyout. Also one should seek to understand to what extent PE managers involve in changing and/or improving these systems. Subsequently it would be possible to conduct a research addressing the issue on how, and which, changes in the MCSs are important in determining efficiency and productivity gains in a buyout, and how the degree of PE managers involvement affect this.
For a thesis, with a limited time frame, one would be confined to study only the first part. This study will concentrate on understanding how the MCS changes and what role the PE firm has in initiating changes. The study examines changes in the overall control package, but places strong emphasis on issues relating to the traditional controls, such as planning controls, budgets, financial control, incentives and governance.

In this paper this is analyzed by studying real cases, conducted by PE firms in Norway. Six cases are analyzed through semi-structured in-depth interviews with PE professionals. In-depth interviews are important to understand the cases at point and the changes in the MCSs. This gives detailed insight in the cases, and can give an understanding on how management control systems change following a buyout.

1.4 Structure

The rest of this paper is divided into four sections:

- Part 2. Prior research and theoretical frame
- Part 3. Research methodology
- Part 4. Empirical data and analysis
- Part 5. Conclusion and further research

Part 2 gives an introduction to the PE industry and buyouts. Furthermore, frameworks for analyzing MCSs are presented, and earlier studies on changes in MCSs are discussed. Given the theoretical perspective and prior research a research framework is suggested. In Part 3 the methodology and research design used in this paper is described. Part 4 includes the empirical data collected and analysis. Part 5 is the conclusion of this paper, which concludes on the research questions, and includes suggestions for further research.
PART 2. PRIOR RESEARCH AND THEORETICAL FRAME

Since the purpose of this thesis is to study how the control package change in a PE performed buyouts it is necessary to understand buyouts, concepts of MCSs, and how MCSs change. This part will present the theoretical background and a review of prior research. Firstly, in part 2.1 and 2.2 the PE business and PE performed buyouts will be introduced, together with relevant prior research. Secondly, MCS will be defined and different approaches for studying the MCS will be presented in part 2.3. Bringing the view of buyouts and MCS together will be done in part 2.4. Both how management control systems change and prior research relevant for how a buyout might affect the MCS will be presented. Finally, in part 2.5, given the theoretical perspective and prior research presented, a research framework will be suggested. This framework will set the foundation for the research design and structure the case analysis.

2.1 Private equity – business, firms and funds

The European Private Equity and Venture Capital Association (EVCA) broadly defines private equity as "investing in securities through a negotiated process" (Bance, 2007, p.2). PE is categorized as an alternative investment, together with such as hedge funds, real estate and currencies. According to the EVCA a private company is a company where few individuals own the shares and where these are not available to outsiders – in comparison to a public company whose shares are traded on a public exchange (EVCA, 2011). The term PE then refers to equity capital provided for private companies.

In the literature (e.g. Hardymon et al. (2009)) there is often made a distinction between venture capital and PE. The distinction relates to the stages of life cycle to companies; venture capital relates to early stage investments, whereas PE relates to later stage buyouts. At the same time it is worth noting that the term PE industry often considers both venture capital and buyout industry (e.g. Kaplan and Schoar (2005)). Throughout this paper the term PE will be used in relation to later stage buyouts.

EVCA typically divides PE investments in five broad categories, shown in Figure 2-1. The categories reflect the fact that PE funds are normally concentrating on firms in certain stage of maturity. According to these categories venture capital funds are related to one, or more, of
the first four stages of maturity, whereas buyout funds focus on mature companies later in the business cycle.

![Diagram: Maturity of portfolio companies]

**Figure 2-1: PE funds according to portfolio company maturity (model after Bance (2007))**

PE firms are normally organized as a partnership or limited liability corporation. The firms raise most of their equity capital through PE funds. Each firm usually manages different funds with different focus, considering such as industry, size and/or activity. Usually the PE firms are small, employed by professionals with a wide variety of experience and skills (Kaplan and Strömberg, 2009).

The investors in the PE funds vary from institutional funds, banks, pension funds and corporate investors, as well as business angels. In addition to outside investors it is customary that the PE firm provide 1% of the capital. During the period 1998-2002 banks, pension funds and insurance companies accounted for 58% off the total value of funds raised in Europe. Geographically over 70% of committed value in European funds comes from investors in Europe (Bance, 2007).

A fund itself is organized as a limited partnership, where the PE firm is referred to as the general partner while the providers of equity to the fund are referred to as limited partners (see Figure 2-2) (Gilligan and Wright, 2010). The general partner operates and manages the fund on daily basis, according to a defined investment mandate, which the fund managers need to respect. It is common to have restrictions on the amount of capital invested in one
company, and what sort of companies the fund should invest in. The PE fund usually has a limited lifetime, regular no more than 10 years. During the lifetime the fund normally acquires several companies according to the investment mandate. These investments need to be developed and exited in 3-7 years, as the fund has to pay back the capital and return at the end of the contracted lifetime.

The PE firm earns compensation from managing the fund as well as return on their investment in the fund. According to Kaplan and Strömberg (2009), compensation is earned in up to three ways: The most common compensation is earned through an annual management fee as a percentage of the investment. Also it is common that the firm earns a share of the profits generated by the fund, generally called “carried interest”. The last sort of compensation, although not that common, comes from deal and monitoring fees.

PE as an investment class is today highly valued and acknowledged. The business is highly professional and the capital managed by PE firms is rising. The Norwegian Private Equity & Venture Capital Association (NVCA) had in the beginning of 2012 36 primary members¹ (NVCA, 2012). About half of these focus on later stage buyouts. In Argentum’s² database of

¹ Primary member requirements: Independent professional investment companies and venture companies, with a capital base of minimum 100 MNOK, with seed, venture or buyout investment in Nordic private equity funds, and is funded by the Norwegian government

² Argentum is an asset manager specializing in Nordic private equity funds, and is funded by the Norwegian government

---

*Figure 2-2: Private Equity Fund Structure (model after Berg-Utby (2007))*
PE activity in the Nordic region, there are listed over 180 fund managers, 460 funds and more than 5,000 PE owned companies, within all types of industries (Argentum, 2012).

2.2 Private equity performed buyout

"(...) leveraged buyouts and what later became known as "private equity" were fundamentally a new way to think about corporate governance, a new model of management if you will."

Michael C. Jensen in Jensen et al. (2006, p.11)

2.2.1 Types of buyouts

Typically buyouts can be divided into two groups, characterized by the driving force; insider-driven deals and outsider-driven deals (Wright et al., 2009). The main type of insider-driven deal is what is called a management-buyout (MBO). The buyout is driven from the inside by the existing management, which take a high equity stake in the company. A type of outsider deal is a management buy-in (MBI). A MBI is similar to a MBO, but the management team consists of outsiders. A combination of MBI and MBO is called a buy-in/management buyout (BIMBO), and is a combination of outsider- and insider-driven deal. What is studied in this paper is what is called investor-led buyouts (IBOs). This is a type of outsider-driven deal where the transaction is lead by a PE firm. When the buyout industry emerged in the 1980s it was for the most part leveraged buyouts (LBOs). A LBO is similar to an IBO, and the difference between them is more or less understood as a historical transformation of LBO associations into PE firms, as the outsider-driven buyout industry has developed (Meuleman et al., 2009). An LBO and a IBO should necessarily not be distinguished, other than a LBO expect a high degree of leveraged, which is not a necessity for a buyout to be characterized as an IBO. In the following the focus will be on IBOs and LBOs.

2.2.2 Understanding buyouts

It is today well known that separation of ownership and control and dispersed ownership structure, well known from public companies, create agency cost and reduce the value to shareholders. Among others, academics like Jensen and Meckling (1976), and Hart (1995) have documented this. In 1989 Jensen wrote an article where he predicted that the leveraged
buyouts would take over a large fraction of the mature sectors of the US economy (Jensen, 1989). He argued that the structure – where the major part of the equity was privately held, with management also holding an equity stake, and the firm being highly leveraged – would result in a rise in the firm’s value. Jensen called this an “organizational innovation” and argued that leveraged buyouts made huge gains in operating efficiency, employee productivity and shareholder value. This was done by “resolving the central weakness of the public corporation – the conflict between owners and managers over the control and use of corporate resources” (ibid, p.61).

A buyout is typically performed when a PE firm buys the majority share of an existing mature firm, obtaining a controlling part (Kaplan and Strömberg, 2009). The focus is normally on large companies that have been in business for a while, and has a steady cash flow. Further, target companies often have low debt level and an identified future potential. A buyout is different from venture capital; a venture capital firm typically does not buy a majority share of the company, also investment are typically in young or emerging companies. When the buyout is financed with a high portion of debt, often 60-90%, it is called a leveraged buyout (LBO). The cash flow from the acquired company is normally used for paying interest and other costs of the debt. Except from debt the buyout is financed with capital from funds of the PE firm. Typically the new management team of the purchased firm also contributes with a small portion (Gilligan and Wright, 2010).

2.2.3 The appearance and cycles of buyouts

The appearance of leveraged buyouts as a phenomenon started in the US in the 1980s, and had its first peak with the leveraged buyout of RJR Nabisco in 1988 for USD 25 billion. However, the market for PE dates back to the 1930s in Europe and 1940s in the US. After the Second World War there were a shortage of long-term capital for development, and technologies developed in the war needed capital to commercialize. Institutional capital was raised and investors employed industrial experience to develop the companies (Bance, 2007). These first investments where primarily what today would be called venture capital. First in the 1970s greater portion of the capital was put into more established companies, and investments were taking the form of leveraged buyouts.

The PE industry is known for being a cyclical industry. The committed value to PE increased during the 1980s, with the buyout of RJR Nabisco at the peak in 1988. During the beginning
of the 1990s the industry declined, before increasing during the late 1990s, peaking in 1998. After a downturn in the beginning of 2003 the industry again started increase in 2003, with record levels in 2006 and 2007 (ibid; Wruck, 2008)

In US PE funds the committed value each year has risen from USD 0.2 billion in 1980, to more than USD 200 billion in 2007 (Kaplan and Strömberg, 2009). Since the start in the US in the 1980s the buyout market has spread worldwide, especially in Europe. In Europe the committed value to buyout funds reached almost EUR 59 billion in 2007 and more than EUR 65 billion in 2008. Being hit by the financial crisis the market soared up in 2009 when there was committed less than EUR 10.5 billion. During the first half 2011 year there was a noticeable recovery in the market when committed value to buyout funds reached EUR 10.7 billion over a 6 month period (EVCA 2011).

In Norway there are located 16 PE management companies (including foreign funds with office in Norway), focusing on the buyout segment (Menon Business Economics, 2011). The committed capital to PE (including seed and venture capital) totaled EUR 1.4 billion in 2011, up from as little as EUR 0.1 billion in 2009. It is noteworthy that almost 80% of the committed capital in 2011 came from the raising of one single fund (ibid). The access to PE in Europe is today highly limited, while the Norwegian market has not had the same downturn. Norwegian businesses are in general viewed as attractive among international PE investors. An example of this is the recent buyout transaction of the Norwegian discount retailer Nille, which was bought by the London based PE firm BC Partners for about EUR 250 million in 2011.

2.2.4 Performance in buyouts

Kaplan and Strömberg (2009) argue that empirical evidence supports the view that PE on average creates economic value. Most of the studies conducted show that leveraged buyouts lead to both operating and productivity improvements. Wright et al. (2009) reviewed different studies on performance and concluded that PE leads to performance gains. This finding is consistent both for industry studies and academic research and also by whatever measure of performance that is employed. The studies above only look at gains in performance without considering whether or not the firms undergoing a buyout perform better than industry peers not undergoing a buyout. When the return is measured on fund level one finds that on average LBO fund returns, net of fees, actually are somewhat less than the return of the S&P 500
companies\(^3\) (Kaplan and Schoar, 2005). However one find persistence in fund performance in PE firms. In general, if a firm outperform the industry in one fund, it is likely that the firm’s next fund also will outperform the industry.

A recent study by Wilson et al. (2012) shows that during the recent severe global recession PE-backed buyouts in the UK outperformed comparable firms that did not undergo a buyout transaction. The PE-backed buyouts outperformed in growth, productivity, profitability and working capital management. In the sample the productivity in PE-backed buyouts had a positive differential of 5-15%, compared to others, and 3-5% higher profitability. The study concludes with the results being consistent with earlier results, showing that PE firms add value to their portfolio companies, and they are actively involved in assisting their investments.

Based on earlier studies Cumming et al. (2007) also agrees that buyouts enhance financial performance. However they do some interesting findings when investigating the sources of value gains. They conclude with the main source of value gains being undervaluation of the pre-transaction target firm, increased tax shields and incentive alignment. This suggests that earlier studies concluding that buyout on average leads to gain in operating performance are somewhat misleading. To further understand what this may imply one has to look into what changes and actions PE firms conduct to gain value, and the effects of these.

### 2.2.5 Changes and actions performed in buyouts

When a PE firm is making an investment, they does so believing that the investment will yield a positive return to the owners of the fund. The managers of PE firms can commit time on different actions to make sure that the investment will be successful. The actions performed can be split into actions pre- and post-investment. Pre-investment actions includes in general contracting and screening, while post-investment actions includes, among others, monitoring and advising (Kaplan and Strömberg, 2001).

Kaplan and Strömberg (ibid) argues that the post- and pre-investment actions are highly interrelated, in the way that thoroughly performed actions pre-investment reduces the need and time used on actions post-investment. The actions done pre-investment are meant to

---

\(^3\) S&P 500 is a capitalization-weighted index including 500 leading companies of the U.S. economy.
support a decision on whether or not the PE firm will make an offer. Before most investments there are conducted an extensively due diligence, where all parts of the company are looked into.

The actual changes done to a firm undergoing a buyout are performed post-investment. Kaplan and Strömberg (2009) categorize three sets of changes PE firms can apply to firms they invest in; financial, governance and operational engineering. Financial engineering are mainly referring to leverage. Jensen (1989) argues that debt plays a role in limiting management discretion. His argument is that increased use of debt limits the waste of free cash flow, by constraining the managers to use it to make payments on debt, instead of using it within the firm on non-value adding activities. Further, limited free cash flow motivates managers to make efficiency improvements. Financial engineering also includes management taking a stake in the company through management ownership. Governance engineering in buyouts includes PE firms being more actively involved in the governance of firms through taking a position on the board, compared to other owners. Operational engineering refers to the industry and/or operating expertise that PE firms hold, and use to add value.

As stated above, earlier studies show that buyouts enhance financial performance. Theories show what changes as an active owner can do to their investment through different actions. Jensen’s argument from 1989 have been closely debated, as academics have found that other changes can have a significant impact on value gains, perhaps more than leverage. Phan and Hill (1995) found that changes in the governance structure of LBOs affected goals, strategy and structure of firms. These changes in the firm have an impact on efficiency by increase in productivity and profitability. Further on, findings from their study show that management holdings of ownership have a bigger impact on goals, strategy and structure than leverage. These findings suggest that Jensen’s focus mainly on the importance of leverage in enhancing the performance of buyouts may be wrong. Another relevant factor is whether or not management practices in PE owned firms differs from others, and whether or not this could have an impact. A research by Bloom et al. (2009) discovers that PE-owned firms are better managed than those owned by family, privately and government. On average this is also the case for public companies, but this is not statistically significant. In contrast to just focus on importance of performance incentives (Wright et al., 2009) and/or leverage (Jensen, 1989), these findings suggest that improvements in management practices, through the introduction of new managers and better management practices, also could be a source of value gains.
2.2.6 Corporate governance

“The long-term interests of companies would be better served by having a smaller number of long-term or near permanent owners, whose goals are better aligned with those of the corporation (...)”

Michael Porter in Monks and Minow (2008, p.205)

Corporate governance can be defined as "the system by which companies are directed and controlled" (Committee on the Financial Aspects of Corporate Governance, 1992, p.15). According to Monks and Minow (2008) the major challenge addressed by corporate governance is that of delegating powers to managers while holding them accountable for the outcomes and use of the power. Corporate governance deals with the issue on how to create incentive and control devices to make sure the firm’s managers behave and use the resources of the firm according to the interests of the owner towards maximizing the value (Wright et al., 2009).

Buyouts backed by PE firms have been said to be a governance mechanism to restructure organizations (Cumming et al., 2007). In a paper by Nikoskelainen and Wright (2007) it is indicated that corporate governance mechanisms are an important factor for enhancing the real returns in buyouts. According to Cendrowski et al. (2008) PE firms themselves have a unique governance structure that enable them to operate as active investors. The potential for altering the corporate governance of a firm following a buyout is in other words significant.

The model of corporate governance used in PE is said to be substantially different from that used in public companies (Gilligan and Wright, 2010). The PE governance model manages in many ways to reduce the governance problems well known from public companies. The shareholders are much more active, monitoring and directing their investment. Managers’ success is highly rewarded at the same time as failure is directed and penalized.

To engineer the corporate governance PE investors introduce active control to the boards and act as a more active owner, compared to owners of public companies. In addition the board in PE owned companies are smaller and meet more frequently than those in similar public companies. It is also shown that boards controlled by PE investors do not hesitate to replace underperforming managers (Masulis and Thomas, 2009).
By combining a share ownership, which is significant and concentrated, with an effective board involvement, PE firms are “reuniting the corporate risk-bearing and governance functions that are separated when companies go public” (Wruck, 2008, p.12). The involvement by PE investors gives incentives to reduce both agency and free cash flow problems, through a government structure different from that of public companies (Jensen, 1989; Wright et al., 2009).

2.2.7 Agency costs

In an agency relationship there is generated agency costs, as it is not possible for the principal to make sure that the agent will make the optimal decisions, at no cost (Jensen and Meckling, 1976). Contracts between the principal and agent cannot be written and enforced without incurring costs. (Fama and Jensen, 1983). Agency costs are by Jensen and Meckling (1976) defined as the sum of monitoring expenditures by the principal, bonding expenditures by the agent and a residual loss. The residual loss represents the factum that it is in general impossible to get the interests of the principal and agent to coincide 100%. The relationship between the stockholders of a firm and the managers of the firm represents an agency relationship in its pure form. In a firm agency costs, from the agency relationship between owners and managers, occur because of divergence between their interests (Jensen and Meckling, 1976). This as the managers´ utility is not necessary maximized by those activities that maximizes the firms value.

When Jensen (1989) said that buyouts would resolve “(…) the central weakness of the public corporation (…)” (p.61) he was referring to the agency relationship and the inherent costs. In 1986 Jensen (1986) proposed the idea that increased level of debt could be used to reduce the agency costs of free cash flow. Increased debt would reduce managers’ possibility to use free cash flow on non-value adding activities. This would motivate managers to be more efficient. According to Jensen (1989) leveraged buyouts would resolve the conflict between owners and managers.

2.2.8 Categories of buyout opportunities

Wright et al. (2001) have categorized buyout opportunities into four categories, with a growth-oriented perspective, which recognize that buyouts commonly are used to enhance entrepreneurial initiatives. The categorization is made by two types of buyout mindsets and
two types of wealth creation focus. According to the categorization the mindset in the buyout can be either managerial or entrepreneurial. A managerial mindset can be understood as the use of systematic decision-making, based on established norms or prior experience, while entrepreneurial mindset is the use of more rules of thumb decision-making and individual beliefs. In wealth creation focus it is distinguished between enhancing efficiency and innovation. By combining the two types of mindsets and wealth creation focus Wright et al. (ibid) identify four categories: efficiency, revitalization, entrepreneurial and failure buyouts.

<table>
<thead>
<tr>
<th>Mindset</th>
<th>Managerial</th>
<th>Entrepreneurial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Efficiency</td>
<td>Efficiency buyout</td>
<td>Failure buyout</td>
</tr>
<tr>
<td>Innovation</td>
<td>Revitalization buyout</td>
<td>Entrepreneurial buyout</td>
</tr>
</tbody>
</table>

Figure 2-3: Buyout categories

An **efficiency buyout** is a buyout where there pre-buyout exist agency problems, which reduces efficiency and where decisions are based primarily on data, and pre-set criteria. The firm will because of poor governance and low monitoring easily overdiversify and overinvest, especially present in mature industries where firms generate high cash flows. A buyout, which concentrates ownership, should introduce stricter monitoring, and a better incentive plan to enhance efficiency and create value. Increase of leverage can also be used to put pressure on management.

If a firm suffers from bureaucratic procedures, which prevent necessary innovation and investments that is needed for a firm to stay competitive a **revitalization buyout**, focusing on creating value through focus on fostering innovation can be performed. This could often be the case of divisions in large firms, where the division is not part of the company´s core area, putting restriction on management.
An **entrepreneurial buyout** can be performed in the case where strategic innovation is needed for creating value. This could be the case in firms where there are misalignments of incentives and also the management is frustrated, or when firms based on technology runs into problems. This could happen in growing firms that needs continuous innovation, but where the management is lacking a managerial mindset to support the growth.

A **failure buyout** can arise where there exist a firm with managerial mindset, but where the future growth lies in enhancing efficiency, rater than focusing on new innovations. Pre-buyout there is often a misalignment of mindset, incentives and governance. More monitoring and control is needed to enhance efficiency, and often the existing management needs to be replaced.

### 2.2.9 Conclusion on buyout

The buyout industry focus on developed companies with a steady cash flow, where the PE fund in most cases can obtain a majority ownership. The objective behind the buyout is to make a long-term investment, which can yield a positive return to the PE fund. From the appearance as a phenomenon in the US in the 1980s, the number of buyouts has skyrocketed. The reason for this has mainly been due to profitable funds, which again have attracted more investors and capital to this asset class. While it was hard to document the value in the beginning of this phenomena, it is today documented that on average, PE-led buyouts creates economic value and lead to both operating and productivity improvements (e.g. (Cumming et al., 2007; Kaplan and Strömberg, 2009; Wright et al., 2009)).

Traditionally leveraged buyouts has been said to resolve some of the agency problems, well known from public companies (Jensen, 1989). The model used in leveraged buyout, is a different, and in most cases highly effective, governance model. A governance model far away from dispersed ownership and little owner involvement. Instead the PE firms have acted as an active owner, monitoring and to some extend controlling their investment.

Before making and investment the target company is undergone an extensive screening process, where the PE company evaluate the future potential and the company current investment requirements and capabilities. Usually other investors cannot commit this amount of time and capital before making an investment. PE companies will only invest in targets
where they see a high potential, and where the risk of failure is low. After investment the PE company uses its power as a majority owner to the extent that is needed. Together with expert knowledge they “engineer” the company as best as they can. The PE company is under high pressure as the investments need to be realized at latest by the end of the fund’s lifetime.

While a lot of research has been conducted on buyouts, the perspective on the systems managers use to control the organization has been little studied. This can be an important aspect in understanding buyouts further.

2.3 Management control systems (MCSs)

“management control systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities”

(Simons, 1995, p.5)

2.3.1 Defining management control systems

When a company grows the managers need systems to motivate and monitor the employees, as it becomes too costly to continue with direct observation. In absence of certain control mechanisms, direct observation is the main control approach in making sure the agent is doing what he/she is set to do. Informal management styles works for small companies where the manager has constant interaction with the employees. However, when the company grows the manager will be in the need of certain systems for making sure that the company is on the right direction and that the employees are doing their job. According to Malmi and Brown (2008) all the systems and devices managers uses to make sure that their employee´s actions and decisions are in line with the objectives and strategies of the organization, are management controls. A key point in Simons´ definition above is that the systems are used to “maintain or alter patterns in organizational activities”. The systems can be used to implement, choose and communicate a strategy to the employees, to make sure and motivate employees to work according to the strategy and goals of the organization, to solve problems and to control performance.

The agency and information-processing perspective has been the argument for the need of appropriate management control systems: “As companies grow, direct observation of the agent’s effort – the main control approach in the absence of systems – becomes to costly and
motivation and monitoring have to happen through the design of appropriate MCSs” (Davila and Foster, 2007, p.909).

The tools in MCSs are important to manage a company in a professional way. MCSs are said to help managers turn their attention to the right questions and liberate them from tasks and decisions that can be delegated to others (ibid). Primarily the MCSs have two roles, which are complementary and interdependent: The first role is the use of MCSs to exert control over the attainment of organizational goals. The second role is the use of MCSs to enable creativity, such that employees search for opportunities and solve problems (Mundy, 2010). The two roles are competing: managers want to exert control, and at the same time give the employees enough autonomy to ensure creativity.

A complete MCS includes various form of systems, aiming to different elements in the organization. The strategy of the firm is seen as contingent variable of how the system in a specific organization should be implemented. According to contingency theory of management accounting there is no system applicable for all organizations (Chenhall, 2003). The systems and controls depend on the strategy and objectives that an organization pursues (Otley, 1999).

2.3.2 Concepts of systems and management control

Anthony and Govindarajan (2004) define a system as “a prescribed and usually repetitious way of carrying out an activity or a set of activities.” (p.6). To be able to characterize a system as a control system, it needs to have at least four basic elements:

1. A detector or sensor
2. An assessor
3. An effector
4. A communications network

The system works like a process: First, the detector gives information about what is happening in the process controlled. Much like a thermometer, which measure the temperature. Second, the assessor compares the measure with a standard or expectation of what should happen; like the part of a thermostat that compares the present temperature with the preset standard. The effector, also called feedback, alters behavior if needed. E.g.: If the
temperature in an oven reaches the preset temperature, the oven will stop further heating. The last element, the communications network, transfers information between the other elements.

These are the elements of a control process in a simple system. A management control system would, even though containing the same basic elements, be much more complicated. First of all there are no preset standards. There need to be conducted thoroughly planning processes to set standards, and these could be altered as the organization finds its path. Second, the controlling part is not automatic, but needs to be conducted consciously by managers and/or subordinates. The managers often have to act as the assessor, deciding whether or not the discrepancy between the preset standard and the actual performance is significant enough to take action. Another significant difference is that much of the control conducted is more or less self-control by managers. There are often nobody telling the managers what to measure and what action to take. Rather the manager needs to use his or her own judgment to decide upon necessary control activities and actions to ensure congruence with company goals and strategies.

To understand and set boundaries for management control, one can distinguish it from strategy formulation and task control. Management control fits in-between the other two systems – or activities (ibid). The relationship between these systems is pictured below.

<table>
<thead>
<tr>
<th>Activity</th>
<th>Nature of end product</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy formulation</td>
<td>Goals, strategies and policies</td>
</tr>
<tr>
<td>Management control</td>
<td>Implementation of strategies</td>
</tr>
<tr>
<td>Task control</td>
<td>Efficient and effective performance of individual tasks</td>
</tr>
</tbody>
</table>

*Figure 2-4: Relationship between planning and control functions*

The distinctions between management control and the other two are easiest viewed by comparison. While strategy formulation deals with deciding new goals, and strategies to attain these, management control is dealing with the implementation of the strategies. Task
control deals with assuring that individual tasks are performed efficient and effective. Management control, in contrast, deals with more broadly defined activities, and not on a very specific level. The focus is on control of organizational units, and not on the specific tasks in these units (ibid).

To put a distinction between the two concepts management control and management control systems, the former one can be seen as the package that helps steering the organization towards its goals and objectives. The latter one can be seen as the devices employed to attain management control.

2.3.3 Approaches to management control system

MCSs have been conceptualized in many ways. Anthony (1965) presented the first traditional framework of MCSs. In his framework there was made a distinction between management control, strategic planning and operational control. The most well known framework today is the levers of control (LOC) framework by Simons (1995), which focus on four levers to control business strategy. Otley (1999) has presented a framework for analyzing the operation of management control systems, where the focus is on management of performance. A different and more holistic approach is presented by Malmi and Brown (2008), who conceptualize management control systems as a package. In the following the approaches by Simons, and Malmi and Brown will be presented and discussed.

Simons four levers of control

Simons (1995) introduced the levers of control framework for studying MCSs. The levers of control framework is according to Simons a theory for controlling business strategy. The framework is aimed at the possibility for using MCSs to facilitate creativity at the same time as providing constraints on employees’ behavior. By other means, the framework has one controlling use and one enabling use.

The levers of control framework consist of four levers of control, concentrating around four key processes to implement and control business strategies. The four levers are: belief systems, boundary systems, diagnostic control systems, and interactive control systems (Simons, 1995).
These levers of control must be applied so that operational effectiveness is maximized, and at the same time not limiting employee creativity. The diagnostic control systems can be used to measure operational effectiveness and help improve this, while the other levers of control can help handling the negative effects on employee creativity, which a focus on operational effectiveness might have.

According to Bruining et al. (2004) the two levers, belief systems and interactive control systems, could help managers stimulate employees’ creativity and innovation. The other two levers, boundary systems and diagnostic control systems, could help managers to minimize surprises and take corrective actions.

The use of belief systems might be viewed as a way to communicate and prioritize organizational values. These systems are used to “inspire and direct the search for new opportunities; provide basic values, purpose and direction for the organization” (Bruining et al., 2004, p.158). Arrangements in the organization that could emphasize these systems are use of mission statements, goals, core values, internal business magazines, and formal processes of recruitment and training where the values of the organization are promoted. According to Simons (1995) these systems help managers to articulate the values and organizational beliefs into the activities the employees are performing. This helps to align the employees’ behavior with that sought of the company.

The boundary systems are primarily used to “set limits on opportunity-seeking behavior” (Bruining et al., 2004, p.158). Managers set boundaries employees should operate within. This includes setting strategic constrains for where the company should operate, regarding both product markets and investments. The aim of these systems is to reduce waste of the organization’s resources. By focusing on the right activities, and limit employees’ constant improvements beyond the optimal level, this could be accomplished.

To monitor and control where the company is heading, diagnostic control systems needs to be in use. These systems are used to “motivate, monitor, and reward achievement of specified goals” (ibid). The monitoring is done ex post, and gives the managers a view on the company performance in relation to predefined goals. The systems can include both financial and non-financial measures.
“Interactive control systems, are used to stimulate organizational learning and the emergence of new ideas and strategies” (ibid). The operating environment of the company is constantly altering, and the use of interactive control systems can help the company understand these changes and respond to them. Interactive control systems build pressure on changing old routines and habits and stimulate innovation. This could be done through formal two-way communication between managers and employees, and constantly monitoring of the operating environment.

To sum up the four levers of control: The belief systems can be said to stimulate opportunity searching while boundary systems make sure that only the acceptable ones are selected. The other two systems, diagnostic control systems and interactive control systems, are put into work to keep control of the implementation and formulation of the strategy (ibid).

**Management control system as a package – Malmi & Brown**

In the article ”Management control systems as a package – Opportunities, challenges and research direction” Malmi and Brown (2008) present a typology for MCSs structured in five groups, as shown below.

<table>
<thead>
<tr>
<th>Cultural Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clans</td>
</tr>
<tr>
<td>Planning</td>
</tr>
<tr>
<td>Administrative Controls</td>
</tr>
</tbody>
</table>

*Figure 2-5 Management Control Systems Package (Malmi and Brown, 2008)*

Malmi and Brown argue that the different controls should not be defined holistically, but as a package of systems; the management control systems operate together and are interrelated. However, as Simons (1995) framework, the central point is to ensure that the employees are behaving in consistence with the strategy and goals of the organization.

The view of MCSs operating as a package was first presented by Otley (1980). His view was built upon the research by Ouchi and Maguire (Ouchi and Maguire, 1975; Ouchi, 1977), which found that companies used several different control mechanisms simultaneously to
serve multiple purposes, from what they concluded makes it difficult to isolate the effect of one single mechanism of control. The control devices are interconnected, which together form an organizational control package. What Malmi and Brown do is to conceptualize what constitutes in a MCS package, divided into five groups of controls.

The five groups of MCSs are pictured as above for a specific reason. The cultural controls are at the top, showing that these are broad and subtle, yet important for how the rest of the controls should be applied. In the middle the planning, cybernetic, and rewards and compensation controls, are placed showing that these are more tightly interrelated and in the natural chronological order (from left to right in the figure) they will most often appear. The administrative controls at the bottom of the figure shows the structure in which the other controls operates.

**Cultural controls**

When culture is used to control and regulate organizational behavior it is a control system, even if culture often is seemed as out of the control of managers (Malmi and Brown, 2008). The cultural controls are divided into three parts; clans, values and symbols. The value controls coincide with the belief systems to Simons (1995), while the symbol-based controls appears when organizations create visible expressions, to emphasize and create a culture. Visible expression could be made by the construction of buildings, working space, dress code, etc. Clan controls are implemented by using values and beliefs and expressing these for the employees. This will help control the socialization process in an organization, and prevent the rise of unwanted subcultures.

These broad and subtle controls will often stay relative stable, even when goals and strategies are changing. Because culture is not something easily changeable these controls will often act as a frame for the other groups of controls.

**Planning controls**

Planning controls is a set of ex ante controls, i.e. they are set out before the other controls, and could somewhat look much like strategy making. However, the essence is that planning controls are set out to commit employees to future plans. The goal of the planning controls is to direct the actions to the employees and create an expected level of effort, so employees know what is expected of them. At the same time planning controls should make sure that
action, across functional areas of the organization, are aligned with the overall strategy of the firm.

Planning controls include two dimensions: Action, or short-term planning and strategic, or long-term planning. Short-term planning most often relates to goals and actions for the upcoming 12 months, while long-term planning includes goals and actions for the longer run with a more strategic focus.

**Cybernetic controls**

Cybernetic controls are defined as “a process in which a feedback is represented by using standards of performance, measuring system performance, comparing that performance to standards, feeding back information about unwanted variances in the systems, and modifying the system’s comportment” (Green and Welsh (1998) in Malmi and Brown, 2008, p.292). The cybernetic controls measure performance and gives feedback about the outcome, so managers can react to this. Performance is usually compared to given goals or standards. This process of feedback and performance control creates a foundation for change in the system or activities performed. In their typology Malmi and Brown (2008) divides cybernetic systems into budgets, financial measures, non-financial measures and hybrids.

Budgets are used in almost all organization, and have several uses. As a control mechanism budgets sets a performance level and evaluates the actual performance against planned performance.

Financial measures can often be linked to performance targets set in the budgeting process. However budgets and financial performance measurement systems are not the same: Whereas budgets is often broad and complete, financial performance measures can often me much more narrow and targeted at specific areas. This includes measures such as, return on investment (ROI), residual income (RI) and economic value added (EVA). A control used of this measures would for example be holding employees accountable for some of these measures.

The financial measures have some limitations, as for example the limited ability to identify the drivers of performance. By the use of non-financial measures (e.g. research and development, customer satisfaction, and product quality) an organization can better identify these drivers and have a more future looking perspective.
A hybrid system would be one that contains both financial and non-financial measures, such as the Balanced Scorecard. Further it can also include the use of key performance indicators (KPIs) in a system including both financial and non-financial measures. Such systems create a balance between financial and non-financial measures, which are favorable to consider both short- and long-term performance measures.

Cybernetic control is often connected to the reward and compensation controls. The cybernetic performance measures can be connected to employees’ reward and compensation, and motivate them to work towards organizational goals and objectives.

**Reward and compensation controls**

All individuals and groups within the organization need to work towards the goals and activities of the organization, to meet the organization’s goals. To motivate and increase the performance, to attend these goals and activities, reward and compensation controls can be integrated in the management control system. This rests upon the argument that rewards and compensation lead to increased effort, especially when effort is closely linked to the tasks. These systems could then help to control effort direction, effort duration and effort intensity.

Even though reward and compensation is often linked to the cybernetic performance measure, it can also be linked to encourage cultural controls, e.g. group rewards.

**Administrative controls**

In this framework administrative controls consist of three groups: organizational design and structure, governance structure within the firm and procedures and policies. By organizing the individuals and groups in the organization, specifying how task should be performed and monitoring of how these individuals and groups perform; administrative control systems can direct behavior, in accordance with the strategy. The administrative controls forms the structure that the planning controls, cybernetic controls and reward and compensation controls operates within.

By employing a specific organizational design certain types of contact and relationships can be encouraged. It can further reduce the variability of behavior and increase the predictability (Malmi and Brown, 2008).

Governance structure can be altered by changing the board structure and composition, as well as the formal lines of authority and accountability. Also it includes management and project
teams, and the structure and composition of these. The governance structure must be seen as a part of the overall control package as it can be designed in many ways and are linked to the other controls (ibid).

Procedures and policies is a way to specify the processes and behavior in an organization. It outlines lines of authority and accountability, as well as setting limit for activity and behavior. It helps control the organization in a formal and bureaucratic approach.

The typology presented by Malmi and Brown (2008) is set up in a way that it should be able to capture the whole set of controls that could encompass a management control system. The reason for being so broad is the risk of not noticing some controls and links to other controls if the typology being narrower (Malmi and Brown, 2008). Tools, systems and practices that managers have and can use to direct employee actions and behavior towards the organization´s strategy, are structured around how control is exercised. What is most different in Malmi and Brown´s approach from other approaches is the inclusion of administrative control. Whereas others view for such as the organization structure as a contingent variable (e.g. Simons (1995)), this is included as a control mechanism in Malmi and Brown´s package. This because managers can alter these structures to control the organization. Further, the framework includes cultural controls, which have been given little attention in empirical research, but is supported by Simons (Simons, 1995).

2.3.4 Conclusion on management control systems

Management control systems are needed in every organization above a certain size. Managers use these systems to “maintain or alter patterns in organizational activities” (ibid, p.5). MCSs are used to make sure that employees´ actions and decisions are in line with the objectives and strategies of the organization. An effective use of MCSs can help the management of a company considerable, liberating managers´ time and attention.

Management control is distinct from strategy formulation and task control. Management control is dealing with the implementation of strategies and deals with broadly defined activities, not as specific as task control (Anthony and Govindarajan, 2004).

There are several approaches to study MCSs. Anthony (1965) first presented a framework of MCSs, while the levers of control framework to Simons (1995) is the most well known framework today. In this paper the framework by Malmi and Brown (2008) will be employed.
to study changes in the MCSs in buyouts. The framework by Malmi and Brown takes into account that MCSs operate together and are interrelated, and MCSs should be viewed as a package of systems, in contrast to separate systems. This framework is also more broadly defined than for example the framework by Simons (1995) and Otley (1999), and includes such as administrative controls as a part of the MCS. In this paper where changes in the complete control package are analyzed the framework by Malmi and Brown is comprehensive and complete, in the essence that all parts of what may constitute a MCS are included and analyzed.

2.4 Prior research on changes and effect on MCSs

“Private equity firms also contribute to the development of management control systems that facilitate strategic change in different types of buy-outs.”

(Gilligan and Wright, 2010, p.86)

Organizations are not static entities; they change over the lifetime to fit the current environment. The same is true for MCSs; they change as the organization is changing. There are a number of studies on changes and effect on MCSs. In this section this will be addressed both in general terms and more specifically on buyouts. First the issue of changes and effect on MCSs in general will be discussed. Second, there will be presented at number of studies showing how a buyout affects strategies and goals to a firm. Third, and last, studies on changes on MCSs following a buyout process will be presented.

2.4.1 Contextual factors and studies on changes and effect on MCSs

From a contingency-based perspective MCSs are viewed as passive tools, which are designed to assist managers in their decisions (Chenhall, 2003). The use of contingency-based research is according to Chenhall (2003) widely adopted and used in research on MCSs. According to contingency theory there is no MCS that is universally applicable to all organizations (Otley, 1999). What system that is appropriate for an organization depends on the specifics of the organization and the environment that it operates within.
In contingency-based research on MCS, the MCS is seen as a contingent variable. This implies that when the context, which the MCS operates within, changes the MCS also would most likely change. The assumption is that when the context changes managers act to adapt their organization to maintain a competitive position and preferably improve performance (Chenhall, 2003).

Chenhall (2003) reviews studies on contextual variables of the MCS and divides the variables into external environment, technology, organizational structure, size, strategy, and national culture. The external environment relates to such as uncertainty, complexity and diversity (e.g. of products, input factors, customers). It is suggested that in an uncertain environment a combination of both traditional financial controls, such as budgets, and interpersonal controls are needed. Technology as a contextual variable of MCSs concerns how an organization operates its work processes (i.e. how inputs are transformed into outputs). The complexity, task uncertainty and interdependence of work processes are variables that can affect which MCS to apply. For example, with standardized and automated processes the more formal controls are used, including process control and budget, and less emphasize are put on slack. The organizational structure as a contextual variable works in the sense that a company with a highly decentralized structure is normally associated with traditional and formal MCS, such as budgets and formal communication. As a company grows in size, often related to number of employees, managers need systems and controls to manage a large amount of information, and hence need more formal MCS. This makes size a contextual variable of MCSs. Culture is a contextual variable mostly in the sense of different national cultures. Different countries have different cultural characteristics, which responds differently to MCS. Chenhall (2003) describes strategy as a different contextual variable. Managers can change the strategy and thereby influence the organization’s environment, technologies, structural arrangements and control culture.

The linkage between MCS and organizational goals is stressed by Chenhall (ibid) as one of the main functions of a MCS is to measure performance and progress, relative to the goals of the organization. Both Langfield-Smith (1997) and Simons (1995) has suggested that strategy and goals are specific contingent variables of the MCS. When strategy and goals change,

---

4 In this paper organizational structure will not be considered as a contextual variable of the MCS as it is considered a part of the MCS, according to Malmi and Brown (2008)
5 In this paper culture will not be considered as a contextual variable of the MCS as it is considered a part of the MCS, according to Malmi and Brown (ibid)
MCSs would most likely change too. The levers of control framework to Simons lets managers achieve control of the business strategy by integrating the forces of the four levers of control. Strategic control is not achieved by using the different systems separately, but through the systems working in coherence towards achieving goals and strategies. Each of the systems has “a different purpose in controlling strategy” (Simons, 1995, p.157).

Another aspect is how different managers impact the management control. Anthony and Govindarajan (2004) argue that the specific style of the CFO has a significant impact on management control. If a top manager is replaced, and the new manager possesses a different management style, the MCS tends to change. Different managers have different management style, which impact the systems themself and how they are employed. In addition the control process is also affected, as different managers use the available information differently, which affect how the control system actually operates. There exist the possibility that a new manager will adapt his management style to fit the certain systems already present in the organizations. However, top managers are often hired for their specific management style, and it is then more likely the system somewhat will change. Even if the formal structure of the MCSs will not be affected, the control process itself will most likely change.

A research by Verbeeten (2010) indicates that administrative capacity is the main driver of change in management accounting and control systems (MACS). Administrative capacity is defined as “the use of administrative systems in a business unit” (Verbeeten, 2010, p.126), and it refers to the “reservoir of current administrative expertise and experience that can be transformed into change” (ibid). Langfield-Smith (1997) suggests that the managers’ perception could be an indirect variable when considering how strategy drive changes in the MCS. Managers affect strategic change, and thereby also the MCS. This finding suggests that organizations that have managers with expertise and prior experience can more easily incorporate changes in the MCSs.

During the traditional life cycle of an organization it goes through different stages (e.g. birth, growth stage, mature state). Research, based on organizational life cycle models, has showed that MCS has different importance in different stages of a firm’s life cycle (Moores and Yuen, 2001). The emergence of MCS can, and should be, seen in relation to the organizational life cycle (Davila, 2005). Organizations lacking proper MCS can have difficulties growing and passing on to the next life cycle stage. Davila (2005) studies the emergence of MCSs in small
growing firms and finds that size, age, replacement of original founder by a new CEO and presence of venture capital is all positive related of the emergence of control systems.

2.4.2 Studies on buyouts´ effect on strategy and goals

Several studies on buyouts have considered how the strategy and goals to a company are affected following a buyout. In general the changes performed to the bought company in some way affect the strategic direction and goals.

Phan and Hill (1995) conclude with “the change in governance structure that occurs with an LBO does affect firm goals, strategy, and structure” (p.730). The change in strategy is associated with the improvement in the firm´s performance. Post-buyout the firm changes its governance structure and together with increased debt managers need to turn their attention towards efficiency, which in turn will lead to changes in strategy.

Wright et al. (2005) reports that empirical evidence has shown that “buy-outs are a means for focusing the strategic activities of the firm towards more related businesses” (p.217). The new objectives, change of ownership structure and also changes in the capital structure of a firm post-buyout has consequences for its strategic direction (Easterwood et al., 1989). Seth and Easterwood (1993) analyzed 32 MBOs and discovered that the firms were implementing a more focused strategy post-buyout, instead of diversification.

2.4.3 Studies on buyouts´ effect on MCSs

Prior research on buyouts´ effect on MCSs is, as pointed out, limited. However, there are some relating studies, which will be presented here. Roughly the studies can be divided into three groups. First, studies that have investigated buyouts´ effect on MCSs in a holistic approach, i.e. the complete MCS has been taken into account, not just separate systems. Second, there are studies that have investigated separate systems within the MCS (e.g. accounting systems). Third, and last, there are studies that do not fit into the prior two groups, but which could be related to buyouts.

**Holistic approach**

Bruining et al. (2004) have conducted a study on the impact of management buyouts (MBO) on strategy and MCSs. By using the levers of control framework to Simons (1995) to analyze change in the MCS in two buyout firms, they report that there is a need develop “coherence
between a change in strategy and the application of levers of control” (Bruining et al., 2004, p.171). The buyout enables changes in strategy and the MCSs. Emphasize is especially put on the belief and interaction control systems in more entrepreneurial buy-outs.

Davila and Foster (2007) reports that the presence of venture capital is positive related with the rate of adoption of MCSs in early-stage startup companies. The intensity of MCSs is significant and positive correlated with the presence of venture capital. In their paper Davila and Foster underpin that venture capital is important to understand the adoption pattern and intensity of MCSs in early startup companies. In one of the companies in the sample it was reported that some of the MCSs were imposed directly by the venture capitalist, and others were applied by new key managers, hired by the venture capitalist.

The approach to Davila and Foster (ibid) was to examine the adoption of 46 different systems, grouped in eight MCS categories. This makes the approach holistic, in the way that all parts of a MCS are examined. Early-stage startup companies, which are examined in the study, will necessarily have a high rate of changes in the MCSs, as the systems helps to facilitate growth (Simons, 1995). Companies backed by venture capitalists also grow much faster than other companies (Davila and Foster, 2007). On those grounds it is arguable whether the primary cause of higher adoption of MCSs is the fact the company is growing or the presence of the venture capitalist. Most likely the answer lies somewhere in-between.

**Separate MCSs**

Jones (1992) studied changes in accounting control systems (ACS) following 17 management buyouts. In the sample considerable changes were done to the ACS. The preparation and plans in the ACS were changed to more appropriate formats and procedures. The use of ACSs was also more selective post-buyout. However, many of the old systems and techniques remained the same as before. Changes were foremost done to parts of the system, which the managers had been unhappy with, and few new systems were implemented. New techniques were implemented to respond to changes in the environment and structural changes. Overall the buyouts studied had a better match of ACSs and the operating environment of the companies post buyout.

Mitchell et al. (1997) studied the development of accounting information systems (AISs) in twelve firms that were backed with venture capital. Overall the extent of change reported in their study was not tremendous, but in most cases there were reported some changes. In many
of the firms the AISs changed after the venture capital investor became involved in both the performance measurement and control and decision-making functions. However, the extent of involvement highly varied among the cases.

**Other related studies**

Other findings that do not fit in the two categories above, but are interesting findings are included in this category.

As early as 1993 Singh (1993) indicated that in corporate restructuring the adoption of appropriate control systems was linked to, among others, the management. Changes in management and ownership can be important to enhance management control (Robbie and Wright, 1995). Bloom et al. (2009) report that management practices in firms with PE owners are better than in other firms. Their study includes a survey of 4,000 medium sized manufacturing firms throughout Europe, Asia and the US. Statistically, firms owned by PE firms have better management practices than family, government and privately owned firms. However, the difference between PE owned firms and those with dispersed shareholders (including public quoted firms), was found small and insignificant in the study. The management practices PE owned firms primarily performs better in, than other firms, are operational management and people management.

In a research by Davila (2005) it is found statistical support for the presence of venture capital in small growing firms having positive effect on the emergence of management control systems. Davila (ibid) argues this suggests that a transfer of management experience from venture capital professionals to invested firms is happening, and this could help growing firms in a faster adoption of MCS. Silvola (2008) also finds support for management control techniques being more often used in firms backed by venture capital investors, opposed to those without such investors.

**2.4.4 Conclusion on changes and effect on MCSs**

From a contingency perspective a firm’s MCS is a contingent variable, which most likely will change as the contextual variables are being altered (Chenhall, 2003). Among others, strategy and goals are considered specific contingent variables of the MCS (ibid; Langfield-Smith, 1997; Simons, 1995). A change in strategy and goals will in many cases rise a need for a change or altering of the MCSs. There are several evidences that the strategic direction and
goals for a company changes in a buyout transaction (Phan and Hill, 1995; Seth and Easterwood, 1993). In prior research and papers there are concluded that the MCS changes in a buyout transaction (Bruining et al., 2004; Davila and Foster, 2007; Gilligan and Wright, 2010). The research in MCSs changes in buyouts has in some cases focused on the MCS as a whole system, and in others on separate systems. In general the research conclude with the MCS changing in buyout transaction but the extent of changes vary among the research conducted and the cases analyzed. Further studies are needed to understand how the MCS changes in a PE performed buyout.

2.5 Research framework

Given the theoretical perspective and prior research presented in this part, a research framework is suggested below. The framework will be used in forming the design of the empirical research, and structure the case analysis.

Private equity is a special kind of asset class where the investment in each company is substantial and where the owner acts as a professional active owner in managing the investment, putting efforts into the investment in order for the investment to yield a positive return to the owners of the PE-fund. Firms undergoing a buyout process will somewhat change the governance structure. Not only is there a new majority owner, but the new owner will also most likely change some of the structure of the governance of the company to manage the investment. Phan and Hill (1995) found that these changes that are done to the governance structure of buyouts have an effect on goals, strategy and structure of firms.

MCSs are needed for managers to direct and control an organization. According to contingency-theory there is no universally MCS, or set of systems, which are applicable to all organization. The MCS is seen a contingent variable in contingency-based research on MCS. When the context changes, the MCS will most likely change. Langfield-Smith (1997) and Simons (1995) have suggested that strategy and goals are specific contingent variables of the MCS. If a change in governance structure has an effect on goals and strategy, as suggested by Phan and Hill (1995), it is viable to suggest that the MCSs in place will change.

In analyzing the change in MCSs in companies undergoing a buyout performed by a PE firm the typology by Malmi and Brown (2008), of MCSs as a package of systems, will be applied.
This typology takes into account that the different controls operate together and are interrelated, and should therefore not be defined holistically. In the research there will be put emphasize on how the components of the MCS as a package changes. Also how changes are initiated will be emphasized. The research model below will be applied in the following research.

Figure 2-6: Research model

The framework suggests that the MCS change following a buyout. The important part is to see which parts of the system changes to get an overall perspective, but also to understand how the various components change and how those changes are initiated. The typology by Malmi and Brown (ibid) is applied to study the different components of the MCS.

Each PE transaction is unique and has its own characteristics. According to contingency-theory it is important to understand the contextual variables to understand the applied MCSs (Chenhall, 2003). Further, the characteristics of the firm for transaction, the industry, ownership, leverage, objective of transaction and PE firm experience are important factors for understanding the possible changes in the MCSs a PE transaction can cause.
According to Chenhall (2003) the variables size, age, growth and how work-processes are operated are specific firm contextual variables of the MCS. It is also supported that the organizational life cycle stage is a contextual variable (Davila, 2005). Externally the industry environment is a contextual variable, including intensity of competition and industry life cycle stage (Chenhall, 2003). These variables are specific to the firm and industry and something not dependent on the PE-transaction as such. However, the variables can be determinants for how the PE-transaction will cause changes. If the contextual variables are changed in the transaction, and the following process, the contingency theory suggests that the MCS changes.

The characteristics of the PE-transaction caused by the PE firm include ownership, leverage, objective and experience. A PE-transaction includes a change in ownership. The change in ownership can be characterized by more than just the name of the owner. For example the ownership can change from a dispersed to more concentrated ownership, from entrepreneurial ownership to professional ownership and also between two professional owners. Also, the ownership is characterized itself by the share of ownership between the investors, for example the PE firm and the entrepreneur(s). The characteristic of ownership as a variable is supported by Phan and Hill (1995), which found support for management holdings in PE-transactions having impact on goals and strategy and structure.

When a PE firm invests in a company they do so believing that the investment will yield a positive return to the investors of the fund. What level of return that is positive differs from case to case and fund to fund. Hence the objective will be different among different PE-transactions. Also how each PE firm chooses to reach its objective will be different. In that sense the objective of the PE-transaction will be a variable affecting to what extent and which changes will be needed in the MCS.

Verbeeten (2010) indicates that administrative capacity is a driver for changes in MCS, and Anthony and Govindarajan (2004) argue that different managers impact the MCS differently. A PE firm operates as an active owner and their expertise and administrative capacity will be a factor for how they manage their investment.

Chenhall (2003) considers strategy as a contextual variable for the MCS. In this framework strategy and goals are defined as an indirect variable for changes to the MCS in a PE-transaction. Both Phan and Hill (1995), Wright et al. (2005) and Seth and Easterwood (1993)
have argued that in a buyout the strategy and goals are changed. Further Chenhall (2003) describe strategy as a different contextual variable of the MCS, as a change in strategy can directly influence the other contextual variables. In this framework a change in strategy and goals is not considered as a characteristic in the PE-transaction as such, but as a change performed to the company after transaction, often necessary for the PE firm to reach its objective for the investment.
PART 3. RESEARCH METHODOLOGY

This chapter will describe the research design applied to the study, as well as how the data collection was performed. The chapter will also discuss why these methods are applied, and include a section with an evaluation of the research design and the reliability and validity of the study.

Methodology is the combination of techniques used to enquire into a specific situation, while methods are individual specific techniques for such as data collection and analysis (Ahrens and Chapman, 2006). The choice of which methods to apply to a research depends on the nature of the research problem (Noor, 2008). To understand the relationship between data and theory it is important to understand related philosophical issues. This will help to clarify research design, it will help to choose the appropriate design for a certain study, and it can help the researcher to identify designs (Easterby-Smith et al., 2008). A research design is a description of how the research study shall be conducted (Johannessen et al., 2005). Choice of research design should be based on how to best answer the research questions (Saunders et al., 2007).

In the following the field of study will be presented together with a presentation of the objects studied. Consequently the chosen research design for the study will be outlined and argued. Afterwards the data collection process will be presented. In the end there will follow an evaluation of the research design employed and its implications for reliability and validity of the study.

3.1 Field of study

During the last decades both buyouts and management control systems have been extensively researched. However, the connection between them, and how MCSs changes following a buyout is not given much attention. Changes to MCSs should be recognized using both a theoretical and practical point of view. To understand the changes, and how they are initiated several cases should be analyzed. Because of the novelty form of this study, and to understand the cases at point a qualitative subjective research will be conducted.
Six cases from six different Norwegian based PE firms have been chosen to perform this research. The cases chosen are of great variety, both regarding such as industry, size, turnover, competition and objective of investment from the PE firms’ perspective. This variety is chosen to best gather all aspects of how the MCSs changes following a buyout. The advantage of having cases of a great variety is that the research will get a better understanding of the overall perspective of changes in MCSs, and cover many different aspects. The disadvantage is that different cases are difficult to compare, and different PE firms have different objectives, making the observed changes hard to explain on a broader basis, and findings will not be subject for generalization. However, this method is considered favorable, in relation to the novelty of this study, and for bringing a higher understanding of changes in the MCS, and also so more formally testing can be conducted in the future.

The cases chosen should have some similarities to make them comparable at some levels. As a criteria for the cases all should be subject to current ownership of Norwegian based PE firms, and should have had a holding period for at least one year. A current ownership will make sure that the PE firm still is participating as an active owner with the necessary insight needed. Further, with all PE firms being from one country the difference in cultural impact from the owner is sought limited. A holding period for at least one year was set to ensure that some changes could have been initiated, together with knowledge on the effect.

Arguable it would be favorable for the researcher to have a list of PE firms with accompanying portfolio companies to choose from, to best get the variety sought, and still have comparable cases. However, because of the limited PE industry in Norway (totaling approximately 16 PE firms), and the research’s need for confidentially information from professionals with limited time, the cases have been picked on the availability of the PE companies.

There have been conducted six interviews, one for each case, of PE-professionals with good knowledge of the cases. The PE-professionals have been on different levels in the PE firms, ranging from partner to associate, but they have all been working closely with the portfolio company, both before and after the buyout. Several of them also hold a board position or have been working operationally in the company for some period. Preferably there should also have been conducted interviews with management in the portfolio companies, but since
several of the PE firms would not disturb their portfolio companies with this type of work, this was not possible.

### 3.2 Research design

When deciding on research design it is important to keep in mind the overall research question as the design should be chosen regarding how to best answer this:

**How does the control package change following a buyout transaction performed by a private equity firm?**

To understand how this changes several aspects must be considered. First, the different components of the control package employed in each case, and the package itself, must be studied. Second, how the package changes and how changes are initiated must be analyzed and understood, both within and between the cases. Third, conclusion of research findings and implications of these must be discussed. This is a comprehensive study, which seeks qualitative knowledge and a deep understanding of each case.

To describe the research design employed the following will present; the research approach, the three main categories of research design and in the end the specific research design chosen for this study, the multiple-case design with one research unit.

There are two different types of research approach, deductive and inductive. A deductive approach, the traditional scientific approach, includes development of hypothesis based on theory, and collection of empirical data to test the hypothesis, to either confirm or disprove the hypothesis. This method is usually preferred where the issue is already explored, and theory is available. Inductive method is the opposite, and this approach tries to generate theoretical understanding based on the empirical data. The inductive method is preferred on issues where limited research and theory is available (ibid). The approach used in this study is an inductive one. Little research is conducted on the matter studied, and hence there is not enough available theory to make a foundation for hypothesis testing, making the deductive approach inappropriate.

Based on the purpose of the research Zikmund (2003) classify research designs into three categories; exploratory, descriptive and causal. Exploratory studies aim to explain and clarify
the understanding of a topic, and are often used if the topic is unclear and not prior studied. Descriptive studies are employed to describe the characteristics of a phenomena or situation, with some prior understanding. Causal studies aim to explain the casual relationship (i.e. cause-and-effect relationship) between several variables, and are applicable when the topic is clearly defined. For this study the exploratory design is mainly used as it aims to get an understanding of how MCSs changes, where there is little prior knowledge.

Further, the information gathered for analysis can be done using qualitative or quantitative methods, or a mix of these (Creswell, 2003). The use of the concept qualitative and quantitative refers mainly to the characteristics of data gathered and subject to analysis (Grønmo, 2004). Quantitative data can be expressed in numbers or quantity, while qualitative data does not have this characteristic. Surveys and reviews are examples of quantitative methods for data gathering. To evaluate this data statistical models and theories are often used, and the results are often quantitative presented in tables or graphs. Qualitative methods on the other hand includes such as observations, in-depth interviews, focus groups and content analysis (Zikmund, 2003). The emphasis is on understanding the particular research object. While objective methods can be applied for quantitative data, this is not possible for qualitative data.

To address the research questions in this study the information will be gathered using mainly qualitative methods. The method found most appropriate is the case design. The characteristic of the case study “allows investigators to retain the holistic and meaningful characteristics of real-life events” (Yin, 2003, p.2), and is advantageous when questions as “how” and “why” are being asked on topics where the researcher does not have full control. The nature of the case design gives the researcher good possibilities to research and understand the context of the phenomenon studied. Yin (2003) categorizes four types of case study designs, based on the number of cases studied and the number of units analyzed.
This study will have the form of a multiple case design. Every buyout case is unique, and understanding the variety between the cases is important. Several cases will be studied to draw on the information from each of them, and understand the variety of how MCSs changes. Because of the nature and the limited availability of informants, each case will be based on a single unit of analysis. This study gathers information from several cases, but only with one unit within each case, and in that way has a multiple case design with one unit of analysis. Each case will be studied using in-depth interviews and available written information.

To sum up, this study uses an inductive research approach with the use of mainly exploratory research design. The multiple-case study method with a single unit of analysis is being employed to gather qualitative data with in-depth interviews, together with some written information.

### 3.3 Data collection

To answer the research questions one needs to collect data for analysis. There are two main forms of data, primary data and secondary data. Primary data is data collected and assembled specifically for the current research, while secondary data is data collected by others with other objectives (Gripsrud et al., 2004). Since there are no available data to answer the research questions the study is mainly based on primary data. According to Yin (2003) the most common methods of data collection in case studies are; documentation, archival records, interviews, direct observation, participant-observation and physical artifacts. All sources have
different strength and weaknesses and preferably many sources can be used for the same case study. In this study, because of limited time for conducting the research and limited availability to the research objects, the data collection has primarily been based on interviews, together with some documentation.

An interview can be done face-to-face, by telephone or in groups. Further, interviews vary in the way they are structured. There are broadly three different interview structures: unstructured, semi-structured and structured. The unstructured, or the informal conversational, interview has no formal structure and relies on spontaneous generation of questions and information (Patton, 2002). The structured interview has less flexibility and consists of a set of pre-defined questions, asked in the exact same way and sequence to all respondents. The semi-structured interview is a form of interview that involves the use of an outline with a set of issues that are to be discussed, and could include some prepared questions. This form of interview gives the interviewer a high degree of flexibility to let the respondent come with insight, at the same time as the discussion is limited to certain issues. Semi-structured maintain the ability to compare different interviews at the same time as the issues can be explored on different aspects.

For this study five interviews were conducted by phone and one face-to-face. Preferably all interviews should have been conducted face-to-face, but due to travel distance and availability this was not possible. Further the semi-structured interview form was chosen, because this gave the necessary flexibility to approach each case differently at the same time as all aspects of the MCS were examined, and gave the insight needed to understand how the MCS had changed.

To get a good structure on the interviews, an interview guide was prepared. An interview guide can be prepared as a list of questions or issues, which should be explored in the interview. The same interview guide should be applied for all interviews to make sure each interview is conducted in the same manner (ibid). The structure of the interview guide was developed based the research framework (see 2.5), and was divided into five parts, with emphasis on part 3 and 4, regarding changes in the MCS and influence on the changes (see APPENDIX 1). The structure of the interview guide was chosen to cover all aspects of the research questions and get the necessary background information needed to compare the cases. The different parts of the interview guide were structured with an open and broad start,
and finishing with more narrow issues, within the same area. This structure was applied to let
the respondent speak as freely as possible, and at the same time cover all important aspects.
All respondents received the interview guide a minimum of two days prior to the interview.
This way the respondents were given the opportunity to prepare and get an understanding of
which information that was relevant. There was developed a separate interview guide for the
interviewer. This followed the same structure, but was more detailed and included more
follow up questions.

PE firms were contacted by mail, both electronic and per letter. To get in contact with PE
firms I first used the professional network to a professor at Norwegian School of Economics.
Later I contacted PE firms based on the member list to NVCA. All companies received a
standardized letter, signed by me and professor Johanson. In total 11 PE companies were
contacted, and out of this 6 agreed to participate in the study. The first interview was
conducted in June 2011, and the last in February 2012. Interview length varied from 45-70
minutes. An overview of the conducted interviews is provided in the table below.

Table 3-1: Interview overview

<table>
<thead>
<tr>
<th></th>
<th>CASE 1</th>
<th>CASE 2</th>
<th>CASE 3</th>
<th>CASE 4</th>
<th>CASE 5</th>
<th>CASE 6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length</td>
<td>57 min</td>
<td>45 min</td>
<td>70 min</td>
<td>50 min</td>
<td>60 min</td>
<td>62 min</td>
</tr>
<tr>
<td>Type</td>
<td>Phone</td>
<td>In-person</td>
<td>Phone</td>
<td>Phone</td>
<td>Phone</td>
<td>Phone</td>
</tr>
</tbody>
</table>

The use of interview as a form of data collection has several limitations. Creswell (2003)
points out four different limitations. Firstly, interviews only give indirect information, from
how it is interpreted and filtered by the informants. In this study the view of changes in the
MCSs is only from the point of view of the PE firm, represented by one person. This could
preferably have been avoided by interviewing multiple persons in each case, but this was, as
pointed out above, not possible because of limited availability. Secondly, interviews are often
set in a place distant from the natural field setting. In this case all interviewees were in their
own office during the interview. However, the communication by phone could for some of
the respondents be unnatural. Conducting interviews by phone requires a different approach,
as there is no non-verbal communication present. It also requires a more structured interview,
which in this case was done by providing a structured interview guide. Thirdly, presence of
the interviewer may bias responses, because of the interplay between the two parties. Among
other, the interviewer’s voice, tone, wording, questions asked can bias the responses. During
the interview it was emphasized to keep the questions simple and understandable in wording, with a clear voice. Lastly, respondents not being equally articulate and perceptive also represent a limitation with interviews. All interviews have started with an explanation of the goal with the research and which information that was relevant, as well as follow up questions and clarification during the interviews.

Interviewing is not an easy form of data collection and has several pitfalls. As Oakley has put it: “Interviewing is rather like a marriage: everybody knows what it is, an awful lot of people do it, and yet behind each closed door there is a world of secrets.” (Oakley in (Patton, 2002, p.340)).

3.4 Evaluation of research design

In order to avoid misleading and wrong conclusions in the final report it is important to have an adequate research design and a good evaluation of this. The data gathered must be evaluated in a specific manner. Also, both the conduction of the data evaluation and the analysis of reliability and validity must be considered (Grønmo, 2004).

The data evaluation was done in a three-step process: First, the interviews were recorded and transcribed. This was done to both keep the interviews flowing, without being disturbed by writing down notes, and to reduce the possibility for misinterpretation. Second, shortly after the interviews a first impression of the cases was written down, which linked the top findings to the research framework. Third, and last, the collected data was formally structured to fit into the research framework, and was used to outline the analysis. During the interviews a lot of information was collected, much of which later has been discarded, as it has shown not to be relevant to the research questions. Only relevant information to answer the research questions is included in the analysis.

If the measures in a study give consistent results over time and across situations, and therefore are free from errors, the study is reliable (Zikmund, 2003). If a later researcher, which follows the same procedures and investigate the same cases as the first researcher, the objective of reliability is true (Yin, 2003). It is worth noting that for a study to be valid, reliability is a necessary condition. However, reliability is not a sufficient condition for validity, as results
are valid only if they measure what it is designated to. To have trust in the findings of a study a high degree of reliability is needed (Grønmo, 2004).

All interviews have been conducted in the same manner, with the same interview guide, and are presented in the analysis as objectively as possible. An important aspect that can undermine the reliability of the study is the nature of semi-structured interviews. This form of data collection is difficult to replicate, and redoing the study with the same cases could to some extent yield diverging results. Not only because semi-structured interviews are difficult to replicate, but also because the cases studied are live cases, which are constantly undergoing changes. To limit this problem the interview process is documented and the interview guide is included in the appendix. The information collected through interviews has to some extent been highly sensitive. In order to ensure as accurate information as possible all respondents were granted full anonymity before the interview, both regarding persons and companies. In addition all respondents were given the possibility to review their case description and general findings in this paper. Also in some cases a non-disclosure agreement was signed. A granted anonymity will most probably give a higher degree of reliability, as respondents will feel less reluctant to disclose sensitive information. A disadvantage of respondent and case anonymity is the fact that the transcribed interviews cannot be disclosed in the appendix of the paper. This makes it difficult for other researchers to review and evaluate the findings in this study.

The certain way a researcher interprets the information collected represents an observer bias, which can be a threat to reliability (Saunders et al., 2007). This study might be subject to observer bias by the researcher. Interviews have been conducted in Norwegian and translated to English, when reporting on findings and for use in the analysis. Also citations from the interviews used in this paper are translated English version. As the researcher also is the translator this might be a threat to reliability, caused by observer bias.

Validity refers to the data material and its relevance for the research questions. If the research studies something that is not appropriate for the research questions the research has low validity. For case studies there are mainly three types of validity that needs to be considered; construct validity, internal validity and external validity (Rige, 2003). Construct validity is high if what is intended to be studied, actually is studied. This needs to be considered during the collection of the data. Gibbert (2008) argues that construct validity in case studies can be improved by clearly documenting the research process, for example by use of interview
transcripts, and by using triangulation (i.e. using several angels, or sources of evidence). In addition Yin (2003) suggest that having the case informants reviewing drafts of the report could increase the construct validity. In this study construct validity is sought by transcribing all interviews verbatim, and by letting the informants review parts of the analysis related to their specific case. Transcribing all interviews ensures that all information is considered. Review by the informants reduces the chance of wrong reporting.

Internal validity concerns establishing a casual relationship (i.e. certain conditions lead to other conditions), and the concern is put in the analysis part of case studies (Gibbert et al., 2008). In case study research internal validity is only of concern in explanatory case studies (Yin, 2003). This because exploratory and descriptive case studies are not concerned about making causal claims. In this exploratory case study internal validity is thus not of concern.

External validity deals with the generalizability of the research findings, beyond the cases studied (i.e. the findings can be applied to other cases) (Gibbert et al., 2008). It is not possible to perform statistical generalization based on case studies. However, this does not mean that generalization is not possible with case studies. By using analytical generalization, in contrast to statistical generalization, it is possible to generalize a certain set of findings to theory (ibid). Using cross-case analysis with 4-10 cases, or conducting several case studies within one organization, could according to Gibbert (2008) be a start for analytical generalization. By studying six different cases it can be argued that this study has to some extent external validity. However, a not clear rationale for cases chosen, as this was based on PE firms´ availability, undermines the external validity, as the researcher had little, or no, control on cases chosen.

Before continuing it is worth noting that this study and the specific research design has several limitations. First, and foremost, the research is performed by studying a limited number of cases. No buyout case is equal; all have their own specifics, relating to such as industry, turnover, market position and future prospects. This would result in every case being unique, and the changes and actions performed on the MCSs will never be equal. This study will only give an indication on how MCSs might change, and the results will not necessarily be applicable to the buyout industry as such. Second, case studies have been criticized for lack of scientific rigor and possibility of generalization (Noor, 2008). However, Noor (2008) argues that case studies enable a holistic study of a phenomenon or series of events, and by
studying several organizations the accuracy, validity and reliability of the results are enhanced. Third, and last, it is important to understand that results from a few case studies should not be understood as the finite truth, as explained by Zikmund: “(...) the results from case studies should be seen as tentative. Generalizing from a few cases can be dangerous, because most situations are atypical in some sense” (Zikmund, 2003, p.116).
PART 4. EMPIRICAL DATA AND ANALYSIS

This chapter will present the empirical data and the analysis. First each of the six cases will be briefly introduced, with historical background, transaction information and PE firm objective for investment. Afterwards the findings in the case studies will be presented and analyzed. First, findings in relation to strategy and goals, and a discussion of this will be presented. Second, changes in the management control system will be analyzed. Changes within each component in Malmi and Brown’s (2008) framework of MCS for each case will be presented together with a cross-case discussion. Third, the role of the PE firm in changing the MCS will be presented and analyzed, both per case and in a cross-case discussion. Fourth, and last, there will follow a conclusion of the findings.

4.1 Introduction to cases

In the following there will be given a brief introduction to each case. Because of anonymity the specific information given about the companies and PE firms is limited. However, as far as possible the introduction will include information regarding company history, current development stage, industry, competitive position, size, leverage and the PE-company and its objective for investment. Each case is also given a pseudonym in relation to its business. To categorize the cases, and provide some possibility for later comparison the cases have been categorized according to Wright et al.’s (2001) terminology. (see part 2.2.8 for explanation)

The following classification has been applied to characterize size and age of the case companies:

Size:
- Small: less than 50 employees
- Medium: less than 250 employees
- Large: 250 or more employees

Age:
- Young: Less than 10 years
- Middle-aged: 10 to 20 years
- Old: More than 20 years
Case 1: “Producer”

Producer is a large company, with a long history, which has been developed through several mergers and acquisitions. The company has several production facilities in Scandinavia, and also an own distribution center. The products are low-tech and products are produced both according to a given product range and specialized orders. In addition to a production department Producer has a large sales and marketing department. The market Producer operates within is competitive, but products can be differentiated and quality is important. Market position is dependent on access to distribution channels.

The company was bought by the PE-company about one year ago. Before buyout the major shareholder was a venture capital firm, and the minority part was owned by a relative big group of small shareholders. The PE-company obtained a majority part of the company, while the venture capital firm and the small shareholders reduced their ownership accordingly.

At buyout Producer was a company on the edge of crisis. It had recently performed large investments and experienced tough financial times and needed a capital increase to strengthen its balance sheet and liquidity. Both the PE firm and the former owners participated in the capital increase. The objective for the PE firm for investing in Producer was the possibility to do a turnaround process on a company in crisis with good potential, in the need of financial and operational improvements. The buyout lies somewhere between an efficiency and failure buyout.

Case 2: “High-Tech”

High-Tech is a medium-sized engineering company producing highly specialized products to one industry. This middle-aged company was founded on this technology, and an important
aspect in its business is to continuously improve and develop the technology to create better products. The product range is limited, as the company is producing very few different types of products. However, the products are mainly produced on customer orders, and the majority of the products must be tailored to fit customer specifications. The market for these kinds of products is competitive, but because of high value to customers, and product reliability is crucial, the intensity of competition is relative low. High-Tech consists mainly of one engineering & development department, and one sales department.

At the time of buyout the entrepreneurs, a group of more than 10 persons, owned the company. They all worked in the company and held most of the key positions. The PE firm invested in the company about one year ago, obtaining a minority part of the company. However, through a shareholder agreement the PE firm ensured management and control. Also the PE firm is by far the largest shareholder, as the rest of the ownership is distributed more or less evenly among the former group of owners, who all still work in the company.

When acquired High-Tech was experiencing great success in its home markets, but needed professional help for further expansion. The entrepreneurs believed that their products had wide international potential, but needed structure and professionals with experience to perform the process and develop the company. The company was not in the need of capital to perform the expansion, but a professional partner. For the PE firm this case was not about performing a turnaround process or cutting cost, but to help the company grow internationally. The PE firm’s objective for investment was to support this expansion and develop the company to an international attractive player. The buyout can be categorized as an entrepreneurial buyout, or more specifically a busted tech buyout.

**Case 3: “Medium-Sized IT”**

Case 3, called Medium-Sized IT, is a medium sized, middle-aged, IT company providing IT-services to several industries. Medium-Sized IT sells both hardware and software as a service (SaaS) products. The market has been growing lately and Medium-Sized IT is positioned for further expansion. The company is not a developer, but foremost a solution provider. Revenues come from both hardware sales, set up of customer systems, and subscription/use of software/services. Middle-sized IT is the result of a merger of two companies. The organization consists mainly of one moderate-sized sales department, and a large technical department, with technicians setting up and supporting the customer solutions.
The PE firm bought 100% of the shares in Medium-Sized IT about one and a half year ago. At the time of investment the company was owned by financial investors. Before buyout the ownership in the company had recently changed following a merger.

As a merged company Medium-Sized IT was having a strong position in a high-growth part of the IT-market. Also, some of the companies’ segments were growing exceptionally fast. Further, the company had a good customer base with a lot of recurring revenue, and the company was generating a lot of cash, producing good EBITDA margins. These features, together with a high debt capacity, and possibilities for using the firm as a platform for further expansion, made Medium-Sized IT an attractive firm for the PE firm. In relation to Wright et al.’s (ibid) categories this buyout is a type of revitalization buyout.

**Case 4: “Small-Sized IT”**

Small-Sized IT is a small, relative young, IT-company, which provides a specific IT-service to one industry, in its home market. The company has its own infrastructure and sells its services on permission-based contracts. The market is not highly competitive and Small-Sized IT has high margins on its product. Earlier the company has performed huge investments to build the necessary infrastructure to provide the service. Now the company experience high revenues and margins based on their past investments.

Before buyout Small-Sized IT was a wholly owned subsidiary of a big industrialist. The industrialist did not want to invest more in the company, as it was not a part of the core business, and decided to sell it. The PE firm bought 100% of the company, financing a huge part of the buyout with debt. Small-Sized IT has been owned by the PE-company about 1 and a half year.

The PE firm had prior to the sales process been interested in Small-Sized IT, and believed that it could perform better than it had under the prior ownership. Also high profit margins, a high degree of contractual coverage that reduced the volatility of the cash flow and very low churn rate, made the case attractive. In addition the PE firm had good knowledge of the industry Small-Sized IT was serving. The buyout can be categorized as an entrepreneurial buyout, more specifically an entrepreneurial release buyout, where a subsidiary of a company was “released”. 
Case 5: “Service”
Case 5 is a medium-sized, middle-aged company in the business service industry. Service delivers services to other businesses on contractual basis, both on the short and long term. It operates in a competitive industry where price is the main competitive factor. The service provided is tailored according to customer needs. For some customers the service provided is crucial but mostly of low technical quality. The industry is highly affected by the general economic environment and experienced difficulties under the recent financial crisis. The service is provided in mainly one of the Scandinavian countries, but expanding. As the company only provides services, capital expenditure and working capital is very low. The company has grown its business through several mergers and acquisition.

The PE firm bought a majority part of the company more than two years ago, and delisted it from the stock exchange. After buyout the PE firm is by far the largest owner, while the entrepreneur has a substantial share as well. In addition a small share of the ownership is divided among small investors and some employees.

Prior to investment the PE firm had experience in this industry and good knowledge of its main drivers. The PE firm had earlier participated in similar companies, but in other markets. From the PE firm’s point of view the business was attractive, both because of good performance and a general belief that the market was growing and the risk of investing was relatively low. The buyout can be categorized as a revitalization buyout.

Case 6: “Online”
Online operates in the IT-industry, delivering a software as a service (Saas) product. The company is young and medium-sized. It has the major part of its operations in the Scandinavian market, which has been growing exponentially the recent years. Online is by far the biggest player in its home market, and has lately been expanding internationally. The company has developed its own software, and continues to improve it. The organization mainly consists of sales personnel, 60-70% of the organization, and system developers.

Before buyout the entrepreneur held the majority part of shares in the company. In addition some minority owners outside the company and on the management team held an equity stake. About one and a half year ago the PE firm acquired a majority part of the company.
The additional owners after buyout includes the entrepreneur and a small part of the management team.

For the PE firm Online was an attractive company with further good growth potential, and an attractive cash flow. Sources of growth potential included further organic market growth in home markets, consolidation potential in home market, and international expansion. The buyout is a form of entrepreneurial buyout, more specifically a busted tech buyout.

Table 4-1: Case overview

<table>
<thead>
<tr>
<th>CASE 1</th>
<th>CASE 2</th>
<th>CASE 3</th>
<th>CASE 4</th>
<th>CASE 5</th>
<th>CASE 6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pseudonym</strong></td>
<td>Producer</td>
<td>High-tech</td>
<td>Medium-sized IT</td>
<td>Small-sized IT</td>
<td>Service</td>
</tr>
<tr>
<td><strong>Size</strong>*</td>
<td>Large</td>
<td>Medium</td>
<td>Medium</td>
<td>Small</td>
<td>Medium</td>
</tr>
<tr>
<td><strong>Age</strong></td>
<td>Old</td>
<td>Middle-aged</td>
<td>Middle-aged</td>
<td>Young</td>
<td>Middle-aged</td>
</tr>
<tr>
<td><strong>Industry</strong></td>
<td>Production industry</td>
<td>Engineering</td>
<td>IT</td>
<td>IT</td>
<td>Business services industry</td>
</tr>
<tr>
<td><strong>Main owner pre-buyout</strong></td>
<td>Venture Capital firm</td>
<td>Group of founders</td>
<td>Financial investors</td>
<td>Industrialist</td>
<td>Public company</td>
</tr>
<tr>
<td><strong>PE-ownership</strong></td>
<td>50-70%</td>
<td>&lt;50%**</td>
<td>90-100%</td>
<td>90-100%</td>
<td>70-90%</td>
</tr>
<tr>
<td><strong>PE-holding time</strong>*</td>
<td>8-14 months</td>
<td>8-14 months</td>
<td>14-24 months</td>
<td>14-24 months</td>
<td>&gt;24 months</td>
</tr>
<tr>
<td><strong>Buyout category</strong></td>
<td>Efficiency/failure</td>
<td>Entrepreneurial (busted tech)</td>
<td>Revitalization</td>
<td>Entrepreneurial (release)</td>
<td>Revitalization</td>
</tr>
</tbody>
</table>

*By number of employees (small <50, medium <250, large >250)
**Because of shareholder’s agreement control exceed 50%
***Holding time at the time of interview

4.2 Changes in strategy and goals

In all cases the strategy is somewhat changed or re-aligned post-buyout. The PE firms had all an objective and purpose for investment that required some changes to the goals and strategy already implemented in the firms. However, the core strategy, meaning what the firm essential was doing, was not changed in any of the cases. These findings are consistent with those of Wright et al. (2005), Easterwood et al. (1989) and Seth and Easterwood (1993). The main findings in the cases include: re-aligning, specializing, formalizing and clarifying, implementation, and new growth strategy.
All PE firms had specific financial goals for their investment. For all cases, except Medium-Sized IT, it is reported that the financial goals to the PE firms required a shift in the goals of acquired companies.

For all cases the companies have re-aligned their strategy to some extent, in order to meet changes in market conditions. However, the biggest re-aligning of strategy is seen in Producer. The company had to re-align its strategy to position the company in the market with the right products. This was on one hand done by slightly changing the product focus, and on the other hand by changing the focus on distribution channels.

Producer, Small-Sized IT, Service and Online have specialized their strategy post buyout. Producer has turned the focus to the right products and specialized the company on higher value products and distribution channels. Small-Sized IT has implemented a more focused strategy, with a focus on doing what they know best, and not drop into many new and exciting projects. Service, which operated within many segments of its industry before buyout, has after buyout got a more focused strategy, specializing on fewer segments. The new strategy was implemented to mitigate the risk in general economic downturns. Online has specialized its strategy by discarding no or low value-adding activities.

In all cases, except Medium-Sized IT and Service, there are found clear evidence on need for formalizing and clarifying strategy post buyout. For Producer the strategy was in place before buyout, but it was not clearly defined. After buyout this has been defined and formalized. High-Tech did not have a clear strategy before. There existed thoughts on how to expand, but it was not clear how they should perform the expansion. The strategy has been developed and clearly defined after buyout. In Small-Sized IT the boundaries for the company was not clearly defined in the strategy. Together with a higher focus on efficiency the boundaries are now set. Before buyout there was no clear strategy in Online. There had not been a “need” for this in the entrepreneurial company. After the buyout a strategy has been defined, clarified and visualized for the organization.

For Producer, Medium-Sized IT, Small-Sized IT and Online there have been a focus on implementation of existing strategy post buyout. Online needed to implement a strategy, since this was not in place before, and in Medium-Sized IT there has been a stronger focus on the implementation of the strategy post buyout. Producer had many written strategy documents but these were not in use.
In all companies, except Producer, there have been implemented a new expansion strategy. High-Tech wanted to expand, but the strategy was not in place before buyout. After buyout this has been defined as a new international strategy, which should take the products beyond the Scandinavian market. For Medium-Sized IT the PE firm identified an attractive market potential for the company before buyout, which is now a part of the expansion strategy. Small-Sized IT’s prior expansion plan has been clearly defined after buyout, and now includes how and where to do expand, and also where and how not to expand. When investing in Service the PE firm had an expansion strategy for the Scandinavian countries as an important part of their investment strategy. This has been implemented after buyout. In Online there has post buyout been implemented a growth strategy focusing on inorganic growth, through mergers and acquisition, focused on home markets.

It is important to understand these changes in the strategy and the strategic direction for the companies as these changes affect the contextual factors that the MCS operates within (Chenhall, 2003). These changes can help explain how the MCS changes following a buyout transaction, and what role the PE firm has in initiating the changes in the MCS.

**Table 4-2: Findings changes strategy and goals**

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CHANGES Strategy and goals</strong></td>
<td><strong>CHANGES Strategy and goals</strong></td>
<td><strong>CHANGES Strategy and goals</strong></td>
<td><strong>CHANGES Strategy and goals</strong></td>
<td><strong>CHANGES Strategy and goals</strong></td>
<td><strong>CHANGES Strategy and goals</strong></td>
</tr>
<tr>
<td>• High degree of re-aligning strategy</td>
<td>• Re-aligning strategy</td>
<td>• Re-aligning strategy</td>
<td>• Re-aligning strategy</td>
<td>• Re-aligning strategy</td>
<td>• Re-aligning strategy</td>
</tr>
<tr>
<td>• Specialized strategy</td>
<td>• Formalizing and clarifying strategy</td>
<td>• Implementation of existing strategy</td>
<td>• New expansion strategy</td>
<td>• New expansion strategy</td>
<td>• New expansion strategy</td>
</tr>
<tr>
<td>• Formalizing and clarifying strategy</td>
<td>• New expansion strategy</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Implementation of existing strategy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 4.3 Changes in the various components of the MCS

This subchapter will serve the purpose of answering the first specific research question:

**How do the various components of Malmi & Brown’s (2008) control package change following a buyout transaction?**

All buyouts analyzed have experienced changes in several components of the MCS. It appears that most changes have been undergone to the planning controls, cybernetic controls, reward
and compensation controls and administrative controls. In general cultural controls seem to have been of less emphasis in the cases, but there are evidence of some changes. In the following, findings of changes and a discussion of these will be presented according to the framework presented by Malmi and Brown (ibid) (see part 2.3.3). Within each control component the findings for each case will first be presented before a cross-case discussion will follow. The cross-case discussion will highlight and summarize the findings and put them into a context of existing theory and prior research. It should be noted that the findings are based on the interviews, and the MCSs can have undergone more changes than those reported here. Changes will be presented and discussed in the same order as the interviews were conducted: First planning controls, followed by cybernetic controls, reward and compensation controls, administrative controls and last cultural controls.

4.3.1 Planning controls

Producer

Pre buyout Producer had many forms for planning controls. Management was aware of the plans, but they existed foremost as written documents, and neither management nor employees had been committed to plans and responsibilities were unclear.

In terms of long-range planning Producer had many plans, but they were not implemented and commitment had not been established. After buyout a rolling 3-year plan has been set to work, which is revised a minimum of two times per year. The effort after buyout has not been to establish new forms of long-range planning controls, but to revise existing plans, implement them and establish commitment.

At the time of buyout Producer was on the edge of crisis and short-term actions were necessary. First there were established 100-day action plans. These plans were initiated by the PE firm, and were based on hypotheses for what was achievable within the 100-day time frame. The plans were broken down into each unit in the company. As a working tool the plan was in the form of a to-do list, which included the tasks together with a given deadline for completion and responsible person. Both pre and post buyout the plans were made in electronic forms. Nevertheless, pre buyout the plans were more in the form of explaining text, and not a list of specific tasks. In the beginning the 100-day plan was monitored on weekly basis by the whole management team. This frequency has later been reduced as commitment and responsibility to plans have increased. In addition there has been introduced an
integration software that collects data from the different department’s ERP (Enterprise Resource Planning) systems and assemble the information.

**High-Tech**
For High-Tech it is reported that in general the forms for planning, and the planning controls as such has not been significantly changed. On the short-term planning it has been focused on checklists, which includes how to report and at what time. On strategic, long-range, planning there are new plans in relation to the expansion strategy. These plans are also focused on a checklist, and include important development stages. Mainly the planning controls have been set to work, formalized and set into a system after buyout.

**Medium-Sized IT**
In Medium-Sized IT most of the present planning controls existed pre buyout. The biggest changes are found in the use of the controls, to commit management and employees to the plans and make people responsible of the outcomes. After buyout the company has worked with communicating the plans to people and establishing an understanding that it is not an option to not follow the plans and use the system for reporting. The importance of the plans has been highlighted, and they are more closely monitored. Also, significant efforts with respect to improving control and tracking progress of the plans has been implemented.

**Small-Sized IT**
As a former small subsidiary of a big company, where Small-Sized IT’s business was not a part of the core activities, planning controls was not of high focus pre buyout. The former owner did not highlight commitment to plans and goals. Of specific changes after buyout the PE firm has implemented a planning system that they use in all their portfolio companies. This system has both a short- and long-term focus. On the short-term it focuses on milestones for 30, 60 and 90 days. On the long-term the focus is on goals further into the future. It is a project-based focus where both the management and the PE firm have responsibilities. After implementation of the new system there is a higher frequency of follow-up meetings and the planning is more structured.

**Service**
In Service there has been established new long-term plans on how, and in which order, to expand. There is more plans post buyout, and plans have a higher level of structure. However,
the plans themselves are not necessarily formalized in written documents. Problems are easily discussed more or less informally, and actions are decided. Employees in the company are in general committed to goals and plans and know which actions to take.

**Online**

Earlier, when Online was mainly owned and managed by the founder of the company, there was little formal planning and planning processes. The founder set most of the plans and goals on a gut feeling, with the use of little or no analytics. One of the first changes after buyout was the establishment of a formal business plan, which the company did not have before. The business plan had a timeframe of 4-5 years, and included both financial and organizational goals. On the short-range action planning there was implemented internal improvement projects. To commit employees the projects were assigned a responsible person, a follow up procedure, and managers to follow up on the project. Further, responsibilities and delegation of tasks have been clarified.

**Table 4-3: Findings changes planning controls**

<table>
<thead>
<tr>
<th></th>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Planning controls</strong></td>
<td>• Revision of plans, implementation and establishment of commitment • New 3-year rolling long-range plan</td>
<td>• Short-term: focus on easy checklists • Long-range: new expansion plan • Plans formalized and set into system</td>
<td>• Establishment of commitment • Communication of plans • More monitoring of plans</td>
<td>• New planning system (by the PE-firm) • More structure • More monitoring and follow-up</td>
<td>• Long-range: new expansion plan • Higher level of structure to plans</td>
<td>• Formal business plan established • Short-range: impr. projects • Responsibilities and delegation clarified</td>
</tr>
</tbody>
</table>

**Abbreviations:**
- impr: Improvement

**Cross-case discussion**

When analyzing changes in planning controls it is important not only to distinguish between short-range and long-range planning. It is also important to understand if planning is conducted only to decide on future activities or if the planning process also includes committing employees to the plans (Malmi and Brown, 2008).

In all cases there are evidence of planning controls being emphasized more after buyout. It has not necessarily been introduced new planning controls, or new plans, but been a revision of plans and committing management and employees to the plans with the use of different methods.
Long-range planning appears to have been in place, in some form, in all companies before buyout, except for Online where it was first established after buyout. The existing long-range plans have in general been revised and renewed to fit the strategy. A clear evidence of this is the inclusion of new expansion plans, evident in several of the cases. For example in High-Tech there are now plans for how the company shall be established in new regions. The revised plans appears to have a more specific form, like in Producer where it was reported that before buyout the plans were most in the form of a prose text, and not specific goals and actions to take. Although it appears not to be common, new systems for long-range planning can also be introduced after buyout. An example of this is the case of Small-Sized IT where a specific system used by the PE firm has been implemented.

For Online it is reported that there did not exist a formal long-range business plan before buyout. The former majority owner and CEO had used “a more like gut feeling strategy, which had been working fantastic during the years and that could worked for many more years”. A formal long-range plan was established shortly after buyout, with a timeframe of 4-5 years. Online is the most entrepreneurial buyout in the sample, and also the company with the highest growth, both in revenues and employees. Before buyout there was little need for a long-range plan because the company was performing well, and the management had no separate investor that kept them accountable. After buyout the new owner had to set specific goals to reach its objective, and a plan how to reach them based on analytics was necessary to get the full potential of the firm. This evidence indicates that in buyout cases where fundamental forms of planning controls are not in place this will be introduced after buyout.

The most significant changes to short-term planning are found in Producer. The 100-day action plans that were implemented right after buyout was an action necessary to get the company stabilized. In difference from the other cases, Producer was on the edge of crisis and the short-term focus was of high importance, highlighted by the interviewee: “the first phase is to patch the holes in the boat so it does not sink, and then put things in order so you can get the boat on the right course”. The short-term planning highlighted after buyout, in both Producer and other cases, like High-Tech, have been focusing on simple to-do lists and check lists. In the cases where necessary it has been focused on getting better plans with more specific actions, making the plans easier to understand and easier to follow.
An important emphasis after buyout in several cases has been to change the planning controls from simply being a means of deciding on activities, to commit employees to the plans, both on the long- and short-term. In all cases, except Service, it was reported that there existed problems regarding commitment to the plans, both for the management and the employees. In Medium-Sized IT it was before buyout perceived as an option not to follow established plans. In Producer plans had been established but the implementation process had not been done, and hence the organization had little commitment. In Small-Sized IT it was reported that the former owner “had a much more hands-off approach” to the monitoring of plans. In several of the cases it is clear that commitment has been established by simplifying the plans, focusing on specific actions to take, monitoring the plans more closely, assigning responsibility to actions, and also assigning managers to follow up on specific parts of the plans. Further, there has been a need to specify actions to be taken when plans are not followed. For example, if planned actions are not carried out within the given time frame the responsible person needs to have a good explanation for this.

In general the emphasis on planning, and the use of planning has increased. The need for this has been established partly by a new owner demanding more control and planned processes, and partly by a change in strategy demanding new and more specific plans. This has been done both directly, for example by establishing 100-day action plans and new planning systems, and indirectly by a new strategic direction, requiring more specific plans and commitment to plans to get the full potential of the company. In general, there are few new forms of planning tools, but the plans have been revised, put into a system, and there have been established commitment to plans. These finding is supported by Jones´ (1992) study on MBOs, where he reported that after MBO the planning techniques were “adapted and used in a more relevant manner” (p.158).

4.3.2 Cybernetic controls

There are four groups of cybernetic systems: budgets, financial measures, non-financial measures and hybrids. In all cases the importance of good cybernetic controls has been emphasized, and there is clear evidence of changes.

Producer

As a control system Producer had and used budgets before buyout. However, the follow up, and actually use of the budgets as a MCS, was lacking. The ownership to the budget was
weak and it had little foundation in the organization. It was expressed from the former management that the budget was a board decision and not theirs. To improve the use of budgets as a control system the business unit leaders have post-buyout been given attention to make them responsible for their budget, both in developing realistic budgets and actually stay on track. To commit more of the salespeople to the budgets there has been introduced a progression based payroll system. The monitoring of the budget is also highlighted now, with different monitoring levels ranging from the board to the operational units.

The use of financial measures to monitor and control the organization is more or less something new for the organization. The measures are new, and managers are now responsible for the measures, and are followed up on a regular basis. New financial measures have made it possible to delegate responsibilities easier, and if goals relating to financial measures are not reached action must be taken. For example, an action to take would be for the responsible person to suggest a plan B.

On non-financial measures it is not reported about significant changes. Work has been performed on improving the quality system, which did not work properly before. Product quality has also been measured and monitored more closely after buyout. Further efficiency measures have been important, as Producer needs to keep the direct labor cost down in the production, to stay competitive.

Of hybrid systems Producer uses a KPI (key performance indicator) system, which include both financial and non-financial measures. The system was present before buyout, but after buyout the new integration software implemented has been used to set up new and more relevant KPIs for all business units.

**High-Tech**

In High-Tech budget there is no new form of cybernetic control system present. Nevertheless, the follow-up procedures and report system is new. The budget as a control system has developed from measuring according to the budget no more than twice per year, before buyout, to reporting and monitoring of financial measures according to budget monthly, after buyout. Also, the budget is now more divided and monitored by regions. Budgets and the use of financial measures have been developed into a more detailed set of controls that are more formalized and more frequently measured.
After buyout there has been implemented what the company calls a KPI dashboard, which works as a cybernetic control system. This system tracks financial and non-financial measures monthly. The KPIs are not evaluated based on preset goals, but rather the information collected are accumulated into time series, and the experience gathered is used to develop insight about performance and also as basis of decision on actions. Most of the information that is now accumulated in the KPI dashboard was present before, but it was spread between several persons, and not necessarily accumulated up on a high level to get the complete picture. Today the information is collected and presented for both the management group and the board, and is used actively in decision-making.

**Medium-Sized IT**

Medium-Sized IT has been, and is still using, a budget that is built up with a bottom-up approach. The budget is used as a control system, where it is used as a measurement for performance, and forms the basis for bonuses. There are no significant changes in the routines and system of budgets. The changes are more related to the credibility to the budget – both the budget work and the collection of information to be used in the budget. From the interviewee’s point of view this enhanced credibility comes from a change in management, with new managers with more credibility and structure.

There have been no significant changes in the form of financial measurement systems. The new owner has implemented some new measures, but the system has not changed. Financial measures now important includes revenue, EBITDA, investment level, working capital level, debt level and down payment of debt. On non-financial performance measures it has been an increase in the number and quality of measures. Also there has been formalized a form of collecting market intelligence, to collect information about ongoing market concerns, as a way to be updated on market developments. In general the use of both financial and non-financial measures and the collection of the data have increased.

Before buyout there existed a KPI system, but the system was more or less a patchwork of indicators. After buyout the KPI system has been redesigned, been split up into quantitative and qualitative KPIs and put into a system that is designed for the organization.

**Small-Sized IT**

The budgetary process in Small-Sized IT has been strengthened after buyout. Earlier budgets were systematically set low for the management to easily reach predefined goals. After
buyout the new owner has put pressure on the budgetary process to produce more realistic budgets, which puts pressure on the organization. Regarding financial measures there are now implemented new measures and higher frequency of reporting. There is now monthly reporting on financial and non-financial measures. Before buyout reporting was concentrated on four board meetings each year.

**Service**

In Service the budget and the reporting on budget is more or less the same now as before buyout. Monitoring is more quarterly focused, but that is mainly because of demands of new creditors. The budget is used as a management tool for goal achievements, but this is no change from before buyout. The use of some financial performance measures have been changed from a prior focus concentrated on earnings before and after tax, to a focus on return on equity and cash flow, and earnings before interest tax depreciation and amortization (EBITDA). Also, after buyout there has been a higher degree of monitoring of accounts receivable and to some extent accounts payable. Of non-financial measures there are no significant changes reported. Service uses KPIs, but they are not organized in a system. However, it has been discussed internally the need for implementing a KPI system in the future.

**Online**

Before buyout Online only used budgets as a control system to some extent. Mainly only sales budgets were used, where each sales person had his/her sales targets. If sales target were reached a bonus was triggered. There did not exist a good overall budget for the firm. Also the organization was not involved in the budgetary process. After buyout the budget has been strengthened, and both the depth and monitoring of the budget have increased. In addition the organization is more involved in the budgetary process now.

When the PE firm invested in the company they suggested new financial measures to monitor the company. This required a lot of data from the company, which the company had existing systems to collect. Nevertheless, the data quality and features of the systems were not always sufficient to report on the new measures. This resulted in a need for improvement in both the systems and the basis for the data. It was later defined new formats for reporting on financial measures, to be reported on a monthly basis. Together with a new basis for collecting data and increased data quality there has also been implemented a KPI system, which was not present.
in Online before. The KPI system includes both financial and non-financial measures, with measures such as growth, churn rate, recruiting of new employees, revenue, earning margins, measures per geographical location and per product.

**Table 4-4: Findings changes cybernetic controls**

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cybernetic controls</strong></td>
<td><strong>Budget: established commitment and responsibility, more monitoring</strong></td>
<td><strong>Budget: New follow-up and report system</strong></td>
<td><strong>Budget and fin. measures formalized and monitored</strong></td>
<td><strong>Budget: KPI system implemented</strong></td>
<td><strong>Strengthened budgetary process</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Implemented use of fin. performance measures</strong></td>
<td><strong>Improved credibility of budgets improved</strong></td>
<td><strong>Increased number and quality of non-fin. measures</strong></td>
<td><strong>KPI system been redesigned and systemized</strong></td>
<td><strong>Increased monitoring of some non-fin. measures</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Improvement of efficiency measures</strong></td>
<td><strong>Few new fin. measures</strong></td>
<td><strong>Higher frequency of reporting</strong></td>
<td><strong>New fin. measures</strong></td>
<td><strong>Higher frequency of budget reporting</strong></td>
</tr>
<tr>
<td></td>
<td><strong>New KPIs</strong></td>
<td><strong>Increase in number and quality of non-fin. measures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Cross-case discussion**

All companies had budgets before buyout. However, few of them used the budget as a MCS. For a budget to be specified as a MCS there are several factors that need to be in place. First of all, it needs to be in the form of a system, meaning that it needs to have present the four basic elements described by Anthony and Govindarajan (2004) (see part 2.3.2). In Producer it was reported that the budget was not anchored in the organization and was of little use. Hence, the assessor function was not properly in place, comparing the budget to the results, and the budget did not work properly as a control system. In High-Tech the follow up and report system is partly new and improved. Measures are reported and monitored in relation to budget more frequently, in comparison to pre buyout. This has changed the system from being an information system to become more like a control system. For a cybernetic system to be a control system there must be established some sort of accountability for the variations in performance, with a linking of behavior to targets (Malmi and Brown, 2008). In several of the cases it is reported that there are new and better links between the reward and compensation systems, the budgetary system and KPI targets. This is discussed more in-depth under reward and compensation controls (4.3.3) and subchapter 4.3.6 below.

The use of financial performance measures has in general intensified after buyout. Medium-Sized IT is the case with fewest reported changes, as it seems that sufficient financial performance measures were already present. Meanwhile, for Producer the use of financial
measures was almost absent before buyout. Both companies were not small, had been in the industry for a while, and had prior been owned by financial investors. The biggest difference between them was the state they were at when bought. While Medium-Sized IT could be characterized as a revitalization buyout, Producer was closer to an efficiency/failure buyout. The emphasis put on financial measures in Producer after buyout has clearly come from the PE firm: “It has been a process where we had to force the organization to start using it [financial performance measures]”. Further, it is interesting from evidence in Service, that after buyout the performance measures turns from a focus on earnings before and after tax to return on equity, cash flow and EBITDA. This could perhaps be seen as a more advanced form of financial performance measures. Regarding the system needed to collect and organize data to compute the preferred performance measures there is no evidence that this has been changed in any of the cases. However, there is evidence from Online that the quality of the information collected, and the features of the system, had to be altered to get the best measures.

Of non-financial performance measures it is observed that there are in general reported about few significant changes. There appear to be some new measures in some of the cases. Further processes have been more formalized, as in Medium-Sized IT where the collection of market intelligence has been more formalized. Other changes performed to non-financial measures can be summed up in closer monitoring and improved quality of existing measures.

One of the most significant changes in the cybernetic systems is seen on the hybrid systems. In High-Tech and Online there were not present a form of hybrid system before. In both companies there have been implemented a form of KPI system after buyout, with both financial and non-financial measures. In Producer the use of a KPI system is not new, but the setup, measuring the whole corporation is new. Also in Medium-Sized IT it is reported that the setup is new, based on a need for re-designing the system. In Small-Sized IT there is not used of any specific hybrid system before or after buyout, while in Service they use some KPIs, but they are not organized and monitored in a system.

When discussing cybernetic system it is important to understand the link between the different subsystems. This includes both how one cybernetic system sets the premises for the others, and also how targets in one subsystem are linked to the others (ibid). It is arguable that after buyout there has in several cases been a higher understanding of the linkage between the
different systems, and this has been used to customize the systems and information needed to better fit the organization. For example in Service this is evident with a wider use of budgets – extending the budgets from just being sales budgets to have a complete budget for the company. Not only did this improve the budgeting as a control system, but also made it possible to better set financial performance targets. For Online a focus on better quality of the data reported and collected have made it possible to implement a KPI system. It is likely that this understanding and importance of data quality to first build up the systems and second ensure credibility of the system is improved after buyout. In Medium-Sized IT it is also evident that the linkage between the systems is better understood after buyout. Earlier the KPI system was a patchwork of indicators, in a system that did not fit the organization, now this has been re-organized and put into a better system designed for Medium-Sized IT.

4.3.3 Reward and compensation controls

Producer
In Producer changes in reward and compensation controls includes a shift from sales persons having only a fixed wage, to a progression based wage system, based on sales goals. In addition the top management has been included in a stock purchase program.

High-tech
Of new compensation and reward systems there has been implemented a stock purchase program for the top management, where they can co-invest with the PE firm. There are no other specific changes. As before buyout there exist some individual bonus agreements, and a yearly bonus for all employees based on company performance. It has been discussed internally to look for new ways to incentivize the salespeople and the engineering department, but so far there does not exist any programs for this.

Medium-Sized IT
Before buyout Medium-Sized IT was merged with another company. After the merger there was not performed a proper integration of the different reward and compensation systems of the two companies. At the time of the interview a new incentive structure for the whole company was on the agenda. So far a new management incentive program, offering top management and sales managers to invest in the company, has been established. Under the
former owner there existed a similar incentive program for top management but the design is new.

**Small-Sized IT**

Small-Sized IT is a small company with a flat organization structure. Before buyout the employees and management had few economic incentives. After buyout the organization has been incentivized with a slight increase in general salaries, a relative significantly increase in the bonus program, and three managers have been invited by the PE firm to invest in the company.

**Service**

In addition to the founder of Service, which continued as the CEO (chief executive officer) after buyout, three new persons in the management group have received an ownership share in the company. There also exists sales bonuses, which also was present before buyout.

**Online**

The most significant change in the reward and compensation controls for Online is the establishment of a stock purchase program. Initially the program was offered to the top management, but subsequently the rest of the organization also received a similar offer. The existing sales bonus program for sales persons has only been slightly adjusted after buyout.

**Table 4-5: Findings changes reward & compensation controls**

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reward &amp; Compensation</td>
<td>Employees: new progression based compensation system</td>
<td>Employees: integration of compensation system, new incentive structure</td>
<td>Employees: increase in salaries and bonus program</td>
<td>Mgmt: Ownership share in company</td>
<td>Employees: adjustment in sales bonus program</td>
</tr>
<tr>
<td></td>
<td>Mgmt: Stock purchase program</td>
<td>Mgmt: Stock purchase program</td>
<td>Mgmt: Stock purchase program</td>
<td>Mgmt: Stock purchase program</td>
<td>Mgmt: Stock purchase program</td>
</tr>
</tbody>
</table>

Abbreviations:
- mgmt: management

**Cross-case discussion**

Of reported changes in reward and compensation controls there is a clear difference between management and employees, both regarding changes reported and objective of these. For both management and employees the changes are aimed at increasing the congruence of people´s and organization´s goals and objectives. Nevertheless, reward and compensation controls
aimed at management have a higher emphasis on directly aligning the interest of the managers to those of the owners, with both an upside and downside potential.

For employees there are reported about changes in the reward and compensation controls in four cases, and in one case there has been discussed new ways to incentivize the employees. In the last case, Service, there was not reported about changes for employees. In general the changes undergone have increased the portion of compensation based on performance of the individual and/or organization. Where there did not exist performance-based compensation this was introduced as an addition to general salary, increasing the overall compensation. In Small-Sized IT there has been a slight increase in general salaries, and a significantly increase in the bonus program, increasing employees’ incentive to work for the overall company performance. In Medium-Sized IT the incentive structure was a patchwork of different systems, because of the recent merger, and changes were needed to get all employees working against a common goal.

On the management level an ownership program is offered in all cases, and in five out of six cases this is a new way of incentivizing the top management. Only in Medium-Sized IT the top management had a type of stock purchase program before buyout, but the design of the program has been changed after buyout. It appears that a form of stock purchase program is offered in all cases, offering managers to invest in the company at a relative low price. This type of compensation program for the top management is designed to align the interest of the top managers to those of the owners, as best as possible – as stated by one PE firm: “We give share ownership so that they will be in the same boat as us – the same development profile”. Several of the PE firms note that the ownership in the company is not given as a “gift”, like expressed by the owner of Medium-Sized IT: “It is not some sort of gift, they have to invest their own personal funds”. By introducing new managerial incentives the management risks some of their own personal capital in the company, at the same time as their upside potential is substantial. This does not only make them work harder, but also on the right tasks, as expressed by the owner of Small-Sized IT: “It helps to straighten them up, to discipline them. They do not run around with that many high-in-the-sky dreams anymore.” The new managerial incentives work as a boundary system, as traditionally argued by Jensen (1989). The findings of new compensation and reward controls are consistent with making the management and employees more committed to the plans, budgets and performance measures.
To categorize the reported changes they have a focus on extrinsic reward system, consistent with what is generally focused on in management accounting research (Malmi and Brown, 2008). The monetary incentives are thought to increase both effort and performance of employees and managers, by focusing on tasks.

How the reward and compensation controls changes can be summed up as a higher focus on linking compensation to performance, on both the individual and organizational level. This is evident for both employees and managers. New forms of compensation are introduced, or existing forms of compensation are altered. This can be seen as a method to achieve congruence between the goals and activities to employees and managers, to those of the organization (ibid), and also create boundaries (Bruining et al., 2004).

4.3.4 Administrative controls

There are three types of administrative controls in the framework by Malmi and Brown (2008): governance structure, organization structure, policies and procedures. The changes in relation to these controls will be presented and analyzed one by one, as they appear differently and are not as interlinked as the cybernetic controls.

Governance structure

Of administrative controls the biggest changes have been done to the governance structure. All companies, except High-Tech, have received a new majority owner. The PE firm investing in High-Tech has not acquired a majority of the shares, but has control of the company through a shareholder agreement. In all cases there have been significant changes in the governance structure, especially in relation to the board structure and composition, as well as how the board as a governance function works with the rest of the organization. Further, all companies, except Service, have changed some of the top management. Either one or more members of the top management have been replaced or the management team has been strengthened with more resources.

Producer

The board to Producer is almost completely new. A new composition includes the use of industrial advisors, with extensive industry knowledge, as well as representatives from the PE firm. The number of board members has increased from five to seven, where three are industrial advisors, three are representatives from the PE firm, and the last person is from the
former majority shareholder, now minority shareholder. Post buyout the board has been more involved in company matters and strategic discussion. Today the board works closer to the organization and challenges it on strategic choices and budgetary processes. The quality of the information received and used by the board is also reported to be higher after buyout. The respondent explained that the board and the owners today has a much more active role than before.

The management team has changed after buyout, with new a CEO (chief executive officer) and CFO (chief financial officer) as well as two other replacements.

**High-tech**

The former board of High-Tech existed of two of the owners, who also worked full-time in the administration, and three external members. The work performed by the board was limited; basically the board functioned to fulfill the requirements by the law. After buyout the board changed: Firstly, nobody working in the organization is now on the board. There was established a clear line between the board and the rest of the organization. Secondly, an external chairman of the board was appointed, and two other external board members. In addition to three external members two persons from the PE firm are represented on the board. In contrast from before the board meetings are now used as an active forum for discussions, between owners, the board and the administration.

In High-Tech the management team was strengthened with a temporary placement of a member from the PE firm, working 100% operational in the company.

**Medium-Sized IT**

In Medium-Sized IT the changes are less significant than in the other cases. The board structure is not changed, but all board members, except the employee representatives, are new. The biggest change in the composition of the board structure is a new external chairman. The information and issues discussed by the board is today more thorough, and the board is more actively involved in company issues, in contrast to before buyout.

In the management team the CEO has been replaced and the management team has been strengthened with a COO (Chief Operating Officer).
**Small-Sized IT**

In Small-Sized IT the board has changed from being a small board, consisting of three persons who all worked in the company, to be more professionalized with a clear distance between the board and the company. Today the board consists of two persons from the PE-company and an industrial expert, who also is the chairman of the board. The frequency of the board meetings has increased from four small yearly meetings, to six meetings with more substantial discussion. The new board is more actively involved and there is almost daily contact between the management and board members. Further, the new chairman of the board has extensive contact with the CEO, and is more or less used as a sparring partner on organizational issues and strategic discussions. Often tasks discussed at the board meetings have already been discussed several times before getting to the board, both between the board and management and also between the board members. The PE firm has also established a separate investor team, which includes 3-4 persons from the PE firm and also the management group from Small-Sized IT. The persons from the PE firm on the investment team are also board members.

On the management team the CFO has been replaced.

**Service**

In service the size of the board has decreased from six to four persons after buyout, and all board members are representatives of the owners. The number of formal board meetings has decreased, but the informal contact and meetings between the board members and between the board and the management have increased significantly. The four board members have short phone conferences almost every other day. Today the board is more oriented about the company situation and monitors the company more closely and frequently. Before buyout the board was to a high degree focused on budget and earnings. After buyout the board has taken on more responsibilities and been involved in more processes. For example the board has been working with cost cutting and acquisition processes. To some extent board members from the PE firm have been working close to operational in the firm, as a free resource.

So far there have been no changes in the management group in Service, but following an acquisition the management team will later be reorganized.
Online
Formally Online had a board before buyout, but in reality it was close to non-existing, as the board was inactive. After buyout there has been established a new formal and functioning board, with representatives from both major owners and also industry professionals. With the new board there are established new formal procedures for board reporting, in the form of standardized monthly reports, and planned board meetings.

In online there have been no replacements in the top management, but the management team has been strengthened with more members.

Table 4-6: Findings changes governance structure

<table>
<thead>
<tr>
<th>Governance</th>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>External board members (industrial advisors)</td>
<td>Functioning board members on board</td>
<td>New board members</td>
<td>No working members on board</td>
<td>New board members</td>
<td>Established new formal board</td>
</tr>
<tr>
<td></td>
<td>Board size increased</td>
<td>External chairman</td>
<td>External chairman</td>
<td>External board members (industrial advisors)</td>
<td>No working board members</td>
<td>New formal procedures for board reporting</td>
</tr>
<tr>
<td></td>
<td>More active board</td>
<td>More active board</td>
<td>More active board</td>
<td>More active board</td>
<td>Informal contact increased</td>
<td>Management team strengthened with more members</td>
</tr>
<tr>
<td></td>
<td>New CEO and CFO</td>
<td>Temp. placement from PE-firm in management</td>
<td>New CEO and COO</td>
<td>New CFO</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Cross-case discussion
The governance structure in all cases is significantly changed, not only by the introduction of a new majority owner, but by the way the governance mechanisms are constructed and employed. Most evident are the changes to the board structure and composition as well as the management team, but there is also clear evidence of changes of the way the board works and the information it uses and how the relationship between the board and management are changing.

The composition of the board in all the cases has changed. As earlier documented in buyouts the new owner takes one or more positions on the board (Masulis and Thomas, 2009). What is also reported is that in most cases the composition of external/internal members changes. In general in changes from the use of no or few external board members, to using one or more external members. This is evident from Producer, High-Tech, Small-Sized IT and Online. These external board members have in general some sort of industry experience, and are characterized as industrial advisors.
It is well known that after a buyout one or more members of the management team often are replaced (Gilligan and Wright, 2010). This has happened in all cases except Service and Online. Further, the management team has been strengthened with more resources in Medium-Sized IT and Online. In some of the cases the PE firm reported that part of the problem with the acquired company was certain people in the management team, and to get the company on the right track it was necessary to get rid of managers that did not perform, or which did not inherent the right competence. One respondent stated the following: “It is correct that one needs control systems to make sure the company is going in the right direction. However, those systems are of no value if you do not have a management that uses them good. Which follows them systematically.” In this case it appeared that it was not enough to change the incentives by new compensation and reward controls to get the management to perform better. The problem was the management that did not inherent the right competence, and this could not be solved with new incentives.

The change in governance structure as a control system is not limited to changes in board and management composition and structure. The information the board uses, and the way it is involved in company issues is in several of the cases reported to have changed. For example in High-Tech: “The board reporting before was only done to fulfill the requirements by the law – what the company strictly had to do. Now we use the board meetings as a discussion forum, between the owners, board and administration.” In Online it is also reported about a more or less inactive board before, where there barely existed a formal board, and where the new board contributes more to the organization. The information the board receives from the management and uses for each board meeting is in Online and Medium-Sized IT reported to be more standardized and specialized. In Medium-Sized IT there is now used a semi-standardized package of documentation, which is assembled and distributed to all board members before each board meetings.

Overall, the governance structure appears in all cases to be more professional after buyout. In the cases where management was represented on the board before, this is not present now. Strictly speaking the formal lines of authority and control are clearer. Nevertheless, the informal contact is increasing. The boards are more used as a device to control and also facilitate the organization after buyout. Where the board earlier was seen as a requirement by law it is now an important part of the organization. After buyout the boards also require more information of higher quality, and are more involved in company issues.
Organization structure

Producer
The organization structure of Producer has been changing and the process continues. The organization is being restructured to fit the value chain better, with a logistical unit in the middle to lower the complexity. There has also been established a new middle management level to improve the coordination and interaction between the different business units.

High-tech
High-Tech was before organized in two different companies, with different names. After buyout these have been integrated into one company with one name. To better coordinate the two divisions of the company there has been established a new corporate level.

Medium-Sized IT
In Medium-Sized IT there has been established an operational support division between the sales and the technical department to get a better integration between the two departments.

Small-Sized IT
The organization structure in Small-Sized IT is not reported to have changed, other than a few new recruitments.

Service
In Service the organization structure has not changed significantly, other than dividing the organization formally into regions to establish profit units.

Online
After buyout the organization of Online has almost doubled the number of employees. To handle this growth there has been established a new middle management level.

Table 4-7: Findings changes organization structure

<table>
<thead>
<tr>
<th></th>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organization structure</td>
<td>* New logistical unit</td>
<td>* Integration into one company</td>
<td>* Established operational support division</td>
<td>* Some new recruitments</td>
<td>* Established profit units</td>
<td>* Doubled number of employees</td>
</tr>
</tbody>
</table>

Abbreviations:
- mgmt: management
Cross-case discussion

In Producer, High-Tech, Medium-Sized IT and Online there is reported about changes to the organization structure to improve coordination and control, as well as the interaction between departments. This can be seen as a manner of reducing variability of behavior and easier predict organizational actions (Malmi and Brown, 2008). In Online it was established a middle management level to handle the exponential growth of employees and enable the management to delegate more responsibility and tasks. For the other companies the changes in the organization structure have been performed to improve the coordination between two or more divisions.

The changes undergone must be seen in relation to a need for separate control and coordination units, needed when the company grows. As reported in several of the cases it was needed a new layer in the organization to coordinate between the divisions. In Producer the new logistical unit was implemented both to improve coordination within the organization, but also to fit the demands of customers better, by responding quicker to demands. The operational support division in Medium-Sized IT was also established to make sure the products sold by the sales department were delivered according to customer needs by the technical department.

Organizational structure is often seen as a contextual variable of the MCS (Chenhall, 2003). However, in this study where Malmi and Brown’s (2008) conceptual framework is applied, the organizational structure is seen as a part of the organizational controls. As evident in this study, the organization structure is something the managers can change, and they do it when necessary to encourage contact and relationship. This is seen both when the organization is growing (Online) and where there is a need to coordinate better and improve communication between departments (Producer, High-Tech and Medium-Sized IT).

Policies and procedures

Producer

Policies and procedures in Producer have been strengthened after buyout. There was a need to define procedures and get them in a written format and gathered in a quality system, where all procedures now are found. Also, there has been created a new and better decision matrix, which show who has the decision-making authority for different matters.
High-tech
There has been performed several changes to policies and procedures in High-Tech, which all comes down to a process of formalizing. This includes new contracts of employment, new work procedures for the CEO and a new decision matrix for several levels in the organization. The formalization has primarily been done at the management and middle-management level.

Medium-Sized IT
There has so far not been any issue with policies and procedures in Medium-Sized IT, but a new human resource director has been hired, and new policies and procedures are on her agenda to handle skills and personal better.

Small-Sized IT
In Small-Sized IT there has been few changes to policies and procedures. Mainly it has been aimed at narrowing task area of focus. However, there are few formal policies for distribution of work. Policies and procedures are mainly focused on which area each employee should focus on.

Service
In Service there is not reported about changes to policies and procedures, as there has so far not been a need to change these.

Online
There have been no significant changes to policies and procedures in Online after buyout.

Table 4-8: Findings changes policies and procedures

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policies and procedures</td>
<td>Improvement of quality system</td>
<td>Formalized – e.g. CEO work procedures</td>
<td>New HR-director will establish new P&amp;P</td>
<td>Narrow of task area of focus</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Abbreviations:
- N/A: not applicable

Cross-case discussion
In general there are not reported about many significant changes to policies and procedures in the cases studied. Producer and High-Tech report about the most significant changes, and it has mainly been processes of formalizing procedures and policies, to highlight responsibilities.
Using policy and procedures to control and direct behavior is often seen as a bureaucratic approach (Malmi and Brown, 2008). In the cases the use of these methods is increased when it is seen as necessary to best direct the organization. The policies and procedures appear to be more bureaucratic in Producer and High-Tech, than in for example Small-Sized IT. However, this must be seen in relation to company size and complexity of tasks. Producer and High-Tech probably have the most technical advanced production in the sample, and hence it should be expected that they would have the highest focus on policies and procedures in the sample.

### 4.3.5 Cultural controls

**Producer**

There has been no active process to change cultural controls in Producer. However a new chairman of the board, with a strong authority, together with a new strategy and strong focus on quality, has impacted the culture in the organization. The culture is now more focused on actions needed.

**High-tech**

In the buyout process High-Tech has gone through a rebranding process. The company has changed and clarified its profile with a new name, new vision and value, and how the company is perceived in the market. There has been a clear focus after buyout to establish a shared culture between the two geographical displaced divisions.

**Medium-Sized IT**

After buyout Medium-Sized IT has been working actively to establish a shared culture and identity in the company, especially between the groups of people from the former two companies. The CEO has spent much time talking to management and employees, and there has been established a new common vision and new goals. The new vision and goals, also including core values, have been clearly defined and formalized in a new strategy document.

**Small-Sized IT**

In Small-Sized IT cultural controls have been of little focus post buyout.

**Service**

There are not reported about significant changes to cultural controls in Service.
**Online**

In Online there is currently an initiative working on defining new cultural controls, such as vision and values to strengthen the culture.

**Table 4-9: Findings changes cultural controls**

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cultural controls</td>
<td>Impact by new strong CEO</td>
<td>Rebranding process – new name, vision and values</td>
<td>Established shared culture and identity – New vision and values</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

**Cross-case discussion**

When culture is used to direct behavior it should be seen as a part of the MCS (ibid), as in contrast to a contextual variable of the MCS (Chenhall, 2003). The cultural controls are impacted in some of the cases, where it appears to have been of high importance (High-Tech and Medium-Sized IT), while for others it appears to not have been a clear initiative to change the cultural controls.

Malmi and Brown (2008) distinguish between three types of cultural controls: value-based controls, symbol-based controls and clan controls. The evidence from the cases only supports changes in value-based controls. Nonetheless, it is possible that changes have been performed within symbol-based and clan controls as well, but this is not reported. In the case of High-Tech the company has been rebranded, both to establish a shared culture, but also to clarify the profile in the external environment. In other words, the change in cultural controls was done to effect the internal culture, but with an expectation that it could improve the perception of the company in the external environment. In Medium-Sized IT a culture initiative has been employed to integrate the merged companies better. This was expressed by the interviewee to be an important part of the strategy.

Bruining et al. (2004) finds that the development of belief systems (according to Simons’ (1995) framework), which is similar to cultural controls, is particularly important in entrepreneurial buyouts. This evidence is only partly supported in this study. Of the two cases with significant reported changes in cultural controls one is characterized as an
entrepreneurial buyout (High-Tech), while the other is a revitalization buyout (Medium-Sized IT). In the two other entrepreneurial buyouts (Small-Sized IT and Online) there are not reported about any significant changes or initiatives regarding the belief system. Of the cases in this study the cultural controls have been emphasized in companies where the departments did not share a common culture, either because of a recent merger (Medium-Sized IT) or because of two geographically dispersed locations (High-Tech).

Cultural controls are subtle, often difficult to grasp, and can be regarded as out of the control of managers, and rather exist as a contextual variable for the control system, in contrast to as a part of it (Chenhall, 2003). To change organizational culture is sought to be difficult (Bruining et al., 2004). Nevertheless, organizational shocks and disruptions, which can be created by a buyout, can create the organizational break necessary to achieve this change (Trice and Beyer, 1993). The evidence from the cases supports the view that managers can affect the cultural controls following a buyout, at least to some extent, and they initiate projects to do so when necessary. It is not given that a new set of vision and values can direct behavior and create a shared culture, but it can be characterized as an initiative for doing this.

4.3.6 The package of controls – a summary of changes

Above there are presented evidences of changes to all five parts of the control package to Malmi and Brown (2008). The variability of changes within the six cases is high, illustrating the fact that each case is unique. An overall impression is that the emergence and introduction of new formal MCS in the buyouts is limited. There are relatively few new systems or tools introduced in the buyouts. In general the control packages have changed from being relatively unorganized and little formalized, to been put together into a system, with more formalization and clearer measures of performance. Further, the use of the systems has changed: After buyout the control systems are more actively used and monitored, and in general a higher understanding of the use of the systems seems to be evident. A summary of the findings in each case can be found in Table 4-10 below.

Ouchi and Maguire (Ouchi and Maguire, 1975; Ouchi, 1977) found that several control mechanisms are used simultaneously in organizations to serve multiple purposes. To isolate the effect of one single mechanism of control is difficult and this supports the view of MCSs operating as a package (Otley, 1980). In the cases in this study it appears that this understanding of the different mechanisms of control being interrelated is higher after buyout,
or at least the systems are designed and used with a higher interrelation between them. Planning for example is performed with a higher purpose of involving and committing employees (Producer, Medium-Sized IT, Small-Sized IT, Online). Further, in general budgets are designed to better include the whole organizations and are set more according to plans (Producer, High-Tech, Small-Sized IT). There is evidence that performance measures have a higher degree of linkage to the budget and compensation and reward controls (all cases). Administrative controls form the structure that the other control operates within (Malmi and Brown, 2008). In all cases there appears to be a better match between the administrative controls and planning, cybernetic and reward and compensation controls. An example of this is how budgets are divided and monitored on regions in High-Tech, and how reward and compensation controls are divided by organizations members according to governance structure. The linkage between cultural controls and the rest of the control package appears to be weakest in the cases. This is not surprising as culture is a subtle control, which is difficult to grasp and measure.

The interviewee for High-Tech summarizes the changes as follows: “I think, uniting and common are two important key-words for this company, at the same time as it have been more formalized.” This statement underlines that overall the changes performed to the MCS have been set up to professionalize the system, at the same time as all system are designed to serve a common purpose; reaching the company’s goals.
### Table 4-10: Summary findings changes in MCS

<table>
<thead>
<tr>
<th>CASE 1 Producer</th>
<th>CASE 2 High-Tech</th>
<th>CASE 3 Medium-Sized IT</th>
<th>CASE 4 Small-Sized IT</th>
<th>CASE 5 Service</th>
<th>CASE 6 Online</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Planning controls</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revision of plans, implementation and establishment of commitment</td>
<td>Short-term: focus on easy checklists</td>
<td>Establishment of commitment</td>
<td>New planning system (by the PE-firm)</td>
<td>Long-range: new expansion plan</td>
<td>Formal business plan established</td>
</tr>
<tr>
<td>New 5-year rolling long-range plan</td>
<td>Long-range: new expansion plan</td>
<td>Communication of plans</td>
<td>More structure</td>
<td>Higher level of structure to plans</td>
<td>Short-range: impr. projects</td>
</tr>
<tr>
<td></td>
<td>Plans formalized and set into system</td>
<td>More monitoring of plans</td>
<td>More monitoring and follow-up</td>
<td></td>
<td>Responsibilities and delegation clarified</td>
</tr>
<tr>
<td><strong>Cybernetic controls</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget: established commitment and responsibility, more monitoring</td>
<td>Budget: New follow-up and report system</td>
<td>Credibility of budgets improved</td>
<td>Strengthened budgetary process</td>
<td>Higher frequency of budget reporting</td>
<td>New complete budget</td>
</tr>
<tr>
<td>Introduced use of fin. performance measures</td>
<td>Budgets and fin. measures formalized and monitored</td>
<td>Few new fin. measures</td>
<td>New fin. measures</td>
<td>New fin. measures</td>
<td>Involvement of org. in budget process</td>
</tr>
<tr>
<td>Improvement of efficiency measures</td>
<td>KPI system implemented</td>
<td>Increase in number and quality of non-fin. measures</td>
<td>KPI system been redesigned and systemized</td>
<td>Higher frequency of reporting</td>
<td>New fin. measures</td>
</tr>
<tr>
<td>New KPIs</td>
<td></td>
<td></td>
<td></td>
<td>Increased monitoring of some non-fin. measures</td>
<td>Requiring higher data quality</td>
</tr>
<tr>
<td><strong>Reward &amp; Compensation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees: new progression based compensation system</td>
<td>Mgmt: Stock purchase program</td>
<td>Employees: increase in salaries and bonus program</td>
<td>Mgmt: Ownership share in company</td>
<td>Employees: adjustment in sales bonus program</td>
<td></td>
</tr>
<tr>
<td>Mgmt: Stock purchase program</td>
<td></td>
<td>Mgmt: Stock purchase program</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Administrative controls</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Governance: more active board, new structure, new CEO and CFO</td>
<td>Governance: new functioning board, more active, temp. PE-firm placement in management</td>
<td>Governance: External board members, more active, new CEO and COO</td>
<td>Governance: decreased board size and meetings, more informal contact, more active</td>
<td>Governance: formal board established, more board members, management team</td>
<td></td>
</tr>
<tr>
<td>Org. structure: new logistical unit and middle mgmt.</td>
<td>Org. structure: integration into one company, corporate level</td>
<td>Org. structure: operational support division</td>
<td>Org. structure: new recruitment</td>
<td>Org. structure: doubled number of employees, middle mgmt. level</td>
<td></td>
</tr>
<tr>
<td>P&amp;P: formalized, decision matrix</td>
<td>P&amp;P: Formalized, decision matrix</td>
<td>P&amp;P: New HR director</td>
<td>P&amp;P: Narrow of task area of focus</td>
<td>P&amp;P: N/A</td>
<td></td>
</tr>
<tr>
<td><strong>Cultural controls</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact by new strong CEO</td>
<td>Rebranding process – new name, vision and values</td>
<td>Established shared culture and identity</td>
<td>N/A</td>
<td>N/A</td>
<td>Currently initiative defining new cultural controls</td>
</tr>
<tr>
<td></td>
<td>Shared culture between departments</td>
<td>New vision and values</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Abbreviations:**
- impr: improvement
- fin: financial
- non-fin: non-financial
- KPI: key performance indicator
- org: organization
- mgmt: management
- P&P: policies and procedures
- N/A: not applicable

### 4.4 The role of the private equity firm

This subchapter will serve the purpose of answering the second specific research question:

**What is the role of the private equity firm in initiating and implementing changes in the control package?**

PE owners are said to exert a very active ownership of their investment, both regarding monitoring and involvement (Gilligan and Wright, 2010). Regarding venture capitalists it has been said that they have a positive impact on the emergence of MCSs in growing firms.
(Davila, 2005). A PE firm has many of the same features as a venture capital firm, where the main difference is related to the life cycle stage of invested companies (Hardymon et al., 2009). While venture capital firms invest in younger firms with good potential for growth, PE also often consider considerable growth in their investment cases, but in more developed firms. From the cases in this study it appears that the PE firms have an active role in changing MCS, at the same time as they are aware of new systems and controls are of no need if they are not customized for the company, and changes need to be of some value before they are initiated.

The findings on the role of the PE firm will be presented for each case before a cross-case discussion will follow.

**Producer**

The role of the PE owner to Producer has been changing over the ownership period. The first period being the most active: “In phase 1 – the first 3 to 6 months – it was a “dictatorship”. We were 4 persons engaged in the company, almost on fulltime, to keep a tight rein on the company.” In the first period the planning controls were reorganized, and the PE firm engaged actively to establish commitment. Further, the PE firm actively changed the governance structure by replacing several managers. It was expressed by the interviewee that the changes in the management team were probably the most important changes they had done to the company. In the process the PE firm met several challenges, and they had to replace several employees. Also, they had to more or less force the company to start using financial performance measures. The high degree of involvement from the PE firm was from their perspective necessary to stabilize the company. Lately the degree of owner involvement has decreased as the company is performing better and the PE firm is more satisfied with the management.

**High-Tech**

In High-Tech the PE firm has been actively involved in the changes after buyout, in particular with a temporary placement of a member of the PE firm in the management. The argument by the PE firm for doing this was: “there were many things that we needed to handle to get it up to our standard, regarding reporting, internal control, and systems and routines.” Nonetheless, it was underlined that the PE firm wishes to work through the board: “The way we want to work is through the board, that is where we have our role, that is the way we want
to work. This situation is only temporary.” The interviewee also underlined that they always are concerned about the changes are being performed with a clear objective. They do not want to put a heavy load of reporting on the company if it is of little or no use. Even with an active involvement in the management, the PE firm considers their role as being a facilitator and contributor to the company. They do not want to impose changes, but rather propose changes if necessary.

The interviewee summarizes the role of the PE-company as follows: “We work after a method where we wish to work through the board, which again work through the CEO and the management group. We do not want to overrule the CEO, he has our full support and trust, and it has to be that way. (...) We enter as a consulting body and support, and then naturally in the power of the board, and as an owner.”

Medium-Sized IT
Prior to investment the PE firm had a hypothesis that there were some changes they had to take an active role in, to get the company in the direction they wanted. However, because of underperformance the PE firm considered it necessary to get more involved in the company. The PE firm launched several initiatives, where they actively participated with the management and organization. In several matters the PE firm has assisted Medium-Sized IT, and been actively involved in company matters. Nevertheless, the interviewee considers the PE firm’s main form of involvement through being an active board member. He summarized the role of the PE firm as follows: “We shall be an active owner, but we shall not interfere too heavily in the daily management of the company. That will only result in a poor dynamic.”

Small-Sized IT
In Small-Sized IT the PE firm has been more involved than the former owner, who was more distant. The PE firm actively challenges the management, but does not want to direct them. One important change the PE firm has worked with is constraining the management from focusing on activities with low or uncertain future value, to put more effort into improving the existing business. The PE firm has improved this by giving the management the opportunity to co-invest in the company. The interviewee underlines that they do not want to change things in the company that is not needed: “The fact that a company is bought by a PE firm does not force things to change unnecessarily. We do not go in there and create a lot of mess and stress, just for fun.”
Service
In Service the new owner has been actively involved in the changes, but probably not as active as apparent in the other cases analyzed. This must be seen in relation to Service undergoing in general fewer changes in the control systems than the other cases. The role of the PE firm has been to help professionalize the company, and help specializing the company more, in order to reduce operational risk. Further, the PE-company has taken a leading role in finding possible acquisition targets. The interviewee underlines that they operate very active, often almost operational in the company, and the line between the board and the management is very weak.

Online
Online was growing exponentially when the PE firm invested in the company, but needed professionalization. The PE firm has been active involved in professionalizing the company, and has been the driving force behind this process. Further, the PE firm has taken the responsibility for handling acquisitions. Because the firm did not have a formal long-range plan at the point of buyout the PE firm actively had to initiate this. The interviewee underlines that their involvement is mainly performed as a board member: “It happens that there are disagreements regarding if changes are necessary. It then happens that we need to put some pressure on, but in the position as the board, an active board”. Further, the interviewee informs that the changes have come both from initiatives by the PE firm and the management, and that the management lately have contributed with several initiatives.

Cross-case discussion
The PE firms in all cases act as very active investors, in both monitoring and controlling the company. PE backed buyouts have been said to be a governance mechanism to restructure organizations (Cumming et al., 2007). In the cases of this study all PE firms are aware of their role as an active investor, and their power to perform changes to the company comes form the position as a majority owner, represented on the board. Some of the most evident changes in the cases have been performed to the governance structure, and how governance mechanisms are used. The new owner is more active, monitoring and directing the investment, in contrast to the former owner.

The PE firms often possess expert knowledge in how to govern and enhance the value of a company. The PE firms have a certain administrative capacity that they can leverage onto the
portfolio companies. Verbeeten (2010) finds support for administrative capacity being the main driver for change in management accounting and control systems (MACS). The PE firms’ expertise and experience can be used to change the systems and/or the way systems are used in the portfolio companies. A clear evidence of this being done is in Small-Sized IT, where the planning system the PE firm uses in its other portfolio companies is implemented. In other words, the PE firm has experience and expertise in one system and transfers this to the portfolio company. These findings are consistent by among others Robbie and Wright (1995).

In initiating changes in the MCSs the PE firm can do this several ways: As shown above in Small-Sized IT by introducing directly a new system, or indirectly by hiring new managers or a change in existing managers attention or initiatives. In some cases it is reported that the introduction of new managers have considerably changed how systems are being introduced and implemented. As in Medium-Sized IT where a new manager has considerably changed how management control is exercised and has concentrated on building a common culture. In Online it is reported that both the PE firm and the existing management have initiated changes. However, in the beginning it appears that most changes were initiated by the PE firm. It is lately that the management has had an eye-opener and is now suggesting more changes. Davila and Foster (2007) discovered the same features of adoption of systems in studying early startup companies with the presence of venture capital.

In the case of implementing the changes the role of the PE firms appears to be as a facilitator, and not a body performing the implementation. However, in High-Tech where an employee of the PE firm had an operational position in the company, the PE firm role has also been one of implementation. Further, for the first period after the buyout of Producer the PE firm was actively involved in not only initiating new control uses, but also implementation. In general it seems that the PE firms do not want to have an active role in the implementation, but when necessary they will assist.

In all cases the monitoring by the board has increased after buyout. The new boards, with the PE firm in front, are in general monitoring the company more and are involved in more company issues than before. This has is some of the cases required more information regarding performance and better plans and budgets in the company. As such the PE firm
have indirectly initiated changes by requiring both more accurate and more extensive information.

The PE firms appear to be aware of their position and use of power to direct their investment. However they do this by employing a new corporate governance structure, and in consistence with Cendrowski et al. (2008) that is what enable them to operate as active investors.

4.5 Summary of analysis

This analysis identifies several important aspects on how the control package change in a PE performed buyout transactions. While there are several evidences on the presence of venture capital being positive related to the emergence and adoption of several new management control systems (Davila, 2005; Silvola, 2008), this is not necessarily evident from the results of this study. It appears that in PE performed buyout transactions there are few adoptions of completely new systems or tools for management control. Changes are foremost related to improving the use of existing systems, and ensuring they have the best fit to the companies, as well as the control systems used are more in the form of a package (i.e. the control systems operate together and are interrelated). Also, an utterly important feature in the buyouts studied has been to establish commitment to management and employees. In all cases there has been a focus to introduce new management incentives to align the interest of the owner and management, either by introducing new forms of compensation system or by re-designing existing systems.

The changes that have occurred must be seen in relationship with strategy. A new and different objective from a new owner has changed the strategic direction and goals for the companies and brought on a need for change. An example of this is the cases where there have been implemented a new expansion strategy that has required systems for control and monitoring of this strategy. Specifically a new expansion strategy has required new plans and an altered organization structure to support this. Further, the PE firms have certain goals of their investment, and to reach these it has been necessary to increase the degree of monitoring of the company, requiring more extensive and more accurate information.

The role of the PE firms has in most cases been to suggest changes and initiate these. The portfolio companies have performed most of the implementation of changes. It is uncertain to
what extent the observed changes would have occurred without the presence of PE. However, as findings show that the PE firms actively have initiated changes, it seems valid to presume that some of the changes would not have occurred otherwise.
PART 5. CONCLUSION AND FURTHER RESEARCH

This study adds insights into the development of management control systems in buyouts performed by private equity firms. The aim of this last part is to conclude the thesis and answer the overall research question:

How does the control package change following a buyout transaction performed by a private equity firm?

Further, this part will include suggestions for further research.

5.1 Conclusion

To add value to an investment after buyout a PE firm can engage in several activities. Kaplan and Strömberg (2009) divide these activities into financial, governance and operational engineering. While financial and governance engineering were at the core of creating value in the 1980s, most PE firms today need to put substantial effort into operational engineering to add value to the investment. Applying the best set and use of MCSs to an investment is a form of operational engineering. Assuming that a PE firm only will engage in company activities to enhance, or avoid a decrease, in firm value, changes performed to these systems are expected to have a positive net value for the firm. This study cannot give any answer to what extent better MCSs in a buyout enhance firm value; only give suggestions to how they change.

This study suggests that following a PE performed buyout there exist a major opportunity to change and alter the use of the MCSs. The findings from the six cases, both together and on an individual level, provide a good frame for understanding how the control package change in PE performed buyouts. Overall the findings suggest that after buyout the control package develops and control is centralized. There are not necessarily introduced new control tools, but the existing ones are developed to better fit the operating environment of the company and an altered strategy. Also, after the buyout the coherence between the different MCSs seem to be higher.

This subchapter will first answer the two specific research questions: How do the various components of Malmi & Brown´s (2008) control package change following a buyout transaction? What is the role of the private equity firm in initiating and implementing
changes in the control package? Subsequently the subchapter will present a general answer to the overall research question: How does the control package change following a buyout transaction performed by a private equity firm?

5.1.1 How do the various components of Malmi & Brown’s (2008) control package change following a buyout transaction?

The framework presented by Malmi and Brown (ibid) has provided a foundation for the analysis of the different components of a control package. Changes in the various components of the control package are not limited to the introduction or discarding of tools and systems, but also includes how the various components are used.

Of new tools introduced after buyout the most apparent is hybrid forms of cybernetic systems, and new tools for compensation systems. The introduction of these two types of tools must be seen in relation to each other. New tools for compensation systems are directly aimed at encouraging employees and managers to work in accordance to the company’s goals and strategies. They do so by increasing the portion of compensation based on performance, both on the individual and company level. In order to evaluate how much compensation an employee should receive based on performance, there can be a need for new or better measures of performance. This is seen in the cases where new performance measures are introduced, often assembled into a KPI system.

The plans, both on the long- and short-term are revised after buyout. In cases where there did not exist such plans this was introduced. Further, there has been a focus on committing employees to the plans. Planning controls as a component of the control package are not necessarily changed with new tools, but the use of the controls is intensified after buyout. Specifically this is seen on the short term after buyout, where 100 days action-plans are commonly used. Most probably this must be seen in relation to the reported changes in the firms’ strategy. It is plausible to assume that a new strategic direction calls for changes in plans, both on the short- and long-term.

The governance structure is changed in all cases. However, the change with biggest impact is most likely not the new structure, but how the new board operates, and how new managers are introduced into the company. The new boards are more active, demanding more extensive and
more accurate information about the firm’s performance, and also actively engage in outlining the strategy of the company.

To conclude, there are seen changes in all components of the control package. However, the changes vary highly between the cases, and even though there are relative few new tools introduced, the use of the components have changed significant. Most changes are seen in relation to the governance structure and compensation and reward controls, and also planning controls. Least changes are found in cultural controls.

5.1.2 What is the role of the private equity firm in initiating and implementing changes in the control package?

In a buyout the PE firm has a special role. Prior studies have showed that PE companies employ a specific governance mechanisms, leverage their own administrative capacity and inherent experience and expertise, which is transferred to the portfolio companies (Cumming et al., 2007; Robbie and Wright, 1995; Verbeeten, 2010).

In changing the MCS the PE firm’s role seem to be foremost in the form of initiator. The PE firms have their mandate through the board, and express this as their way of governing. However, when necessary the PE firms seem to assist the company also in implementing the changes. Nevertheless, this role is only reported to be temporary. The PE firms are careful with directing their portfolio companies, as they seem aware of this as a potential harmful action, which can demotivate employees and managers.

The degree of PE firm involvement seems to change over time. The PE firm involvement is highest in the first period after buyout. After a period of the time it seems to be a gradually lowering of PE firm involvement. It is possible that as long as the PE firm is not satisfied with the general level of control, or does not have the necessary information to evaluate the performance of the company, they will stay highly involved. After a desired level is reached this involvement decreases, and the PE firm becomes less involved.

The PE firm involvement in initiating and implementing changes in the control package can be considered a step to manage risk. When investing in a company the capital to the PE fund has been put at risk. By directing the portfolio company and demanding regular information this can improve the contractual efficiency between the managers and the owner. Mitchell et al. (1997) argues that for the providers of capital to risky investment opportunities one will
expect them to take actions to ensure that the management has the necessary information that is relevant for taking good and sound managerial decisions. An active role by the PE firm can lower the risk of investment failure. Employing this perspective the role of the PE firm will depend on the degree of risk perceived of the PE firm in the investment. For a relatively risky investment one will then expect a high degree of involvement, both in initiating and implementing the changes.

When the PE firm is initiating changes to its portfolio company, it employs a certain administrative capacity. Davila (2005) has suggested that venture capital professionals transfer their management experience to the invested firms. In all cases in this study the PE professionals use their administrative capacity to drive changes in the control systems. Both Verbeeten (2010) and Langfield-Smith (1997) has suggested that administrative capacity is an important factor in changing the MCSs. Which role the PE firm will take in initiating and implementing changes in the control package will hence depend highly on the knowledge and experience of the professionals of the PE firm.

5.1.3 How does the control package change following a buyout transaction performed by a private equity firm?

Looking at the package of controls it is possible to summarize the changes that have occurred in the different components, and also how the control system operates as a package has changed after buyout. The wide variety of changes across the cases indicates that changes in the MCS are context-dependent. The context is not limited to the contextual variables of a MCS suggested by Chenhall (2003), but also include such as PE firm objective of investment and the administrative capacity of the PE firm.

In general terms it can be said that there has been significant changes to the MCS system, in particular in the way the systems are used, and how the systems operates together. The design of the controls is not necessarily changed, but the use of them is altered.

The use of the control systems is in general intensified. After buyout the new owners have put emphasize on the use of the systems and requested more and higher quality data on the performance of the companies. Before buyout it is possible that the degree of informal types of control, where managers kept direct control and supervision on the employees, was relative high. Further, the degree of aggregation of information was perhaps lower. It is also possible
that there have existed formal control systems at the time of buyout, which the PE firm has not been aware of. This can have brought on a need for formalizing the already existing systems. Further, it is possible that before buyout the information was present throughout the organization, but this was not collected and centralized. After buyout the new owner has required more aggregated information, and use of more formal controls. From the PE firms perspective this can be seen both as a form to reach a desired level of information for performance evaluation, and also as a way to engage managers and employees. These initiatives have likely centralized the control and information. After buyout information is aggregated and used for managerial control on a higher level.

At the same time as there is a seen a centralizing of control there is a focus on incentivizing the employees and managers. The reward and compensation controls seem to be connected more tightly to the performance of the company. After buyout there is a higher degree of connection between the performance of the company and the compensation of employees and managers. This seems to have been a clear initiative from the PE companies, to get the organization moving and inspire the employees and managers to think new, and also align the interests of the managers and employees, with those of the PE firm.

The findings from this study both supports and add insights to findings from similar studies. Davila and Foster (2007) found that early-stage startup companies with presence of venture capital had a higher than average rate of adoption of MCSs. It is not possible to conclude on this for later stage buyouts, as the sample in this study is small and there is no control group. Nevertheless, the adoption of MCSs in the later stage buyouts does not seem to be high. This is not surprising as none of the cases studied in this paper can be characterized as start-up companies. Nonetheless, evidence from the cases points to younger companies, or companies owned by the entrepreneurs before buyout, having the highest degree of adoption of new systems or tools for management control after buyout.

The results from changes in planning controls, with a low introduction of few new tools for planning, but a significant changes in formats and procedures for planning, is supported by the findings from Jones´(1992) study on MBOs. Further, the findings by Jones (ibid) that planning techniques have a better match with the organizational context after buyout, are also supported by this study. After buyout planning is more concentrated on current issues, and
strong pressure has been put on planning for short-term actions. This is underlined by the introduction of 100-day actions plans in some of the cases.

Bruining et al. (2004) suggested that a MBO’s change in ownership provides a major opportunity to change cultural controls. From the cases in this study it is not apparent that there is a major opportunity for changing the cultural controls post buyout. The opportunity for changing the culture is present, however changes will first be initiated when it is viewed as a necessity to direct the organization. Evidence from the cases points to culture not being of high importance when PE firm looks for improvement potential in the control package. Possible explanation for this include such as cultural controls being subtle and difficult to grasp. Even if the opportunity to change the culture exist, it can be difficult to approach. Further, effects from initiatives on changing cultural controls are likely to take time, and effects can be difficult to measure. It is likely that effort will first be put into easily changeable and measurable initiatives, and cultural controls will hence be of less emphasis.

This study has implications for practitioners involved in buyouts. It is well known that a change in ownership provides the opportunity for a development of planning and cybernetic controls in mature company (Jones, 1992). However, as Bruining et al. (2004) also finds, this also seems to be the case in more entrepreneurial companies, experiencing high growth. Further, it appears that after buyout there is in many cases a need to align the interest of the managers and the owners, which is done by offering key managers an ownership in the company. For companies undergoing a buyout transaction it is worth noting that the PE firm will engage in activities to initiate changes, and only if necessary participate in the implementation. It appears that the PE firms inherent a certain managerial expertise that they leverage to their investment when needed. However, the primary role of the PE firm is governing through the board, as an active owner. For PE professionals it is important to consider a change in the MCS to realize a company’s full potential. When evaluating possible acquisition targets it can be valuable to assess the state of the MCSs and look for possible improvements in these systems.

The study further contributes to existing literature on buyouts and MCSs. As earlier discussed the prior research on buyouts has for the most part concentrated on economic performance, efficiency, governance and value creation for shareholders. Little research attention has been
given to what happens to the MCSs after buyout. This study provides suggestions for how MCSs changes after buyout, and provides interesting opportunities for further research.

5.2 Suggestions for further research

The aim of this study has been to understand how MCSs change following a buyout transaction and how the PE firm involves, as an active owner, in these changes. As this was a novel study it sought to get an overall impression on how the MCSs changes, and did not seek to understand why the changes happened and the effects of these. Further, the study analyzed changes by using a single unit of analysis in each case; hence a generalization of changes on buyouts is not possible. The results from this study are exploratory and there are several avenues for future research. In particular there are three interesting research propositions, which can be investigated further.

The first proposition is as follows: In a buyout transaction performed by a private equity firm the management control is centralized and intensified, and the use of performance based compensation is increased. This proposition derives from the findings in this study, and the cases points to this being evident. However, a quantitative study with a larger sample is necessary in order to generalize on this. A potential study should employ a framework, and investigate the centralization and intensification across several types of control, for example by using the framework to Malmi and Brown (2008).

The second proposition is that PE firm involvement and managerial expertise affect the degree of changes to the MCSs in buyouts. There are found support for the proposition in this case study, but a more specific study is needed to conclude on this. PE firm involvement can be measured by the time the PE firm spends on interaction with the portfolio company, and managerial expertise can be sought measured based on prior experience. To measure the degree of changes in the MCSs it is possible to measure changes to some specific controls, as a general measure of the complete control package can be difficult. Evidence from such a study can point to the importance of the PE firm involvement and expertise after buyout, for changing the MCSs.

The third proposition is that changes in the MCSs in private equity performed buyout transaction are positively related with firm performance. This proposition derives from the
rational view that one will only engage in value adding activities. If found support for the proposition it can be shown that for a PE company to maximize fund return it needs to focus on employing the best in class control package in the portfolio companies. It is difficult to isolate the effect the MCSs have on performance, but by using comparable buyout cases a study investigating this should be possible. This would be interesting because if there is clear positive relationship between MCSs and performance in buyout this could provide a source of value gains for investors.
REFERENCES


APPENDIX

Appendix 1: Structured interview guide

Structured interview guide
Master thesis NHH
Private Equity & Management Control Systems
2012

<table>
<thead>
<tr>
<th>Interviewer</th>
<th>Interviewee</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Tore Aas</td>
<td>Name:</td>
</tr>
<tr>
<td>M.Sc. Student</td>
<td>Company:</td>
</tr>
<tr>
<td>Norwegian School</td>
<td>Position:</td>
</tr>
<tr>
<td>of Economics</td>
<td>CASE:</td>
</tr>
<tr>
<td>Phone: +47 932 18</td>
<td></td>
</tr>
<tr>
<td>965</td>
<td></td>
</tr>
<tr>
<td>E-mail: john.aas@</td>
<td></td>
</tr>
<tr>
<td>stud.nhh.no/john.</td>
<td></td>
</tr>
<tr>
<td><a href="mailto:tore.aas@gmail.com">tore.aas@gmail.com</a></td>
<td></td>
</tr>
</tbody>
</table>

Date: 

Interview type: 

Length of interview: 

Instructions

The interview is performed as the empirical part of a master thesis at Norwegian School of Economics

The objective with the interview is to understand how internal control systems have changed in one specific buyout case. The focus will be on systems that the management uses to get the company to work against defined goals and strategies. In other words, the focus is on the systems that the management and possibly the owners use.

E.g.: Use of financial measures can ensure that employees focus on what is needed to reach predefined goals. Together with for example incentive system this will increase the possibility for employees doing what is preferable for the company. Further, control systems also include the use of such as reporting routines and system, financial and non-financial measures, planning systems etc.

Beyond understanding which systems that are used and which have been introduced/discard post buyout, it is also sought to understand how these changes have occurred and how the PE firm possibly have impacted this.

Interview structure:
1. Introduction
2. The PE-company and the acquired company (the CASE)
3. Changes in the control system
4. Influence on the changes in the control system
5. Concluding remarks

The interview is completely confidential and all information will be anonymised in the final paper
## 1. Introduction

Information and introduction to the interview

## 2. The PE-company and the acquired company (the CASE)

<table>
<thead>
<tr>
<th>PE-company</th>
<th>Short questions about the PE firm</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>What kind of companies is in focus?</td>
</tr>
<tr>
<td></td>
<td>Main objective of investment?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Acquired company</th>
<th>Background information about the acquired company</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>If possible this information can be sent in advance</td>
</tr>
<tr>
<td></td>
<td>- Company history</td>
</tr>
<tr>
<td></td>
<td>- In which industry does the company operate, and what are the characteristics of this industry?</td>
</tr>
<tr>
<td></td>
<td>- Intensity of competition in the industry?</td>
</tr>
<tr>
<td></td>
<td>- What strategic position does the company have?</td>
</tr>
<tr>
<td></td>
<td>- What is the core product and competence to the company?</td>
</tr>
<tr>
<td></td>
<td>- Revenue?</td>
</tr>
<tr>
<td></td>
<td>- EBITDA?</td>
</tr>
<tr>
<td></td>
<td>- Key indicators: ROE/ROIC/RI/EVA</td>
</tr>
<tr>
<td></td>
<td>- Leverage?</td>
</tr>
<tr>
<td></td>
<td>- Ownership?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rationale for acquisition</th>
<th>Why was this company chosen as a target company?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Biggest potentials for improvement pre-buyout?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The role of the PE-company</th>
<th>What role do you take as an owner?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In your opinion, how do you create value?</td>
</tr>
</tbody>
</table>
### 3. Changes in the control system

| Strategy          | Strategy before buyout  
|                  | Strategy now  
|                  | What are the most significant and important changes+ |
| Control- and management systems IN GENERAL | How will you characterize that the internal control system has changed – in general? |
| Planning controls and systems | What types of systems for planning are being used?  
|                  | - Short-term planning – tactical focus  
|                  | - Long-term planning – more strategic focus  
|                  | NB: Not financial planning (not budgets). Also not pure strategic planning. More focus on planning how and when tasks should be performed. |
| Cybernetic systems and controls | Systems that measure and give feedback about variance  
| Gives feedback | Which systems exist, before and after buyout?  
|                  | **Budgets**  
|                  | The use of budgets?  
|                  | Is achievements in relation to budget been used as a management tool?  
| Financial goals and measurement systems | The use of financial targets/key figures?  
|                  | ROI, ROCE, RI, EVA  
|                  | Are employees being held responsible for certain financial goals?  
| Non-financial goals and measurement systems | Are employees being held responsible for certain non-financial goals?  
|                  | E.g.: customer satisfaction, process goals, measures of efficiency  
| Hybrids (both financial and non-financial in one tool – e.g. BSC) | Is a form of Balanced Scorecard being used?  
| Reward and compensation - incentive systems | What forms of incentive systems are being used?  
|                  | Introduction of new incentive systems?  
|                  | Management level vs. lower levels?  
| Administrative controls | Management of activities through the organization of individuals and groups  
| Governance structure | How has the governance structure and the way the board works been changed?  
| Organization structure | Have there been done any changes in the org. structure in the means of better goal achievement?  
|                  | Better org. structure for cooperation and contact?  
|                  | Does there exist profit units within the org?  
| Procedures and policies | How are procedures and policies to the employees specified? |
| Cultural controls | The use of:  
- Values  
- Norms  
- Symbols  
How is this being used for goal achievement? |
| Other diagnostic tools | What other systems/tools, than those already mentioned, are being used to determine how the company is performing? |
| Other tools for setting boundaries (boundary systems) | What other systems/tools, than those already mentioned, are being used to make sure that the company keeps itself within certain boundaries? For example, in relation to products and investments. |
| Other systems that are being used to stimulated creativity and innovation | What other systems/tools, than those already mentioned, are being used to stimulate employees? To improve the goal achievement? Other kind of incentive systems being used? Systems to improve innovation? |

### 4. Influence on the changes in the control system

| Change initiation | Can you describe how the changes have happened/occurred in the different kinds of systems? Who have initiated the changes? |
| The PE-company’s influence on changes | How have you as an owner influenced the changes in the systems we have talked about? What kind of resistance/cooperation have you met during the process? |
| Management’s influence on changes | What changes have the management introduced/initiated? |
| Changes coming from new/changed incentives? | How important do you think that new or changed incentives have been for systems changes – both initiatives and the process of change? |

### 5. Concluding remarks

| Wrap-up question |
| Extra from the interviewee |
| Thank you! |