PRIVATE EQUITY IN SWEDEN

An analysis of the private equity industry in Sweden and two case studies on individual companies’ competitive strategy

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Private equity is a term used for investments made in equity in a company that is not publicly traded on a stock exchange. The global private equity industry has grown in recent years, especially in developed economies (dos & Alvaroda, 2016). During the 1980s the private equity industry spread to Sweden as one of the first countries in Europe. The private equity industry didn’t really have a big impact on the Swedish market until mid-1990s. The private equity industry had assets of only 16 billion SEK in 1996 which then grew to 230 billion SEK in 2004 and has since continued to be a major part of risk capital investments in Sweden (Hamzeh, 2009).

Private Equity companies have become a major force in many of Sweden’s industry sectors. They now own more than 800 portfolio companies which together employ about 190 000 people and have an annual revenue of over 318 billion SEK (SVCA a, 2015).

For private equity companies to exist there needs to be investors willing to provide capital. In today’s globalized world an investor has many different options to invest in. The market as a whole as well as individual companies needs to bring sufficient returns compared to its risk profile to attract investors. This means that individual companies must not only compete for capital but also perform afterwards to attract capital in the future.

Purpose

The purpose of the master’s thesis was to describe and analyze the Swedish private equity industry and individual companies’ competitive strategy to increase value of portfolio companies and attract capital.

Methodology

The thesis contains one analysis of the Swedish private equity industry and two case studies. The case studies contained two companies named Ratos and Volati.

Both primary and secondary data was collected for the thesis. The primary data consisted of interviews and the secondary data came mainly from NGOs whom specializes in private equity and from public information published by the case companies. There was one interview per company, the interviewees were with senior investment personnel from both organizations.

Industry analysis

The industry analysis was conducted with a theoretical framework called Porter’s five forces. This framework can be used to analyze the challenges that an industry faces. The five forces that acts upon an industry are: buyers, suppliers, the threat of substitutes, potential entrants and the competitive rivalry (Grant, 2010).

![Figure 1: Porter’s five forces (Grant, 2010)](image-url)
**Conclusion of industry analysis**

From the industry analysis it was found that the vast majority of investors in Swedish private equity funds are made by professional institutions. Most of the investments made in private equity funds originate from outside of Sweden with the majority originating from Europe and North America. There is clearly a large pool of investors interested in Swedish private equity funds which makes it easier for Swedish private equity companies to attract capital.

There is a large amount of differentiation between private equity companies on type of investments strategy, minimum investment size, geographical focus and capital structure. This differentiation is beneficial for the private equity companies as they become less commoditized from the viewpoint of an investor and its beneficial for the investor as they can pick a private equity company that suits their requirements.

A private equity company’s management team will impact the performance of the private equity company and it is therefore essential for a private equity company to have a skilled management team. A convenient way for an external investor to assess a management team’s capabilities was found to be by looking at their previous track record, this is why a good track record is important for a private equity company in their quest to attract capital.

There are many different sources for Swedish private equity companies to buy/sell a portfolio companies from/to. There is a fluctuation in the amount invested by private equity funds from year to year. This indicates that the market conditions can change from one year to the next. Private equity companies and other companies that have acquisitions as a part of their core business must buy/sell companies to keep operating, regardless of current market conditions. This might even out the demand and supply of portfolio companies on the market. A further proof of this originate from the case studies were both companies are of the opinion that there are high valuations on the market right now but despite this continues to invest.

**Case studies**

To analyze the competitive strategy of the case companies a generalized strategy framework was used. The strategy field can be divided into corporate-, business- and operational level of strategy. Corporate-level strategy is the strategy that concerns the overall scope of an organization Business-level strategy is how specific business units should compete in their respective markets. Operational strategies concern how the components of an organization should operate to effectively deliver the corporate- and business-level strategies(Johnson, 2014).

A resource based view was used to further analyze the case companies’ strategic capabilities. The VRIN framework was used to evaluate individual strategic capabilities. This yields a deeper insight into the true power and sustainability of a strategic capability(Johnson, 2014).

**Conclusion of case studies**

The case company named Volati does not intend to sell of their portfolio companies but instead own them in perpetuity. Volati focuses on creating synergies and long-term ownership which may lead to them looking for different types of companies and also evaluating companies in a different way than their short-term focused competitors. Volati have a long-term ownership style that can be attractive to certain sellers of companies which can yield a lower valuation for Volati when purchasing a company.

The other case company, Ratos, is more short-term focused and keeps their portfolio companies autonomous which limits their opportunities to achieve synergies. Ratos wants to find companies that are good standalone investments. Volati values strategic fit more than Ratos since they aim to create synergies and to consolidate their portfolio companies.
From the analysis of both companies it is evident that being a public company can be attractive to investors because of increased transparency and more liquidity than private alternatives, this is beneficial when attracting capital.

Both companies were found to have the opinion that current valuations of portfolio companies are high. Any strategies that can help lower the valuations of the companies they acquire will increase the value of their portfolio. Since both companies are generalists they can be flexible when sourcing and acquiring companies to achieve better deals. Volati promotes bilateral negotiations and have a long-term ownership style which can be attractive to certain sellers of portfolio companies. This can yield a lower valuation for Volati when purchasing a company.

Portfolio diversification is not a high priority for either of the studied companies. Ratos wishes to find good standalone investments and to avoid being overexposed rather than to strive for an even distribution. Volati on the other hand value strategic fit a lot more since they strive for synergies and to consolidate their portfolio companies.

Both studied companies have small corporate offices which lowers their fixed costs. Their finance and investment/portfolio management departments can be considered their core and every other department exists to support their work. Both companies utilize consultants to increase capacity when needed and to gain access to outside expertise. Volati also utilizes consultants as part of their due diligence because it’s a perquisite to get a M&A insurance.

Both companies were found to promote knowledge sharing among their portfolio companies and to provide various support functions and to actively manage their portfolio companies at the top management level. Since both of them only supports their portfolio companies at the top level they don’t need a lot of manpower to manage their companies.

Ratos does not have the same opportunities to create synergies between their portfolio companies as Volati. This is due to their need to sell them independently from each other.

Employees were found to be essential. Having skilled employees gives them a temporary competitive advantage which can be sustained over time if managed properly.

Both companies’ structural capital was found to have the potential for long-term competitive advantage. The knowledge and experienced gained throughout the years have allowed them to create efficient processes and improved their operating model.

Volatis reputation and ownership style was found to be a competitive advantage and possibly long term competitive advantage. In essence it allows them to source deals in a different way and possibly buy companies at lower valuations.

References


