Risk Capital - Private Equity
Fundraising a Swedish Buyout Fund

Master Thesis in Business Administration
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Abstract

The private equity industry has had a fluctuating history. In the years between 2003 and 2007 the private equity industry expanded tremendously, yet in 2008 a financial turmoil caused significant deviation in the activity of the industry. During the credit crunch the liquidity in the market decreased affecting the sources of capital available. When several firms compete about the capital available, fundraising becomes increasingly difficult and competition intensifies. Sweden is one of the largest private equity markets in Europe and has among the Nordic countries been able to raise the largest amount of funds. The purpose of this study is to examine the fundraising process implemented by private equity firms, nevertheless the relationship that emerges between the fund manager and the investor. The authors’ objective is to provide an adequate interpretation of the private equity industry in Sweden.

The authors have implemented a qualitative method, as the objective has been to obtain a profound picture of how private equity firms manage their fundraising. The abductive approach has been used in order to collect empirical data and semi-structured interviews have been carried out with representatives from four private equity firms. In addition, a smaller survey has been performed with two institutional investors to add to the objectivity. Subsequently, the empirical data has been analysed in regards to theory and compared in relation to the sources to end up in a conclusion.

The authors have through the study concluded that private equity firms in Sweden with a focus in buyouts not have a common fundraising model. Private equity funds are selective in their choice of investors and prefer professional, loyal investors with a long-term perspective and strong capital base. It has from the analysis emerged that good reputation, history, team and experience is valuable in fundraising. Firms that are successful in their operations and management appeal to investors. The investors are typically institutionalised and invest in different asset classes, hence the diversification is mainly in the hands of the investor.
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Linda Riahi  Amelie Wilson
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Introduction

The section begins with a description of the topic. A background will constitute the foundation of the problem discussion and lead on to the purpose. Lastly, the purpose will be followed by the delimitations that have been made in order to narrow down the research area.

1.1 Background

According to the Swedish Private Equity and Venture Capital Association (SVCA) risk capital refers to the capital added to a company not related to a loan. Private equity transmits to investments made outside the stock exchange, while public equity transmits to investments made on the stock exchange. Risk capital has on later terms become a generic term for private equity and is today synonymous to investments made with active ownership commitments in unlisted companies. (Svca, 2011)

The private equity industry as it exists today has its origins in the 1940s United States. It was common for wealthy families, industrial corporations and financial institutions to commit private equity investments without intermediaries into issuing firms. In the end of the 1970s this evolved into a professional private equity industry where managers undertook investments on behalf of institutional investors. Certain knowledge was required to make successful investments in the industry and limited partnership agreements were designed in order to create a legal structure in the commitments between the manager and the investor. During the time regulations were modified to allow pension funds to invest in private equity, and the establishment of limited partnership created a greater institutional participation. (Fenn, Liang, & Prowse, 2001).

The private equity industry has since its formation had a fluctuation history. During the 1970s the activity took off yet was inhibited in the latter half of the 1980s as the business cycle turned to favour real estate investments (Svca, 2011). Sweden was one of the first countries in Europe to develop a private equity market (Financial Times, 2006). It became known in 1986 when the first Nordic private equity firm, Procuritas, was founded. Still, it was not until late 1990s that the Nordic private equity funds came to see strong growth and generated a higher return than the United States and the rest of Europe. The industry has received an important role in the Swedish economy and is a driving force for economic activity. Since the foundation of SVCA in 1985 the Swedish private equity firms’ capitalisation has increased from 1,5 billion SEK to 482 billion SEK in 2010. (Svca, 2011)

In the 1980s simply three listed private equity firms existed in the world. The private equity firms have since then increased in number and today correspond to 150 listed private equity firms (Lpx-group, 2011). The most prominent Swedish listed private equity firms are 3i, Bure, CapMan, East Capital Explorer, LinkMed, MedCap, NaxsTraction, Novestra, and Ratos. Among the non-listed private equity firms NordicCapital, Procuritas, Altor, and Segulah are the more recognised. (Svca, 2011)
In the years between 2003 and 2007 the private equity industry expanded tremendously, by Rizzi (2009) referred as the golden age. The benchmark of listed private equity firms in the world indicates a significant decline in activity in the aftermath of the financial turmoil that deranged the global economy in 2007. As the economy recovers from the financial crisis the private equity industry has regained some of its activity and as illustrated in figure 1 it is possible to discern a positive trend in the industry. (Lpx-group, 2011)

Figure 1 Performance: LPX Buyout TR (Source: LPX-group, 28.02.2011)

Along with the United Kingdom, Sweden is in the lead of the European private equity industry. (Svca, 2011) In 2008 the turnover of the Swedish private equity industry corresponded to 250 billion SEK, rephrased eight per cent of the Swedish annual gross domestic product (GDP). Swedish private equity firms invested an amount equal to 0.43 per cent of the Swedish annual GDP in 2009. (Evca, 2010) SVCA (2011) has in earlier research revealed a correlation between buyout investment levels and GDP growth. Sweden has currently forecasted a 2.5 per cent growth in GDP for 2011, which is an optimistic signal for the future of the Swedish private equity industry if the trend persists. (Svca, 2011)

Swedish companies have long been attractive objects for buyout investments as the companies are valued as liquid, well managed and undervalued. Nevertheless, several corporations are interested in concentrating at their core competences and loading of their non-core objects in their operations. Global private equity firm have been increasing their presence in the Swedish market. The market is stiff, as local companies have dominated the private equity industry in Sweden the past decade. The Swedish firms are unlike several foreign firms long-term investors and possess local knowledge. Auctions have become increasingly common which have given foreign funds better access into the Swedish market, yet the competition opts for rising prices that in the future can become problematic for both local and foreign investors. (Financial Times, 2006)

The private equity industry is known for low return volatility, which indicates good risk and return attributes. The past reveals a history of high returns in the industry, with exception for the financial crisis in 2007 to 2009. In a five-year period private equity buyouts have outperformed public equity. Another common attribute is its low return correlation with
other asset classes that implies attractive portfolio diversification benefits. (Bain & Company, 2011) Hence, it is viewed as an attractive asset class. (Emery, 2003) There is often secretiveness concerning the investors in private equity funds and the sources of capital have changed over the years. More than 80 per cent of the capital acquired the last years derives from foreign investors, indicating that the Swedish private equity funds are an attractive market for foreign investors. During the credit crunch the liquidity in the market decreased which reflected in the sources of funds available. In the years between 2005 and 2008 the European private equity industry experienced an overflow of funds raised compared to the amount invested. Contrary the years 2009 and 2010 was characterised by a lack of capital in relation to investments. In 2009 the total capital raised hit a record low level, which had not happened since 2002. On the other hand, it is of importance to take into consideration that fund raising is cyclical and several major actors raised new funds in 2008. (Svca, 2011)

1.2 Problem Discussion

The growth and returns made by private equity firms before the crisis in 2007 have been remarked as extraordinary. The favourable financial situation was mainly caused by favourable lending opportunities. Industries was in general becoming increasingly profitable and likewise the prices of assets. The increased allocation to the asset class by institutional investors has also benefited the firms. The boom abruptly ended in the crisis causing and the former drivers of the industry in the opposite direction, creating an uncertain future for the firms, their portfolio companies and the economy. (Boston Consulting Group, 2008)

In the aftermath of the financial crisis of 2008 the original business model became questioned. Leverage have always been an important feature in buyouts, thus the industry was heavily affected when the banks tightened the requirements for loans. Javed (2011) reveals alarming statistics of the recent financial turmoil’s effect on the private equity industry.

“The number of firms going out of business has been climbing since the financial crisis hit in 2007. In contrast, only 13 firms went bust during the dotcom crash of 2000. The total number of private equity managers now stands at 4,146… … Preqin estimates that about 150 firms will go out of business this year, based on those who last raised funds in 2001.” (Javed, 2011)

Over the past decade the industry has doubled in size and it is growing by several hundreds every year, currently adding up to more than 4,100 firms. This has contributed with more dry powder in many firms creating an aging to put capital into work. Nevertheless, it has contributed with a stiffer competition that is driving bids higher. General and limited partners interviewed by Bain and Company (2011) express concerns whether the high prices required to pay for buyouts yield corresponding returns. In the mean time Bain and
Company (2011) find that the fundraising activity has been weak in 2010 compared to previous years, indicating a lower level of new commitments from investors. (Bain & Company, 2011)

During the golden age the abnormal returns generated by private equity firms absorbed an increasing amount of interest from institutional investors. Hence, the proportions allocated to the asset class increased remarkably from both new and existing investors. When the boom ended the depreciation in other asset classes increased and caused denominator effects, meaning that the investors’ write-downs in the valuation of their holdings lagged those of their portfolio as a whole pressing the target allocations to private equity to the limit. Also the confidence and trust in the private equity industry was affected by the crisis and as returns declined from the asset class limited partners questioned its future ability to meet absolute and relative return expectations. Furthermore, a study preformed by Bain and Company (2011) has found limited partners concerned about the lack of transparency in the ability to view track records of general partners. (Bain & Company, 2011)

According to Bain and Company (2011) the private equity industry has emerged from the recent financial turmoil much like from previous cyclical downturns in the industry. However, concerns are expressed towards the future as the industry face powerful crosscurrents that will introduce changes in the funds in the future to come. New EU regulations concerning the private equity industry will be implemented\(^1\) in 2013 and the terms of fundraising will change by its implementation. The EU directive is only one of many regulations to be implemented in the industry in the future as both Solvency II\(^2\), Basel III\(^3\) and a review of the regulations concerning pension funds’ investment strategies is in head of the industry in the long term (Svca, 2011). In order for the private equity market to be successful fundraising is a vital cornerstone and it is questionable to ask how Sweden’s private equity funds deal with their fundraising? Has the fundraising become increasingly difficult? Have investors become more conservative in their view of private equity?

These questions pose for interesting research of private equity firms in Sweden with a focus in buyouts.

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1. In spring 2009 the EU Parliament proposed a directive on the regulation of alternative investment fund (AIF), with the purpose of protect professional investors, eliminate potential systematic risk and increase the transparency (Svca, 2011).

2. Solvency II has the purpose of increasing protection for policyholders, by strengthening the requirement of risk management and capital adequacy for insurers in EU. It will be adopted by all 27 states of the EU by 2013 (The Financial Services Authority, 2011).

3. Basel III will involve increased regulatory global standards on bank capital adequacy and liquidity. Its purpose is to frequently enhance the regulatory framework for the bank industry (Bank for International Settlements, 2011).
1.3  Question of issue

The main question.

• How do private equity firms certify capital to buyout transactions?

The main question can be divided into the following three sub questions.

• What makes private equity successful in Sweden?
• What are the investors’ incitements in investing capital in private equity?
• What can private equity contribute with in a buyout?

1.4  Purpose

The purpose of this study is to examine the fundraising process implemented by private equity firms, nevertheless the relationship that emerges between the fund manager and the investor. The authors’ objective is to provide an adequate interpretation of the private equity industry in Sweden.

1.5  Delimitations

Private Equity is a complex and comprehensive area to study, thus the authors have delimited the paper to create an interesting and adequate report.

Since the authors have a limited period of time, nevertheless a constrained capacity to conduct and compile material, the oral interviews will be constricted to four interviews. In some cases the authors will use information of the European and Nordic market in order to create an objective view yet this paper is delimited to the Swedish private equity industry, hence all the interviewees is operating in Sweden.

The authors will not take fund sponsors into consideration. The focus will be on the market segment that concerns buyouts, thus, venture capital aspects will not be incorporated.

1.6  Disposition

The authors will in this section describe the remaining disposition of the report.

In the second section of the thesis the authors describe the chosen scientific approaches and research methods that have been implemented in the study. It considers the authors approach in gathering of data, implemented methods and the motives behind the chosen methods for this study.
In the third section the authors will frame the theoretical line of the paper and tie together the classic finance theories with earlier scientific research. It will commence with the fundamentals of buyouts and private equity and lead upon concentrated theories concerning the study.

The authors will in the fourth section read upon the empirical data collected. It will initially specify the data collected from four semi structured interviews, and secondly the information gained from the survey.

In the fifth section the authors discuss and analyse the findings in relation to theory. The section intends to analyse and compare the similarities and differences among the different sections in order to answer the research question in the following section.

Lastly, the authors will in the sixth section read upon their conclusion and made reflections upon the findings. Nevertheless the authors have made remarks of how further studies could contribute to the research area.
2 Method

In this section of the thesis the authors will describe the chosen scientific approaches and research methods that have been implemented in the study. It considers the authors approach in gathering of data, implemented methods and the motives behind the chosen methods for this study.

2.1 Research Approach

The general approaches used in academic researches are the inductive approach and the deductive approach, nevertheless the abductive approach. The main distinction between the different approaches is seen in the initial phase of the research. (Gummesson, 2000)

When carrying out an inductive approach the researcher attempts to understand the reason behind a specific phenomenon’s occurrence. Beginning with a specific observation and proceeding with broader generalisations and theories to result in a conclusion. (Sekaran, 2003) Meanwhile the deductive approach seeks a description of the phenomenon. The researcher makes use of an existing theory to develop a hypothesis and create a research strategy and question. The hypothesis is accordingly tested or confirmed. (Lewis, Saunders, & Thornhill, 2000).

A benefit linked to the inductive approach is the low prerequisite of a clear defined theoretical framework, since you instead aim to identify the relationship between the collected data. This approach can thus be of use when a research subject is recently discussed and there is little literature available. Conversely, there exist several gains of having a research originating from theories which is the case in the deductive approach. It can link the research subject with existing knowledge and make possible for an analytical framework. On the other hand, there is a possibility of introducing a premature closure of the subject which disfavour the study. (Lewis et al., 2000)

Based on the belief that this paper emphasis on both logic reasonings and experience, the method implemented is the abductive approach. The approach is a combination between the inductive approach and the deductive approach. (Gummesson, 2000). Nevertheless, the approach is focused on discovering a phenomenon instead of justifying it. Rather then testing an existing theory, it considers how a theory was developed, (Miller & Fredericks, 2003) The approach is suitable when the purpose is to discover new theories (Dubois & Gadde, 2002).

Private equity is not a new phenomenon, thus the purpose of this paper have required the use of general theories and existing literature. Interviews were further necessary to conduct, which generated in-depth knowledge that proved to be an important part in the analysis. Nevertheless, the abductive approach has been practised in the paper by the means of comparing theories with the different perspectives of fundraising in private equity.
2.1.1 Research Method

There are two methods that can be used in research studies; the quantitative and qualitative method. The most significant difference is seen in the initial face of the study when empirical material is collected. The quantitative method derives its meanings from numbers, implicating it collects result in numerical and standardised data. Meanwhile, the qualitative research method has an aim of creating a deeper understanding of the issue in hand. Collection of results entails classification and the analysis is carried out with the help of conceptualisation. (Lewis et al., 2000)

Reliability and validity are in the quantitative method of vital importance to enable for reproductions of the conclusions. In contrast the qualitative research method contribute with a better in-depth understanding of the examined subject and focus on how the respondent perceives the subject. (Bryman, 2002) Based on this assessment the authors of this report have implemented a qualitative research method.

The researchers’ purpose is not to discover how frequent a specific phenomenon occurs or to generalise a specific theory; rather it is to understand why specific theory is carried out. The qualitative research method has allowed the authors to be more flexible in the collection of empirical data and the data obtained have been detailed. (Bryman, 2002) The private equity industry is reputable for being secretiveness and the authors believed that a quantitative method would be of less quality and harm the intentions of the paper. In-depth interviews can facilitate in the creation of a better and in-depth knowledge of the purpose than would statistical measures. The qualitative research method thus enhanced the authors to understand a larger context of the private equity industry and required that the study be deducted through a careful selection of a confine amount of data.

2.2 Sources of Data

Two different sources can be used in the collection of data for a research; primary data and secondary data. Primary data refers to data collected directly from a source, given in example interviews or observations. (Lewis et al., 2000) Hence, primary data are in general produced during the investigation phase (Belk, 2006). Secondary data denotes empirical data that has been collected for another purpose and is collected from the Internet, former performed studies and literature (Lewis et al., 2000). The authors have chosen to combine both primary and secondary data in order to get a deeper understanding on the subject.

2.2.1 Primary Data

The characteristics of a paper and the intention of a study determine the type of primary sources used (Belk, 2006). The primary data in this paper constitutes of interviews carried out with the purpose of receiving different perspectives on the subject. Data has also been collected from a survey conducted to strengthen the objectivity of the paper. Figure 2
illustrates the primary data sources used and how the communication between the researchers and the respondents has been carried out.

![Primary Data Diagram](image)

Figure 2 Sources of primary data (Source: modification of Ghauri, Gronhaug, and Kristianslund, 1995)

The interviewees were selected with the objective of creating a diverse base that could contribute with different perspectives on the subject (Belk, 2006). The chosen interviews were performed with one fund-of-fund firm, one listed private equity firm and two non-listed private equity firms. Interviews facilitated for the researchers to cross-examine the participants that enabled to reveal sources of bias (Belk, 2006). The private equity market is known to be secretive concerning its operations and interviews helped provide a deeper view of the issue as well as trustworthiness to the findings.

Attempts were made to obtain additional perspectives from institutions known to the subject, although the authors were not able to receive information from these sources. The Centre for Management Buyouts Research in the University of Nottingham, the European Private Equity and Venture Capital Association (EVCA) and SVCA were contacted.

### 2.2.2 Secondary Data

Secondary data has been collected through books, scientific articles, news articles and websites. The quality of a past research is heavily dependent on the data sources that have been selected in the research and the historical time period, which will have an impact on the mix of data sources. (Belk, 2006) When collecting secondary data there exists difficulties with being selective. The authors therefore formulated a well-structured and focused purpose in order to identify information needed (Crowther & Lancaster, 2008). In the search for literature, the main subjects have been buyout, private equity, limited partnership and fundraising.

It is of importance for the researcher to determine what sources to be used when collecting secondary data (Crowther & Lancaster, 2008). The authors of this paper have primarily used the following databases, Business Source Premiere, JSTOR and Science Direct. Websites that have been of focal point in this paper are EVCA and SVCA, organisations developed to individuals and companies actively involved in the private equity industry.
2.3 Interview Technique

In-depth interviews have been conducted to collect primary data for the purpose of this study. The authors’ view of in depth interviews is consistent with that of Seidman (2006) described below.

“The purpose of in-depth interviewing is not to get answers to questions, nor to test hypotheses, and not to “evaluate” as the term is normally used. At the root of in-depth interviewing is an interest in understanding the lived experience of other people and the meaning they make of that experience.” (Seidman, 2006, P. 9)

In other words, the authors’ objective is to gain an understanding of the individuals’ experience in the industry that concerns the subject of the paper. When performing an interview there are different techniques that can be adapted to enhance the obtaining of data. The authors generalise among three techniques; the structured, unstructured and semi-structured interview form. In a structured interview the interviewer has questions that are predetermined and do not exceed that frame of questions. This facilitates the comparison of the different interviewees answers. Contrary, unstructured interviews do not use a frame of questions and gives the person interviewed the liberty to discuss the subject in a way that the person prefers. (Ghauri et al., 1995) In between the two methods there exists a middle hand called semi-structured interviews. The semi-structured form has an open structure with specific areas determined connected to the subject. Questions are prepared beforehand, however the interview should be a two-way communication that gives the interviewer the opportunity to ask follow up questions. (Bryman, 2002) Also, semi-structured interviews open up for discussion between the interviewer and the interviewee. By using this technique the authors gained deeper information, yet it required deep knowledge on the subject. (Ghauri et al., 1995) During the interviews it has been possible to ask follow-up questions where the authors have acted upon the answers given to them and to the different interviewees experiences. It has not been of importance to have the possibility to fully compare the interviews to each other; instead it has been of greater value to create a deep understanding.

It is possible to discern between different types of techniques in the interaction between the researchers and the participant. The authors choose to carry out three interviews on a one-to-one basis, where the researchers met with the participants in a face-to-face meeting. Additionally one interview was conducted through telephone due to constraints by the firm, yet this was on a one-to-one basis. (Lewis et al., 2000) To attribute for a qualitative in-depth discussion the authors found an interview of one hour in time relevant. The interviewees had time to prepare for the interview as the authors sent the question frame by mail one week in advance. This was made in order to increase the quality of the answers as well as by requests by the firms. The frame of questions have been developed based on the purpose and question of issue, nevertheless adapted to the fact that one of the interviewees is English speaking while the remaining three have Swedish as mother tongue.
The Swedish and English interview frames can be found in appendix 1 and appendix 2 respectively.

2.4 Data Collection

The strategy used by the authors to select the chosen interviewees has been a non-probability sampling. The selection of firms was based on firms’ availability to commit time and the ambition of having a diverse selection of firms with different unique characteristics. Hence, the findings made through the research are not able to confidently generalise to the population (Sekaran & Bougie, 2009). The chosen firms are in order of the interviews:

- Naccess Partners AB
- CapMan
- Segulah
- Altor Equity Partners

In this section the authors will read upon the motives behind each interview. Firstly, the authors believed that it was significant to receive a fund-of-fund firms view as they act as an investor towards buyout firms yet at the same time have own commitments to their shareholders and investors. Fund-of-fund firms are a relatively new phenomenon of its kind in the Swedish market. It is one of the few alternatives for private investors with smaller capital bases to invest in buyout. The authors carried out this interview first, which enhanced the view of the investors’ perspective and added to the questions asked in the following interviews. The company interviewed within this category is named Naccess Partners AB and is an advisory firm to the NAXS Nordic Access Buyout Fund AB. The authors’ reference is the initiator Thomas Åkerman. Together with Amaury de Poret he established Naccess Partners in 2007 when launching NAXS and created the structure that is current today. With a background in investment banking and private equity and over fifteen years of experience, Åkerman has been head of corporate finance for Sweden at Alfred Berg ABN Amro, head of merger and acquisition for Sweden at Enskilda Securities and president of Novestra.

Secondly, the authors included a firm that is active within the Nordic countries and operates within several different areas of private equity, buyouts being one of them. The authors valued that one of the private equity firms be noted on the stock exchange, and the company interviewed within this category was CapMan. By including a company with diverse operations that is established in several Nordic countries the authors believed that the company would add to the width of the study. The authors’ reference is the Sales and Marketing Manager Mari Simula who has five years experience of working within the CapMan group.

Thirdly, it was of value for the study to include a firm with a national focus as the authors aimed to provide an adequate picture of the Swedish industry. Hence, by including a firm
that primarily foster Swedish buyout investments, value was added to the purpose. Furthermore, the main supervisor of this paper recommended the authors to contact a firm with earlier experience of having contact with students. The company interviewed within this category is named Segulah and historically the majority investments made by this firm have been in Sweden. The authors’ reference is Marcus Jansson, board member of Segulah Advisor AB, Info Care, Almondy and Gunnebo Industrier.

Finally, it was important for the authors to include a firm that is considered to be one of the most eminent private equity firms in Sweden. This since larger firms are more exposed in media and has experience of being imaged differently. Nevertheless, the authors wanted to know if the fundraising is differently viewed among larger firms compared to smaller firms. The company interviewed within this category is named Altor Equity Partners founded in 2003, and is an advisory firm to Altor Funds. The authors’ reference in the interview is the CFO of Altor Equity Partners AB, Jesper Eliasson who joined Altor in May 2003.

In the latter stage of the study when the in-depth interviews had been carried out, the authors lacked an objective view of the investors’ incitements. The private equity industry is typically secretive about the investors in their funds. However, the interviewees mentioned some of the more known Swedish investors and with that in mind the authors decided to carry out a smaller survey where the respondents were known investors in the private equity industry. The questions in the questionnaire were based upon the information received from the interviews, and are found in appendix 3. The survey was sent out to several investors by email and two responses were received from Ap-fund 7 and Skandia Liv, which were of great value to the report.

2.5 Trustworthiness

It is of importance for the authors to ensure that the research is valid and reliable. The reliability and validity of a research question is dependent on the level of relevant information that the subject contains. Accordingly, the methods carried out in this report should obtain true responses and relevant information in order to be valid. (Taylor, 2005)

In order to contribute to the reliability in this report the authors have chosen to use different sources of primary data. The reliability of this report could be higher if the authors would have performed additional interviews with investors instead of a questionnaire.

The trustworthiness of this report is strengthened by the fact that the information gained from the interviews is confirmed when studying existing literature on the subject. (Svenning, 2003). Information received from interviews is not as easy to validate as from traditional sources of data. In order to improve the validity of the data collected in this report the authors have used multiple sources to compare and to validate the information. (Taylor, 2005) The questions were sent in advance to the interviewees, which added the quality of the answers and enhanced the reliability. The interviews were recorded and by
listening to the taped material again it has been possible to discern if the interviewers were leading the interviewees towards specific answers. It is important to recognise the fact that the interviews may be biased by the act of the interviewer. Hence, the interviewers must be self-aware and analyse their own biases that can have influenced the data received in the interview. (Rubin H. & Rubin I., 2005)

The collected data should be reliable to the extent that other researchers can come to the same results, thus, it has been important for the researchers to develop standardised questions (Taylor, 2005). Further, it is vital that the data is trustworthy in a qualitative research; therefore, the authors of this paper have outlined the researched methods that have been used in order to enable for the reader to trace the steps and verify the process (Sandelowski, 1993).

2.6 The Analysis Process

Initially data was gathered from secondary sources to contribute with theory to the research subject. The method then guided the authors in the gathering of primary data from two different sources, interviews and a survey. As seen in figure 3 the sections in the outer circles were used to help the authors in creating an interesting analysis. Empirical material has been discussed in relation to theory, nevertheless similarities and differences among the sections have been used to come to a conclusion.
3 Theoretical Framework

In this section the authors will frame the theoretical line of the paper and tie together the classic finance theories with earlier scientific researches. It will commence with the fundamentals of buyouts and private equity and lead upon concentrated theories concerning the study.

According to SVCA (2011) “private equity comprises the equity financing of unlisted companies with an active and time limited ownership”. Private equity firms aim at developing and contributing to long-term profitable and successful companies by carrying an active ownership commitment and supply capital. (Svca, 2011) There exist several benefits of private equity, it can be used to develop new products and technologies, expand working capital, make acquisitions and support a company’s balance sheet. Also ownership and management issues can be resolved by private equity. (Evca, 2007) In general private equity firms are actively involved in the governing of the management through taking board seats and influencing the behavior of the management by in detail report requirements and restrictions. (Citron, Rippington, & Wright, 2003) The generic term private equity captures several forms of financing, the most common being: business angels, venture capital and buyouts (Svca, 2011). As illustrated in Figure 4 venture capital and business angels are investments in early stage companies made with minority investments, whilst buyouts encompass more mature companies made with majority investments. Enterprises provided with equity capital from private equity are in general not listed on the stock exchange (Wright & Bruining, 2008).

![Cashflow Diagram](Image)

Figure 4 Cashflow (Source: Svca, 2011)
Private equity firms that are privately owned can roughly be divided into independent firms (which in turn can be divided into listed and private owned companies) and investors that are constructed as funds. Similarly corporate group owned private equity firms can be separated into industrial and institutional investors. (Nyman, 2002)

The internal organisation of a private equity firm is commonly small and comprises a small amount of employees. The employees, named investment managers, are assigned to identify potential investment objects and to follow up the development of present portfolio companies. It is common that the organisation outsource services given in example technical analysts and legal consulting services. In turn, the private equity firm can join the consultants and form an advisory board, which provide advice in investments and often work as a network to the different business sectors. (Nyman, 2002)

### 3.1 Buyout Investments

The purpose of a buyout is to concentrate ownership in the management and the private equity firms’ hands. (Nyman, 2002) A typical investment process is illustrated in figure 5 and in this chapter the authors will read upon it in more detail.

![Investment Process](Source: Reproduction of MTDC, 2011)

There are several forms of buyout that private equity firms can take on. The authors will define the most common.

#### 3.1.1 Leveraged Buyout (LBO):

LBOs are highly leveraged with a significant equity stake acquired from the private equity firms. (Jensen, 1993). A leveraged buyout commonly involves an existing or mature firm, typically a publicly listed corporation or a large division of a group. (Kaplan & Strömberg, 2008)

#### 3.1.2 Investor-Led Buyout (IBO):

IBOs often involve a private equity transaction of an entire company, alternatively a smaller part of a company. Compared to LBOs, IBOs are lower leveraged. Instead of creating
value through efficiency improvement, an IBO create value through developing the company. (Bruining & Wright, 2008)

3.1.3 Management Buyout (MBO)
A MBO shares several similarities with an LBO. Yet, the most significant difference is that the MBO requires support of a private equity firm and a significant proportion of equity from the existing management. (Bruining & Wright, 2008).

3.1.4 Management Buy-In (MBI)
A MBI is characterised by a management team where the leading members mainly consist of outsiders. Management from outside possess less information then would an insider which reflects upon the risk that is more present in MBIs compared to MBOs. (Bruining & Wright, 2008).

3.1.5 Leveraged Build-Up (LBUs)
When a private equity firm take on a buyout with the intention of using it as a platform to make additional acquisitions it is called an LBU. This is made in order to create a superior and stronger corporate group. (Bruining & Wright, 2008).

3.2 Investment Strategy
One of the most known investment theories in finance is the portfolio theory by Markowitz. The portfolio theory refers to investors, rather than manufacturing firms or consumers, that act under uncertainty. Modern portfolio theory is a set of rules that a rational investor can use when diversifying in order to optimise the portfolio and to accurately assess the future performance of portfolios of risky investments. Diversification is according to Markowitz (1953) a common and reasonable investment strategy. (Markowitz, 1953) The private equity diversification measures can be divided into different categories depending on the investment focus. The most common categories are business industry, size of investment, investment phase and geographical focus. (Nyman, 2002)

3.2.1 Business Industry
The risks related to an investment are dependent on the industry. Certain industries are connected to more risks and can be sensitive to business cycles. All industries are exposed to risks and private equity firms often diversify by investing in different industries to reduce the risk. (Nyman, 2002)

Furthermore, Jaeger (2004) argues that private equity firms can be exposed to deal risk. The deal risk is associated with the factors that impact the performance of the portfolio companies in a fund. A portfolio contained of companies with high return deals and few
losses lead to quicker exits, nevertheless an improvement of the IRR of the fund. (Jaeger, 2004)

3.2.2 Size of Investment
The amount of capital invested by private equity firms differs. In general, firms have an upper and lower limit for the investments, with the purpose to diversify the risks. The limitations are often regulated by the size of the total capital and the characteristics of a private equity investment are often dependent on the size of the investment. Smaller investments are most often performed in the earlier phases of development. Generally larger investments are performed in buyouts of companies. (Nyman, 2002)

3.2.3 Investment Phase
The different phases in a company’s business cycle have different needs, thus private equity firms often specialise in specific development phases the most common being mature phases (Nyman, 2002). According to Jaeger (2004) there exist four cycles that can impact the returns of a buyout: economic cycles, specific industry cycles, stock market cycle, and private equity cycle. While the three first mentioned affect company growth, trade buyer activity and exists, the fourth cycle differs as it balance between the number of potential candidates, demand, and supply of finance. As the demand and supply theory suggest these factors have an impact on the valuations of transactions at entry. (Jaeger, 2004)

3.2.4 Geographical Focus
Generally, private equity firms limit their investments to specific areas to diversify the risk. A generic term for this type of risk is called country risk and involve: legal aspects, taxation, banking and corporate finance, accountancy, availability of deals, management, stock markets and the local acquires for buyout exits. (Jaeger, 2004)

According to Jaeger (2004) several of the mentioned aspects are in general disregarded when funds invest in a new area, which results in cases where the first funds of a firm perform worse. However, an experienced buyout manager is able to take advantage of the market when investing in a new area and is able to consider the aspects associated with the risks. In situations where there is a lack of international contacts and resources to enter the new area, the manager needs to avoid investing in it. (Jaeger, 2004)

3.3 The Buyout Investment Process
A private equity investment has its initial focus on the business idea, an entrepreneur or a management team that is in need of financing. There exist certain steps that have to be fulfilled when financing a development of a company. First, it require that the business idea
be concretised through a business plan. It is also of importance to study the business management and the competence within the company. The business idea is presented to the investors, which if successful is followed by a due diligence. An agreement can then be discussed that can result in an investment agreement. Generally, the investment process takes up to three to six months. (Nyman, 2002)

The business idea is of importance, although it is most often not the business idea alone that determines whether the investors will commit. Therefore, the private equity firms have a policy to invest in individuals. It is in general seen as a lower risk to invest in an individual with a great potential with an average business concept, than an individual with an average potential with a great business concept. (Nyman, 2002) A private equity firm’s interest in a buyout candidate depends upon several criteria. Gagliano and Olsen (2003) has specified eleven criteria that are of great value for a financial buyer’s interest:

- A cash flow that is characterised by stability hence is predictable.
- A Balance Sheet that is considered clean with little debt.
- A Market Position that is strong and defensible.
- Limited working capital requirements.
- Minimal future capital requirements.
- Heavy asset base for loan collateral.
- Divestible assets.
- A management team that is strong.
- Viable exist strategy.
- Synergy opportunities.
- Potential for expense reduction. (Gagliano & Olsen, 2003)

### 3.4 Due Diligence

The underlying function of due diligence is “…to assess the potential risks of a proposed transaction by inquiring into all relevant aspects of the past, present, and predictable future of the business to be purchased” (Reed, Lajoux, & Nesvold, 2007, p. 381). As Rockholtz (1990) implies due diligence can act as an early-warning system geared to pinpoint risks (Picot, 2002).

Due diligence can be used by investors to gain information about the business concept and study it more carefully. During this process the investors will get familiar the management team more close. They will also get a deeper knowledge and understanding for the business idea’s potential and the risks connected to it. In order to be confident of the business idea the investors will perform a due diligence that include several features given in example financial and legal aspects. (Nyman, 2002)

It is possible for the investors to perform due diligence internally, however in general the investors will hire external consultants. Most often written information based on specific
questions that later is completed with oral interviews is preferred. (Nyman, 2002) In order for a due diligence to be valuable and qualitative it is essential that the information needed is made available. However, it is common for information that concerns sensitive areas to not be made publicly available and therefore confidence building measure can be of value. (Picot, 2002)

In certain cases the investors can demand to perform a due diligence of the private equity firm which can be demanding for the firm’s employees. (Nyman, 2002)

### 3.5 Fundraising

To remain in business private equity firms need to frequently raise new capital (Prowse, 1998). Overall the funds are closed and only invited investors are able to invest in the fund, although in Sweden there exist listed private equity funds where the fund is open. However, in several cases the financing and marketing can also be done together with financial institutions e.g. a bank that guarantees to invest a certain amount of capital in the fund, the bank is then called a fund sponsor. Private equity funds are characterised by an owner structure of several independent investors. The investors can be institutional allocators e.g. pension funds, banks or insurance companies. (Nyman, 2002)

Dependent on the size of the fund, raising capital can be comprehensive and time consuming. A written presentation with information such as size, time of life and investment strategy of the fund will be developed before marketing the fund. When the investors have accepted to invest capital in the fund an agreement is established. (Nyman, 2002). Buyout fund agreements are usually structured as limited partnership where institutional investors are limited partners and managers of a private equity firm obliges as general partners. The general partner usually contribute with a small proportion of the capital, approximately one per cent, while the limited partners provide the most amount of capital. The capital invested in the funds by the limited partners are in turn managed by the general partners. The number of limited partners differs among the private equity firms and can be everything from one, to more than fifty partners. Also the number of general partners differ yet usually accounts for six to twelve senior managers. (Prowse, 1998)

It is the general partners’ responsibility to make value-increasing investments in the fund. Therefore the general partner needs to have the ability to act upon deals as they become aware. (Axelson, Strömberg, & Weisbach, 2007) Funds raised by private equity firms in general take on four standard requirements. First, a limited partner has certain commitments and responsibilities concerning distribution of equity. A prospecting limited partner is required to entrust a minimum amount of equity. (Gagliano & Olsen, 2003) The committed capital will not be added into the fund initially, rather contributed through time when capital is needed during the investment period (Nyman, 2002). Second, there is always a determined life span for the partnership which in general amounts for ten years with exceptions for provision to extend the partnership with one or two years increments (Prowse, 1998). The first half of the partnership is called the commitment period in which
the limited partners has an obligation to transfer capital to the fund when capital calls are made by the general partner (Gagliano & Olsen, 2003). This period can also be referred to as the investment phase since it is during this time that the capital is invested (Prowse, 1998). The life span has been visualised in figure 6.

![Figure 6 Buyout Fund’s Life Span](image)

In other words, the nature that is current in private equity – a long-term horizon – do not coincide with the nature of stock analysts and public investors who aim to make short-term investments (Prowse, 1998). Third, the second period of the partnership is retained for managing existing investments made during the previous period. The limited partners receive returns in the form of cash or securities when the investments are liquidated. (Prowse, 1998) Finally, it is today common for partnership agreements to involve a stipulate concerning the degree of diversification that is permitted. This usually accounts for a limit of 25 per cent of the fund’s equity in any single investment. (Gagliano & Olsen, 2003)

When an existing partnership ends it is common for private equity funds to raise new partnership funds every three to five years. Raising new capital to a fund can be made by either extending or creating new partnerships. Thus a manager may manage several funds simultaneously in different phases of its life, yet managed separately and separated when it comes to legal matters. (Prowse, 1998)

### 3.6 EU Directive on Alternative Investment Fund Managers

In April the 30th 2009 a proposal was given for a directive by the European Parliament and the Council on alternative investment fund managers and amending Directives 2004/39/EC and 2009/…/EC (AIFMD). It encompasses the investment funds that are not regulated by the UCITS Directive (IP/10/869) and among things include hedge funds, private equity funds and real estate funds. (AIFM Directive)

To ensure that all managers marketing AIF within EU subscribe to efficient supervision and control the proposed directive introduce a legal binding for authorisation and supervision of private equity firms with exception for some features. Referred to as area of applicability. (Svea, 2011)
Further, the directive has the purpose of enhancing the debriefing on a fund level. Thus, managers of AIF shall during the management provide investors and authority with an annual report that includes certain information e.g. liquidity risk. Referred to as Report requirements on fund level. (Svca, 2011)

The directive will introduce new legal aspects for managers and AIF based outside of EU. Three years after the implementation of the directive managers and AIF based outside of EU will have to apply for authorisation to market AIF within EU. During the three years they are solitarily allowed to market in accordance with the individual member states national legislation. After the three years the state that the AIF is based in must fulfill certain criteria to allow for authorisation. SVCA believe that this particular adjustment can cause severe consequences for private equity firms operating across boarders with both fundraising and investment operation. Many Swedish firms are based in Jersey and Guernsey to avoid double taxation and allow for a more suitting legal structure, thus this aspect concerns Sweden. Referred to as regulations for managers and AIF based outside EU. (Svca, 2011)

AIF managers’ base of capital should be at least 125 000 euro. When the value of the managed AIF fund-portfolios is higher than 250 million euro the AIF manager should be able to declare for an additional amount in the base of capital corresponding to 0,02 per cent. A manager’s base of capital needs to be equal to at least 25 per cent of the manager’s yearly fixed costs, regardless of the accumulated amounts that are required. Referred to as capital adequacy requirements. (Svca, 2011)

The manager should choose a valuation organ that is independent in relation to them for every AIF that is managed. The valuation organ should estimate the value of the assets the AIF acquires and the shares in AIF. Nevertheless, the valuation organ is required to make sure that the assets and shares is valued at least once a year and every time when the shares in the AIF is issued or is protected if this happens more frequent. Referred to as independent valuation. According to SVCA (2011) the independent valuation will result in large and meaningless costs for the private equity investors given that the valuation of private equity does not have a practical economic value since the private equity funds do not have a call provision or right to the extended performance fee. (Svca, 2011)

Marketing will in accordance with the directive include passive marketing, meaning that investors in Europe initiative take contact and require information by the AIF-managers. The regulation requires the manager to hand the arrangements to the AIF it aims to manage to the concerned authority to receive authorisation to market AIF. Thus, SVCA find that this will cause harm to the private equity industry as the managers normally market their fund first towards professional investors, thereafter negotiate for investment agreements and not until then can register the AIF in question. Referred to as marketing of funds. (Svca, 2011)

Several states filed for amendment of the proposal yet, in November 2010 the proposal was voted through and president Barroso said "The adoption of the directive means that hedge funds and private equity will no longer operate in a regulatory void outside the scope
of supervisors. The new regime brings transparency and security to the way these funds are managed and operate, which adds to the overall stability of our financial system” (MEMO/10/573, Europa.eu, 2010). It has the goal of protecting professional investors while reducing systematic risk as well as increasing transparency for investors and authority. It presupposes that all types of alternative investment forms must be objective to the same requirements, which has met criticism. SVCA is in general positive towards regulating private equity on a EU level yet expresses concerns towards the disregard of differences among alternative investment funds. It is there belief that the directive can create harm to both the private equity industry, and the investors in Europe if it is not adapted. (Svca, 2011)

3.7 Partnership Interests

When investing in a partnership the limited partner assign the labour-intensive responsibly of selecting, structuring, managing and liquidating private equity investments to the general partners. The limited partners need to actively be aware of how the general partners effectively safeguard their interests. There is a possibility that the general partners support their own interest at the expense of the limited partners through spending too little effort monitoring and advising the portfolio firms, charging excessive management fees, taking undue investments risks and reserving the most attractive investment opportunities for themselves. There are several problems related to the partnership interests, Prowse (1998) mentions a few.

3.7.1 Reputation and Performance Incentives

The resources used are dependent on the reputation and experience of the general partner. Reputable firms have smaller costs for raising new funds. (Prowse, 1998) According to Prowse (1998) experience can be regarded as an asset in private equity. The investment proposals received by general partners can amount for hundreds, yet by estimate merely one per cent is invested in. Thus, a firm’s success is dependent upon the general partners ability to efficiently select buyouts among these. Prowse (1998) explain, “efficient selection is properly regarded as more art than science and depends on the acumen of the general partners acquired through experience operating businesses as well as experience in the private equity field” (Prowse, 1998, p.29).

There exist three different types of measures that are used to identify the reputation of the lead firm. First, the age of the private equity partnership is measured. This since a private equity firm that has a longer track record is generally performing better compared to a younger firm. As younger private equity firms need to prove themselves to create a reputation they consequently have high incentives to invest in risky projects with high potential outcomes (Gompers, 1996). To protect the reputation it is an asset for the general partner to have experience and posses a good track record. Thus, the logarithm of age is frequently used to measure the reputation.
Secondly, it is possible to examine investments syndicated with other firms and discern the number of times the private equity firm has been the leading firm. This is a successful and important measure since being a leading firm can strengthen the reputation. Finally, reputation can be measured in the number of investments made by the firm. This measure is successful since it recognise the private equity firm’s ability to structure deals and to evaluate aspects of the firms’ business plan. To minimise costs managers tend to address to previous partnerships assumed it was a sound relationship. Stable and long term partnerships can contribute to the reputation, hence partnership performance and general partner activity become more transparent for the limited partners. (Lockett, Manigart, Meuleman, Wright, 2006)

When the life span of the fund is reached, the fund will be liquidated and the capital will be distributed between the owners and the management company according to the agreement (Nyman, 2002). The general partner receive a management fee and a portion of the partnership’s profit, more known as carried interest, as compensation for managing the fund (Prowse, 1998).

Depending on the average return the carried interest can exceed the management fees, thus the carried interest can be seen as a performance based compensation. (Sahlman, 1990). The carried interest usually accounts for 20 per cent of the partnership’s net return while the fee often is set at a fixed percentage during the partnership’s life which vary from one per cent to three per cent (Prowse, 1998). This arrangement can be viewed as the centre of the incentive structure in a partnership. Further, it act as an incentive to get general partners more invested and engaged in activities that can increase the value of carried interest which in turn benefits the limited partners. (Sahlman, 1990)

In most situations, the investors will be entitled to the invested capital with a hurdle rate which often is based on the internal rate of return (IRR) that the limited partners demands on their investments. The remaining return will be divided according to the agreement between the limited partner and the general partner. (Nyman, 2002)

External costs related to buyouts will in general be costs for the fund, e.g. financial or legal research. This fee can be reduced when the fund is fully invested. (Nyman, 2002) When comparing investment returns it is possible to recognise features not in control by the general partner, given in example the phase in the business cycle. Since the management fees are specified in the limited partnership agreement it is important to regard the division of management expenses. The expenses are transparent which facilitate for a comparison of expenses across partnerships. (Prowse, 1998)
3.7.2 Direct Control Mechanism

Direct control mechanism in a partnership agreement can be a mean of controlling moral hazard problems. In order to restrict the general partner from neglecting the limited partners’ interest, restrictions in form of covenants on partnership investments and activities of the general partner are implemented. (Prowse, 1998).

The general partner has compensation-based management incentive in place, which makes restrictions on buyout investments of great importance. This will enhance the incentive for the general partner to invest and engage in activities that will increase the value of the carried interest, which in turn will benefit the limited partner. (Sahlman, 1990) Although, according to Jensen and Meckling (1976) this incentive can expose the limited partner to excessive risk taking and Finn et al. (2001) further explain that “in particular, it may be in the interest of the general partners to maximise the partnership’s risk-and hence the expected value of their carried interest—rather than the partnership’s risk-adjusted expected rate of return” (Finn et al., 2001, p65).

Several different covenants can be incorporated to a partnership and a covenant restriction concerning the degree of diversification can help limit the exposure to risk (Prowse, 1998). Commonly, a restriction of the amount of capital that may be invested in a single firm can address this problem. In addition covenants can “preclude investments in… …other private equity funds, and private equity investments that deviate significantly from the partnership’s primary focus” (Prowse, 1998, p32). Usually, the amount of leverage is restricted by covenants. Also the cash received in the sale of portfolio assets can have a constriction that is must be allocated to investors directly at the time of the sale (Finn et al. 2001).

3.8 Corporate Governance Issues

During the time of the contract the two parties in general possesses different information regarding the firm and most often the general partner has the information advantage, thus the principal-agency theory arises. The principal-agency theory is an agreement between a principal and an agent, where the agent is employed to carry out the mission and the decision-making is transferred to the agent. Due to asymmetry of information difficulties can arise when the owner transfer the control to the employed agent. It is possible for the agent to be loyal towards the principal, however the asymmetry of information can be used for individual gain. This problem of information can be divided in two categories, adverse selection and moral hazard. (Ross, 1973)

Adverse selection refers to the asymmetry of information concerning the situation that exists before the contract between the principal and the agent has been formed. This can appear when an outsider invest capital in the firm and possess less information of the risks and the future of the firm. Since it is of interest for the firm to emphasise the positive aspects and to minimise the potential difficulties an important part of an investment is to
perform a credit assessment or firm valuation in order to forecast the future for the investment. Furthermore, according to the theory of finance, external financing is more costly compared to internal financing due to the higher risk associated with the asymmetric information. (Ross, 1973) A possibility to reduce the general partner’s cost of capital for future fundraising is liquid and long term limited partnerships, this since an inside investors have more information about the quality of the general partner compared to outside investors. (Lerner & Schoar, 2002)

The second category, moral hazard, refers to when an agreement is done and the situation around the principal has changed. As the principal transfer the work burden to the agent it can become problematic to discern whether the agent is acting on behalf of the principal. Thus, the asymmetry of information can contribute to moral hazard problems and concerns wanting monitoring opportunities during the time of the contract. (Ross, 1973)
4 Empirical findings

The authors will in this section read upon the empirical data collected. It will initially specify the data collected from four semi-structured interviews that have been carried out with CapMan, Segulab Altor Equity Partners, and Naccess Partners. Secondly, the information gained from the survey will be specified.

4.1 Interview with CapMan

CapMan is a private equity investor within the Nordic region. It was established in 1989 and has its B Shares listed on the Helsinki Stock Exchange. CapMan’s investment areas are divided among four key units, CapMan buyouts being one of them with its own management and fund. The buyout team consist of 23 people and is currently at their ninth fund. The authors’ reference is Mari Simula and the question frame used in the interview is found in appendix 2 - interview questions in English.

4.1.1 Buyout

CapMan implies that most buyouts are made through building long-term relationships built by contacting companies or adversely companies contacting CapMan. It is of preference to avoid auctions and in order to work proactive the search to identify new opportunities with entrepreneurs and management teams is never-ending.

CapMan argues that the intention is to act as a catalyst for change where the aim is to take the company to the next level. Thus, CapMan mean that when cooperating with a private equity firm the seller has good knowledge of what the aims are of selling the company to such a firm. CapMan denote the importance of being transparent.

4.1.2 Investment Criteria

When to evaluate a potential buyout candidate CapMan believes that due diligence is a crucial element and values attractive and interesting industries, exit opportunities, management and culture. In order for CapMan to have a real interest of a buyout investment, the company must fulfil certain criteria. CapMan should be able to add value through active ownership with the aim of being an industrial player that do not take on large portions of debt and rely on financial engineering. Segmentation is important since CapMan is restricted to invest in unlisted small and mid-sized companies within the Nordic region. CapMan operates as a generalist, meaning that their investments do not focus on a specific industry. Further, a controlling position in the buyout is vital for CapMan in order to govern the companies.
4.1.3 Limited Partnership

Private equity is in accordance with CapMan suited for banks, pension funds and institutions that seek long-term investments. These types of investors typically have a portfolio mainly consisting of interest and equities, where private equity and alternative assets represent two to ten per cent of their portfolio. They turn to buyout funds searching for higher returns. The main investor targets are institutional investors that are professional and already act on a global level.

A loyal investor base is of great value for CapMan in their funding. The relationship is key in having a long-term partnership, where regular meetings and providing information to the investor is crucial. CapMan sees availability and transparency as fundamental core stones in the relationship and has therefore advisory boards where the largest investors, if interested, meet more regularly. Listed private equity firms have open books to their investors, yet CapMan see a need for a more transparent private equity industry since there today exist few listed firms.

CapMan considers its limited partnership agreement as a well-formed agreement. The limited partner has a certain power to intervene if the majority is dissatisfied with the general partner and as a matter of course an investor before investing endorses the power wanted into the partnership. More regulations are being put into place as result from the need of transparency openers and the large use of leverage. CapMan believes that this will affect the industry in the future. All is related to trusting the relationship between the general partner and the limited partner, and creating an understanding.

4.1.4 Risks and Diversification

CapMan denote the need of knowledge, experience, thorough due diligence processes, advisors and consultants to decrease the potential risks associated with private equity investments. In addition legal due diligence are of importance and environmental due diligences can be completed if necessary. CapMan imply that diversification is crucial to several of their limited partners. The fund itself can diversify from risk through industry and business types. Also by investing in several countries there is an opportunity to adapt to country risk in the Nordic Region. When defining strategy CapMan analyse deal flow in order to increase diversification. They invest in both cyclical and non-cyclical businesses, buy and built case, and spin offs from large corporation.

4.1.5 Current Climate in the Market

The supply of capital for funds has been soaring as the market has grown rapidly and CapMan considers fundraising a critical element for the future of private equity. The Swedish private equity market is not yet mature and the returns are outperforming other private equity markets in Europe, resulting in a greater interest for the Nordic private
equity market from investors’ abroad. Still, as the Swedish private equity market matures returns will decrease and fundraising will become more limited and critical.

CapMan indicates that the general atmosphere towards buyouts in Sweden is positive and the past history of buyouts has been very successful. The Nordic region has been the best performing market and compared to the rest of the Nordic Countries Sweden is the largest most mature market with the biggest buyout funds. It is easier to access the Swedish market through the many auctions that are held and many players from the other Nordic countries actively attempt to access the Swedish market.

4.1.6 The Success of Private Equity

Currently the Nordic economies are performing well and CapMan believes that the private equity industry has a good eco systems. CapMan further argues that the small market size of the Nordic countries is one of the key reasons to the regions success. Companies in the Nordics may be in need of international and global players as the market is relatively little compared to many other countries in Europe, and this can according to CapMan be provided by the private equity industry.

There exist a large interest for Swedish private equity funds abroad and as a matter of course the fundraising strategy is adapted towards different cultures, even though the investors usually are professional and institutionalised. CapMan sees global investors as a key factor to evidently raise additional capital and believe that they can contribute to the development of the industry. Investors are becoming more professional and the information provided from CapMan is not sufficient as the investor seeks an objective view. This can be gained by thorough due diligence processes, reference calls to investors in previous funds and meetings with earlier buyout objects.

4.1.7 Fundraising

The investment process and the fundraising process are seen as two separate procedures at CapMan that are on going continuously. Screening the market and marketing has to be a constant process while still having the investment process alongside. Depending on the investment phase CapMan need to have funds in place approximately every fourth year when the funds investment period ends. Fundraising is a process that CapMan imply is on going “every day, every year”.

CapMan has a marketing and sales team that have knowledge about CapMan operations on a group level. They screen the market and meet with potential investors informing about CapMan. Investors are seen as partners and it is the buyout team that they invest in, hence is of interest when evaluating whether to invest. When an investor expresses interest, a meeting is arranged with the buyout investment team which contributes with more informed investors.
4.1.8 Summary

The authors have in table 1 summarised CapMan’s response in the interview to facilitate for comparison among the firms interviewed.

Table 1 Summary of CapMan’s response in the interview

<table>
<thead>
<tr>
<th>Buyout process</th>
<th>Building long-term relationships</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment criteria for a potential buyout</td>
<td>Attractive industry, exit opportunities, management culture, adding value through active ownership, segmentations and controlling position.</td>
</tr>
<tr>
<td>The limited partner’s incitement</td>
<td>Long-term investments and turn to buyout funds searching for higher returns.</td>
</tr>
<tr>
<td>Main risks and diversification</td>
<td>The general economical and country risk. Diversifies through industry, business types and among different Nordic countries.</td>
</tr>
<tr>
<td>Current climate</td>
<td>Market is not yet mature and the returns are outperforming other markets in Europe. Great interest among investors abroad</td>
</tr>
<tr>
<td>The success of private equity</td>
<td>Small market size and a good private equity eco system.</td>
</tr>
<tr>
<td>Fundraising</td>
<td>A constant process that is on going every day, every year.</td>
</tr>
</tbody>
</table>

4.2 Interview with Segulah

Segulah is a private equity firm within the Nordic region. It was founded in 1994 and has made 31 of its 32 platform investments within Sweden. Segulah is thus primarily sort as a National Swedish player. For the time being Segulah administer three funds: Segulah II, Segulah III and Segulah IV. The authors’ reference is Marcus Jansson and the question frame used in the interview is found in appendix 1 - interview questions in Swedish.

4.2.1 Buyout

During one year Segulah review approximately 150 possible buyouts and ideas. The process is seen as a funnel where the 150 possible investments are narrowed down to two or three buyouts a year. The buyouts are commonly made through direct contact and are preferred over auctions. Typically, there is a long process behind the buyout and Segulah allocate a great amount of effort in creating a relationship with the company. It is common for Segulah to inform companies about their benefits in selling the affiliate and focusing on their core competence. After several meetings and regular communication it can lead to a deal, yet it can also end up in an auction. It depends upon what attributes that are valued by the corporation. As a matter of course, Segulah’s long built reputation becomes evident and crucial in these deals.
4.2.2 Investment Criteria

Segulah has four key criteria when evaluating a potential buyout candidate. A competent management in the potential buyout candidate is good yet of less importance since Segulah often replaces it with its own in-house management. The competence level of Segulah’s management team is of great value and consists of 35 advisors with a network of competence in most industries. A strong market position is of importance since having a strong position in Sweden easily can be developed into a market leading position in the Nordic Region. Segulah invests in stable and profitable businesses that have good cash flow. Development opportunities are further of importance since the most important criterion is the ability to add value to the business with its competence.

4.2.3 Limited Partnership

The capital in Segulah’s funds is mainly raised from international pension funds, institutions and insurance companies, yet also intermediaries such as funds-of-funds. Segulah’s preference is long-term investors that value its businesses and do not prefer investors that invest according to trends.

Segulah believes that private equity is an opportunistic operation where the business model is to buy for a low price and sell for a higher price. This requires long-term capital and the general partner needs to be able to act free. When an investor invests in a buyout fund it is an active choice, since the investor select the firm and team. Thus, it agrees to the limited partnership agreement. The agreement is detailed and underlying states the general partners’ rules, yet also includes tight boarders for the general partner to act. Segulah believes informing the investors alongside the investments is key in creating trust and safety. The investors in Segulah are possible to change general partners if the individual has mismanaged, however the threshold is set high and requires the majority of limited partners’ votes. Segulah believes that it is of great importance for the key people to earn a good return as they can turn elsewhere if not compensated enough for talent and knowledge, nevertheless mean that the limited partners prevail a view that is natural towards the compensation.

The focal point is that the private equity firm yields good returns, however in some cases reputation can help. Politics and media do not play a major role as the firm expands mandates if it performs well and the opposite if it performs poorly. Segulah have built relations to institutions with experience in the industry abroad, which have assisted them in their development, given in example an American investor spread the word of its operations and brought new investors.
4.2.4 **Risks and Diversification**

The main risk Segulah is exposed to be recruiting the wrong person for the wrong position. The challenge in this case is to build on the network of competent industrial advisors. Furthermore, there are general risks that Segulah is exposed to as experienced during the financial crises in 2007-2009. Case by case Segulah evaluates whether to invest in cyclical or noncyclical industries, however not from a portfolio perspective.

Segulah implies that its funds are less diversified than what is endorsed in the portfolio theory. However Segulah’s investors diversify in the next level as these large institutions and insurance companies invest in 30 to 100 different buyout funds. Segulah describe themselves as a controlling firm that work close with its businesses and control the decisions rather than a diversifying firm who focus on spreading its risk. They believe that with a base of 150 ideas it is unlikely that with two to three investments a year choose a business that is similar to an earlier investment.

Segulah makes platform investments within the Nordic region and 80 per cent of these must be in Sweden as it is the most familiar market and has most expertise in. In the limited partnership agreement there is enacted to what level diversification is needed in the portfolio. In some funds Segulah has restrictions to 15 per cent investment in a single buyout and in some 20 per cent, yet their objective is to have around 10 businesses in each fund, meaning diversification of 10 per cent in every single investment. Segulah do not evaluate macro economical trends or use market timing. They see a risk in using market timing as future predictions are difficult and can be associated with additional risk.

4.2.5 **Current Climate in the Market**

Since the financial crisis in 2007 to 2009 the most significant difference noticed by Segulah is the changed financial structure, yet the prices have been relatively stable. Segulah has not changed its guidelines, as discipline has been key in their strategy at all time. As a natural reaction after the crisis they have become more careful and pensive in their operations. During the crisis the discounts on the secondary market increased dramatically which many investors were unprepared for.

There is according to Segulah different visions of the private equity industry among investors and a trend is recognised in the allocation of capital into the private equity industry. The global pension capital is several times higher than the worlds GDP. If the allocation to private equity would increase from a half per cent to three per cent the market would have increased six times. In the future many investors could allocate capital to private equity and on the one hand it is positive that there exist available capital yet on the other hand Segulah see that as the market matures the returns will decrease.
4.2.6 The Success of Private Equity

Segulah implies that the Nordic region has a reputation of being one of the best markets to invest in since it is a transparent, well established, mature, and comfortable market. Yet Segulah ask the question – how long can it go on? Segulah believe that the key to the Nordic success is how the firms operate and handle their portfolios. Nordic firms have less focus on financial aspects and instead focus on adding value through an active industrial ownership using advisors and boards. Segulah believes that the Nordic players are strong and that the firms current today will remain in the market.

The theoretical explanation to why private equity firms can be given a high leverage rate is by Segulah described as the cost of a financial crisis. In depth Segulah mean that it is common that a company in a private equity firm’s portfolio be leveraged five times it’s operating profit without having any concerns, while being leveraged one to one and a half time the operating profit in a company noted on the stock exchange can create a fear. The difference is according to Segulah when the private equity firms company would perform poorly during a crisis the lender would have a discussion with the owner, in this case the private equity firm, and if adequately the firm, would contribute with additional capital. As the amount of input capital by the owner would increase the returns would decrease, however it would in average not make a significant difference to the owner. For a company noted on the stock exchange a crisis can press down the stock price to dramatic low levels forcing a new issue of stock. In this case the owner would lose ownership share, hence the cost of a crisis is higher for an owner in a company noted on the stock exchange.

4.2.7 Fundraising

In comparison with the regular fundraising process in banks, Segulah find their process different. When Segulah meets with their potential investors to raise funds there is no clear investment plan available as the investments are made after the fundraising. Hence, the investors are investing in the team’s ability to act competently and not in any specific buyouts. It is therefore crucial for the investors to analyse the team at Segulah and study how they work, how they are as individuals, their past history, what models that are used and decide if cooperation is possible. The investors are specialist in analysing these aspects and usually consist of a large team.

Meetings with new potential investors are held regularly during the time of a fund and when the capital has been used in one fund Segulah has early assured that existing investors together with new investors have made a decision to invest in the new fund. A formal review of the agreement is made during one to two months and by constantly having a fundraising process going Segulah never loose their tempo in investing.
4.2.8 Summary

The authors have in table 2 summarised Segulah’s response in the interview to facilitate for comparison among the firms interviewed.

Table 2 Summary of Segulah’s response in the interview

<table>
<thead>
<tr>
<th>Buyout Process</th>
<th>Long Process. Direct contact preferred over auctions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Criteria</td>
<td>Competent management, strong market position, good profitability and development opportunities.</td>
</tr>
<tr>
<td>The Limited Partners’ Incitement</td>
<td>Returns and low correlation</td>
</tr>
<tr>
<td>Main Risk and Diversification</td>
<td>Recruiting the wrong person for the wrong position and the general economic risk. Segulah is a controlling firm and less diversified.</td>
</tr>
<tr>
<td>Current Climate</td>
<td>A trend is recognised in the allocation of capital into the private equity industry.</td>
</tr>
<tr>
<td>Success of Private Equity</td>
<td>A lower cost of a financial crisis compared to the stock market.</td>
</tr>
<tr>
<td>Fundraising</td>
<td>Constantly having a fundraising process going.</td>
</tr>
</tbody>
</table>

4.3 Interview with Altor Equity Partners

Within the Nordic region Altor operates as a private equity firm that focus on investing and developing medium sized companies. Altor Equity Partners functions as the investment advisor to the Altor fund and do not own companies. The investment team consists of members representing all the Nordic countries with international experience in areas within private equity, investment banking, consulting and in different industrial sectors. Altor’s three funds are located in Jersey. The authors’ reference is Jesper Eliasson and the question frame used in the interview is found in appendix 1 - interview questions in Swedish.

4.3.1 Buyout Process

There are two different types of processes; the first process is through a fully structured auction process. The second situation is when Altor Equity Partners locate a company that they want to buy. Then it is important to communicate with the target company and the owners for a period of one year or longer. These transactions most often end up more successful since there are less surprises after the company have been bought.

The market is penetrated with well performing players and advisors, hence it is difficult to succeed to buy a company in a fully private situation. Even if Altor Equity Partners finds an interesting company, the seller of the company most often invites more players in order to test the prices in an auction. Altor Equity Partners does not prefer a fully transparent auction process since the prices will be higher when the player will receive all the available information.
4.3.2 Investment Criteria

Altor Equity Partners’ primary investment criterion is the risk adjusted return correlated to the buyout. They find it interesting to discover companies with a potential of improvement and with a management team that is not fulfilling. These companies have a high potential for improvement, however a higher return will require taking on a high risk.

Further, the firm has four criteria that are of value in a potential buyout. A potential buyout has to yield good returns to be successful, thus expected return is the first aspect Altor Equity Partners scrutinise. The potential risk that is connected to achieve the desired return is an important factor to consider when investigating potential objects. The work contribution and level of human effort that are required to attain the wanted return are also features taken into consideration, nevertheless the amount of capital required.

4.3.3 Limited Partnership

The most common investors in Altor Equity Partners are pension funds, universities and charity funds. Pension capital is an attractive investor type since there is a natural frequent flow of capital that needs to be invested. Altor Equity Partners tries to avoid opportunistic investors that move in and out, nevertheless investors that collect capital only to invest at present. Limited partnership agreements are used and for the firm to attract new investors a prospectus is written including the main purpose of the funds which is to create a return for the investors. As long as the firm operates within the law and regulations there are no restrictions of business sectors and the investors is not able to influence.

Altor Equity Partners have implemented limited partnerships. It is their belief that the investors are provided with the necessary information and thus are well informed with the possibility of having meetings when desired. The firm is very satisfied with its base of investors and mean that the investors are fulfilled with its operations. Thus, as long as the firm performs well and generates a satisfied return the investors will commit capital in a new fund. Not many investors have chosen not to reinvest in Altor Equity Partners.

The investors’ main incitement is according to Altor Equity Partners a return higher than the stock market. The firm have a set target return in the funds, although the history is of greater interest to the investors than the future ambitions of the firm. The firm’s strategy includes taking on high risks and thus it is important to recognise that the firm not always perform well. The investors are committed for ten to fifteen years and is during this time not able to influence the fund. Accordingly it is key for Altor Equity Partners to inform the investors about the risks.

4.3.4 Risks and Diversification

Altor Equity Partners acquire both cyclical and non-cyclical companies. In the aftermath of the financial crisis the firm state the general financial risk as one of the main risks in the
private equity industry. Today, Altor Equity Partners implement more thoroughly historical analysis of their future investments to decrease the occurrence of the risk.

Among Altor Equity Partner’s historical investments, it is possible to discern three different type of transactions that have been proven successful for the firm; acquiring a company from an entrepreneur, a restructuring company, and when acquiring a division of a large corporate group.

Additionally, Altor Equity Partners as a matter of course acquire well performing companies with a successful management in a steady environment. These investments are less risky, yet challenging because of the higher prices and lower returns that are current compared to their other investments. In other words, Altor Equity Partners diversify through different business sectors and types of transactions. The firm is geographically concentrated to the Nordic area, but are interested in both Nordic companies that are local in Sweden and global companies with their head office in the Nordic area. The funds are made in an investment period of five years that also creates a diversification.

4.3.5 Current Climate in the Market

Altor Equity Partners explains that the private equity and buyout market today is competitive. The players are qualified in different types of objects depending on the focus of the firm and the players in the market face different types of challenges. The focus of the investments evolves through time and the strategies used to find investors to commit to the fund differs depending on the track record and the firm’s position in the market. When having a less strong track record a firm needs to have a broad target of investors and communicate with several investors. It also depends on the competition; at present there are several players that need fundraising to their funds.

In the aftermath of the financial crisis, Altor Equity Partners have reformed their strategies. The firm is still interested in the same types of companies, yet perform a more thoroughly analysis process, where longer periods of time is studied. In the past a period of five years was plenty, yet today a historical period of 30 years is studied in order to find fluctuations in the business sectors. The company of interest is not necessary studied alone as it can be interest to study the sector it operates in.

4.3.6 The Success of Private Equity

According to Altor Equity Partners, the media do not illustrate the private equity and buyout sector as a positive investment. The firm describe the industry as successful, since the aim of the firms are to improve companies and have a long-term perspective on their investments. By not being exposed to quarterly pressure it is possible to improve a company through a time period of 10 to 15 years. The firm mean that it is more simple to sell a company after seven years that are well invested and with a well developed plan for
the future, than to quarterly maximise the return for the company. These companies sells at higher prices. Additionally, the management team are positive to the owner structure of a buyout since they are able to develop. Altor Equity Partners further argue that media overlooks the fact that private equity firms increase the number of employees and create improvements, which in turn results in a more efficient business world.

4.3.7 Fundraising

Altor Equity Partners work with consolidation cycles. When one fund is becoming fully invested the firm extend a proposition to current investors whether there exist a desire to assign Altor with an additional trust in a new fund. In past history the firm have generated positive returns and the clear structured profile of the organisation have contributed with a high demand of investors desiring to commit capital in Altor’s funds. Hence, the investment period and the amount of time committed to raise capital is relatively short. Altor Equity Partners has not been forced to look outside the existing base of investors, although the firm has meeting every week with potential investors that have an interest in investing in the future fund.

4.3.8 Summary

The authors have in table 3 summarised Altor Equity Partner’s response in the interview to facilitate for comparison among the firms interviewed.

<table>
<thead>
<tr>
<th>Buyout Process</th>
<th>Fully structured auction or personally locating a buyout. Penetrated market.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Criteria</td>
<td>Expected returns, the potential risk, work contribution and capital required.</td>
</tr>
<tr>
<td>The Limited Partners’ Incitement</td>
<td>A return higher than the stock market.</td>
</tr>
<tr>
<td>Main Risk and Diversification</td>
<td>Fluctuations in the business sector. Diversifies through different business sectors, types of transactions and investment period.</td>
</tr>
<tr>
<td>Current Climate</td>
<td>The buyout market is today competitive and several players need fundraising.</td>
</tr>
<tr>
<td>Success of Private Equity</td>
<td>A long-term perspective and contribute to a more efficient business world.</td>
</tr>
<tr>
<td>Fundraising</td>
<td>Work with consolidation cycles.</td>
</tr>
</tbody>
</table>

4.4 Interview with Naccess Partners

Naccess Partners is the exclusive investment advisor to NAXS Nordic Access Buyout Fund AB (NAXS), which is a fund-of-fund firm that has its core focus on investments in Nordic buyout funds and has market-introduced shares. The question frame used in the interview is found in appendix 1 - interview questions in Swedish.
4.4.1 Fund-of-fund firm

According to Naccess Partners there exist 30 different potential buyout funds in the Swedish market today. Currently Naccess Partners has commitments with six fund managers.

Being a fund-of-fund organisation NAXS act as an intermediary between the buyout fund and the private investors. By investing in NAXS the investor do not necessarily need the competence since Naccess Partners have the experience and knowledge. It increases diversification and decrease the risks, yet requires administration which is a cost for the investor. Naccess Partners define one of the disadvantages as the capital being ear marked, meaning during the five years that the investments are made NAXS has the cash in hand waiting for each buyout to be made.

4.4.2 The Success of Private Equity

Naccess Partners express that competition is positive for the market to some extent, yet if it increases and matures the returns may decrease and more unprofessional firms may be established. There exists four features that Naccess Partners believe are behind the success of private equity in Sweden. First, the international culture and the decentralised operations that have created several strong managers and company executives. Secondly, the education level in the Nordic countries are relatively high. Thirdly, the private equity culture was accepted positively at an early stage that created a solid foundation. Lastly, the Swedish bank system has been very modern in their approach to how private equity is financed and operates. Meaning the banks have been open to lend capital to the firms.

4.4.3 Process of Choosing a Fund

Naccess Partners have five criteria denoting the characteristics that are important in the process of investing in a fund. When investing capital into a buyout fund it is not the fund portfolio itself that is invested in, it is the team. Thus, it is important that the team has a wide network among different industries and are successful in buying mature, stable companies with a limited risk. Analysis is performed of how a management team has fulfilled it strategy, solved adversity, and how the deals has preformed historically. Investments are solitary made into the best quartile of the market, preferably the best 10 per cent. It requires an active ownership, industrial knowledge in several industries and experience.

In Naccess Partners case a firms reputation play a major part when choosing a fund to invest in. Currently Swedish fund managers have a good reputation. It can of course be misleading, yet the firm indicate that firms that have been active for several years have their performance written in black and white. However, Naccess Partners do not see reputation as a criteria for whether to invest or not, only as a part of the analysis.
Naccess Partners are generalists when investing and do not specialise in certain industries since it includes taking on a higher risk. Even though the firm is well experienced in a certain industry and know its risk and pitfalls it is impossible to avoid situations where the market for a certain industry may go down. Typically, the buyout funds are interested in similar type of companies, which especially been education and health care sectors the last years. These companies have usually been managed by families on a local level without any certain knowledge of the industry. Naccess Partners argue that for a private equity firm and the people concerned within these companies a buyout can contribute with competence and improve the organisation radically. The firm can only see benefits with changing the ownership structure within a buyout, since a private equity firm is improving the ownership structure by adding competence and experience. In order to sell something for a higher price it must be substantially improved otherwise there would not be a buyer.

**4.4.4 Limited Partnership**

The primary partnership agreement between NAXS and the fund managers is limited partnership. As demand increases it is today more usual for investors to contact the private equity firm and Naccess Partner’s investments have been made by a combination of contacting firms and investing, as well as being contacted by firms. Naccess Partners communicate with the fund’s general partners at least once every month, where the current portfolio and the future investment plans are discussed. The firm also receive information and material regularly in order to follow every step that is taken within the funds, nevertheless express that they do not lack any certain information.

NAXS experienced a strong search for investors during their IPO and turned to a wider target group with the aim of making private equity investments available to a broad audience. NAXS has certain commitments towards its investors and Naccess Partners believe that the investors are kept up to date with information. The firm however pinpoint that many investors are inexperienced and do not have knowledge about the private equity industry. Therefore, it will take time to create the awareness among investors that is needed to understand all the information that is handed to them.

**4.4.5 Risks and Diversification**

The most apparent risk that Naccess Partners is exposed to is the general economic risk experienced during the financial crisis in 2007 to 2009, where highly leveraged companies faced difficulties repaying their debts. Naccess Partners express that they have not changed their strategies since the crisis. Their objective has consistently been to invest in relatively conservative teams who do not take on extensive risks. Historically, Naccess Partners have experienced that firms tend to avoid too significant cyclical features, although since the crisis firms take even further caution with cyclical companies. To decrease risk and increase diversification the commitments have been scattered between: small-, mid- and large-cap,
geographical areas, industrial areas and fund managers. One of the most important criteria being the restriction of investing maximum 40 per cent in one single fund manager. Naccess Partner further believes that Swedish firms possibly are exposed to geographical risk, since their geographical focus is small.

4.4.6 Summary

The authors have in table 4 summarised Naccess Partner’s response in the interview to facilitate for comparison among the firms interviewed.

Table 4 Summary of Naccess Partner’s response in the interview

<table>
<thead>
<tr>
<th>Fund of Fund</th>
<th>Increase diversification and decrease risk. Associated with an administration fee.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Success of Private Equity</td>
<td>The international culture and decentralised operations have created strong managers in the market. Good educational level, good acceptance for the market early in time, and a modern bank system.</td>
</tr>
<tr>
<td>Process of Choosing a Fund</td>
<td>Ambitious team and managers with a wide network that buy mature companies with limited risk. The best quartile of managers and an active ownership.</td>
</tr>
<tr>
<td>Limited Partnership</td>
<td>Communication with managers and receive information regularly. Keep their own investors up to date yet believe that the investors lack knowledge.</td>
</tr>
<tr>
<td>The Main Risk and Diversification</td>
<td>General economic risk. Diversifies through small-, mid-, and large-cap, geographical areas, industrial areas and fund managers. Also by restrictions to single fund managers.</td>
</tr>
</tbody>
</table>

4.5 The Survey

The authors have conducted a smaller survey to add to the investor perspective of the research. The two respondents were Sofia Kulp-Tåg at Skandia Liv and Per Olofsson Apfund 7. The question frame is found in appendix 3 and original Swedish answers have been translated by the authors.

4.5.1 The view of Private Equity

The respondents were asked the following question: mark with an X on the scale below how you view the private equity market and buyouts, where 1 corresponds to a negative view and 5 positive? Please specify the answer.

Table 5 The respondents answer to question 1 (Translated by the authors)

| Ap-fund 7  | Answered 5. All buyout funds do by no means provide sufficiently high yields, yet AP7 has found a good mix of funds that provide higher returns than the stock market over time. These have been identified through a careful selection process and AP7 are thus very positive towards buyout. |
| Skandia Liv | Answered 5. Private equity has a good and efficient ownership model. For investors in private equity funds there exist opportunities to yield high returns as it can outperform the public market, thus the stock market. |
4.5.2 The view of Limited Partnership

The respondents where asked the following question: mark with an X on the scale below, how you view limited partnership agreement, where 1 corresponds to a negative view and 5 positive? Please specify the answer

Table 6 The respondents answer to question 2 (Translated by the authors)

<table>
<thead>
<tr>
<th></th>
<th>Answered 3. It is difficult to generalise given that it differs from case to case. Usually there is a negotiation and if there is something we cannot accept or agree on we refrain from investing with that particular manager.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skandia Liv</td>
<td>Answered 5. The limited partner’s position strengthens by the agreement.</td>
</tr>
</tbody>
</table>

4.5.3 Allocation to Private Equity Buyout Funds

The respondents where asked the following question: how much of your portfolio is invested in buyout funds?

Table 7 The respondents answer to question 3 (Translated by the authors)

<table>
<thead>
<tr>
<th></th>
<th>A total of 7.5 per cent in Private Equity, where buyout corresponds to 5.5 per cent of the total portfolio. The remaining 2 per cent is a mixture of Venture, Credit Growth and Distressed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skandia Liv</td>
<td>An allocation of 8 per cent of the total balance sheet. Today, 4 per cent is invested.</td>
</tr>
</tbody>
</table>

4.5.4 Investor Incitements

The respondents where asked the following question: what incentives do you possess as an investor, when you invest in a buyout fund?

Table 8 The respondents answer to question 4 (Translated by the authors)

<table>
<thead>
<tr>
<th></th>
<th>It is always to get as high return as possible for our investors. The reason we chose to include buyout funds in the portfolio are that we think we can get at least 5 per cent higher annual return than stock market returns. However, there is a very comprehensive investment process to identify the mix of funds that have the right conditions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skandia Liv</td>
<td>We want to find the best managers (general partners) who can generate the best returns for our investors.</td>
</tr>
</tbody>
</table>

4.5.5 Information Asymmetry

The respondents where asked the following question: Do you have access to all the information you seek on the private equity firm’s investment of your general partner?
Table 9 The respondents answer to question 5 (Translated by the authors)

<table>
<thead>
<tr>
<th>AP-fund 7</th>
<th>Both Yes and No, we often receive all the information we request, but own research will always make a very important component. It can be everything from credentials of the people who will drive funds to gather information about previously made business. I would like to say that it is very much about assessing people and try to ensure that the investment process described are credible and this often requires a range of follow-up questions and own basis of judgement.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skandia Liv</td>
<td>Yes. We are a very large investor who invests up to SEK one billion in individual funds. The General Partner is keen that we are satisfied with the information we receive.</td>
</tr>
</tbody>
</table>

4.5.6 Future Investments

The respondents where asked the following question: what usually take place when a buyout fund you invested in closes for investments?

Table 10 The respondents answer to question 6 (Translated by the authors)

<table>
<thead>
<tr>
<th>AP-fund 7</th>
<th>Since we have an inflow into the fund each year we try to maintain the target portion as per cent for private equity. Therefore, we usually increase our investment commitments every year. Most commonly, individual funds raise a new fund when they reached just over half way through the lifecycle of the current fund. If the figures are good and no other major changes have occurred (e.g. if they have changed key managers) we can consider investing in the following fund. In our fund programs we also strive to have the right mix of underlying strategies and geographical distribution in the buyout segment and may therefore refrain the next fund (even if it has good outlooks) to keep the right mix.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skandia Liv</td>
<td>Sometimes we continue to invest with the same manager and sometimes the managers are replaced.</td>
</tr>
</tbody>
</table>

4.5.7 Attributes valued in a Private Equity Firm

The respondents where asked the following question: what attributes do you value in a private equity firm with a focus in buyouts?

Table 11 The respondents answer to question 7 (Translated by the authors)

<table>
<thead>
<tr>
<th>AP-fund 7</th>
<th>We usually make use of the five &quot;Ps&quot; to evaluate structured funds on the same basis (both fund of funds and to direct funds such as buyout):</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1) Philosophy - Look at the funds Philosophy</td>
</tr>
<tr>
<td></td>
<td>2) Process - Looking Care Fully at the Investment Process</td>
</tr>
<tr>
<td></td>
<td>3) People - The People That Will Carry Out the Process (In The End it is very much about people and Long Term Commitment)</td>
</tr>
<tr>
<td></td>
<td>4) Performance - How Do They Performed in the past and how this performance was created.</td>
</tr>
<tr>
<td></td>
<td>5) Price - Price is also &quot;an important factor and if we are Evaluating two similar funds We Will choose the one with the most attractive pricing.</td>
</tr>
</tbody>
</table>

When we have invested in a company/fund we make us of two reviews each year with the following agenda: (a) Investment Process Implementation, (b) Performance, (c) Risk
Control, (d) Staff changes and (e) Administration.

| Skandia Liv | This type of information can not be shared as it is structural capital. |
5 Analysis

In this section the authors will discuss and analyse the findings in relation to theory. The section intend to analyse and compare the similarities and differences among the different sections in order to answer the research question in the following section.

5.1 Buyout Investment Process

Private equity can be used to develop new products and technologies, expand working capital, make acquisitions or support a company’s balance sheet; nevertheless it can resolve ownership and management issues (Evca, 2007). Nyman (2002) divide the buyout investment process into several steps. First mentioned is the business plan, which is inherent in Altot Equity Partner as they in their communication with a company inform them about their future plan and how they intend to develop the company. The investment process is an on-going process, which Segulah claim can be resembled with a funnel. According to Prowse (1998) the investment proposals received can amount for hundreds, yet merely one per cent is invested in. In Segulah’s case one to three investments are made out of 150 possible investments every year. Thus, it is a proactive work and Prowse (1998) mean that the firm’s success is dependent upon the general partners ability to efficiently select buyouts among these. In total Naaccess Partners imply that a fund manager have approximately 10 companies in its portfolio, with exception for larger funds that can have up to 20 companies. It is from the study possible to discern two different routes that are commonly apparent in the acquiring of a company, an auction or a private arrangement.

Nyman (2002) further see the importance of studying the management and the competence within the company, nevertheless make thorough due diligence processes. This investment process accordingly take up to three to six months. The private equity firm become more familiar with the management team and are provided with more knowledge and understanding of the business idea’s potential and risk attributes. (Nyman, 2002) Private arrangements typically requires a long-term communication with the potential buyout candidate and its owners, in Altot Equity Partners’ case one year or longer. According to Segulah a great amount of effort is put into these kind of process building relationships, yet depending on the attributes valued by the owners it in some cases leads to a deal, while in others end up in auctions.

Even though a process of direct contact has no guarantees and is time, and resource intense the interviewed companies still prefer direct contact to auctions. Altot Equity Partners mean that these buyouts often end up more successful since fewer surprises are current after the company have been bought. As the interviewed firms describe, an auction do not incorporate an exclusive assessment of the buyout. Nevertheless, the auctions are too transparent as all players receive the available information, which decrease the opportunity to find a unique potential and thus increase the prices. However, Altot Equity Partners further imply that the market is well penetrated, which makes it difficult to consult with a company privately today. The authors believe that it is possible to comprehend that
a private arrangement benefits both the general partner and the limited partner as better returns can be provided.

5.2 Buyout investment criteria

Private equity firms strive towards developing and adding value to successful companies in a long-term perspective by carrying an active ownership commitment and supply capital (Svca, 2011). In all firms interviewed there is an underlying importance of buying companies with development potential, where the firm can add value through active ownership. Furthermore, Altcor Equity Partners valued limited work contribution for the amount of capital invested for a good risk adjusted return, while Segulah value good profitability.

Gagliano and Olsen’s (2003) have through earlier research established 11 investment criteria valued in buyouts. A viable exit opportunity is one criterion mentioned, which was valued by CapMan. It is the authors’ belief to regard it as implicit in the industry, since in order to earn a return there must good exist opportunities to sell the company in the future. Another, attribute valued by Gagliano and Olsen is a market position that is strong and defensible, which was strongly valued by Segulah. The criterion is important to Segulah as a strong market position in Sweden can open up for opportunities to become market leading in the Nordic region.

Furthermore, Gagliano and Olsens (2003) put focus on the value of a strong management team in the buyout. Also CapMan value the management culture in a potential buyout, yet Segulah mean that even if it can be of value their in-house managements’ competence is of greater value. Good competence in the buyout’s management can be of value in an investment, yet if the management has less potential a change could open up for value adding development opportunities. General partners are often actively involved in the governing of the management in the companies of their portfolio and it was common for the private equity firms interviewed to change management in their buyouts (Citron et al., 1997).

The firms are in general interested in similar types of companies in their portfolios and according to Naccess Partners, education and health care have been two common sectors to include. The authors believe that the large interest has grown from the fact that education and health care resemble with necessity goods and are less cyclical and exposed to financial crisis. Potential buyout objectives, are according to Naccess Partners often managed by families on a local level that lack knowledge in the particular industry. Altcor Equity Partner argues that media disregards the fact that the private equity firms increase the number of employees and make improvements, which in turn results in a more efficient business world in general. This is somehow subjective, as the authors do not have the opinion of the management in companies that has been objects of buyout. The private equity firms do according to Altcor Equity Partners not have a quarterly pressure and is able to improve a company for a longer time period.
5.3 Fundraising

Limited partnerships have a time limit and it is thus vital for the private equity firm to raise new capital when the initial fund is fully invested to continue its operation in a new fund. There are then two possibilities to either extend or create new partnerships. (Prowse, 1998) It is common to finance and market a fund in collaboration with financial institutions (Nyman, 2002). CapMan view the fundraising process as separated from the investment process and mean that it is on-going continuously every day, every year. They explain that depending on the investment phase the private equity firm needs to have funds in place approximately every fourth year, when the funds investment period ends.

Before marketing the fund the private equity firm can write a presentation of the fund where the characteristics of the fund is described (Nyman, 2002). Altör Equity Partners have in order to attract new investors to their funds written prospectuses, including their main purpose. CapMan denote the importance of continuously promoting and screening the market for funding opportunities, nevertheless meeting with potential investors. It is also of importance to adapt the fundraising towards the different cultures even though most investors are professional and institutionalised. In CapMan’s case the firm has a marketing team and a buyout team respectively, were investors meet with the latter when an interest has been expressed. Common for the interviewed firms are to meet with potential investors regularly during the time of the fund to ensure that capital has been raised when the new fund is initiated. Implementing this procedure Segulah imply that the tempo in investing is never lost. Differing among the interviewed firms fundraising is however whether the firm has invited investors or if investors have come to the firm. When a fund is starting to get fully invested it is common for the private equity firms to ask investors for a trust in a new fund, by Altör Equity Partners described as consolidation cycles.

Raising capital for a fund can according to Nyman (2002) be comprehensive and time consuming dependent on the size of the capital needed. The authors however see that it depends upon additional factors, not solitarily the size of capital. Among the firms interviewed it is not possible to discern a joint practise of how fundraising is managed. Common however is that there is no set strategy to gain investors: rather the authors believe that it is the general partners’ expertise and how they manage funds that raise capital to private equity funds. With that said it is from the study possible to discern certain attributes of importance that the fundraising is dependent upon to be successful.

5.4 Fundraising attributes

Prowse (1998) has in earlier research found that the resources needed to raise funds are dependent upon the reputation and experience of the general partner. The authors will in this section analyse the mentioned.
5.4.1 Reputation and History

According to Gompers (1996) and Lockett et al. (2006) there exist three different features that are important when considering reputation; the age of the private equity firm, the number of times the private equity firm has been the leading firm and the number of investments made by the firm.

The age of the private equity firm was described as very important to the firm that had the longest historical record – Capman. The remaining two firms see history as more important when considering a successful past. In Altor Equity Partners’ case the past history of positive returns has created a high demand of investors that desire to commit capital in their funds. Consequently, Altor Equity Partners have not been forced to look outside their existing investor base and the fundraising period has thus been relatively short. Altor Equity Partners mean that a firm with a less strong track record need to broaden their target of investors and have many meetings with potential investors. In other words, good historical performances have proven to be essential and can contribute with a more straightforward fundraising process. The authors would thus further add past track record to Prowse’s attributes earlier mentioned.

Naccess Partners believe that the reputation of the private equity firm is a major feature when choosing a fund to commit capital in. Network and reputation have also proven to go hand in hand, in Segulah’s case a long-term relationship with an American investor contributed with a word spread of Segulah’s operations to other investors in that region. The reputation can be misleading yet Naccess Partners indicate that a firm’s performance can easily be studied and thus only perceives the reputation as a part of the analysis. On the other hand, Segulah does not consider the reputation as the most important feature and argue that the primary feature rather is that the private equity firm yield good returns. This since politics and media do not play a major role, instead it is the performance that can expand a firm’s mandates and vice versa.

5.4.2 Team and Experience

The general partners experience can be regarded as an asset for the firm. It is the judgment that is of value in efficiently selecting successful buyouts and is gained through experience operating businesses together with experience from the industry. (Prowse, 1998) The firms interviewed provide the interpretation that investors do not invest in the firm itself but rather in the team managing the fund. Thus, Naccess Partners believe that the team requires an active ownership, industrial knowledge in several industries and experience.

Comparing the fundraising process with the process in banks, a private equity fundraising differs, as they do not have a clear investment plan available when meeting with potential investors. The buyouts are made after the fundraising and hence of value are the team’s ability to act competently and successfully. Consequently Segulah identify the following
features of great importance in a team: the past history of the individuals, how they act, what models used and if cooperation is possible.

5.4.3 The Investors’ fund assessment

Investors can demand to perform a due diligence of a private equity firm (Nyman, 2002). The firms interviewed depict that investors perform thorough due diligence processes, reference calls to investors in previous funds and meetings with earlier buyout objects. Ap-fund 7 typically uses five P’s to structure and evaluate funds in the same basis: Philosophy, Process, People, Performance, and Price. They perceive people as a vital attribute since a buyout investment is about people and long-term commitment. Naccess Partners further explain its importance by stating that it is essential that the team possess a broad industrial network is successful in buyouts and takes on limited risk.

Also performance is of importance to Ap-fund 7 in regards to how they performed in the past and how this performance was created. This can according to Naccess Partners be analysed by evaluating how a management team has fulfilled its strategy, solved adversity, and how the deals have performed historically. During the fund’s lifetime Ap-fund 7 further implement two evaluations each year where the following factors are analysed: implementation of the investment process, performance, risk control, changes in management and current management.

5.5 Investors in Private Equity in Sweden – who are they?

Private equity funds most often have an owner structure consisting of independent investors. The funds are generally closed and it is the private equity firm that decides the individuals and institutions allowed to invest in the fund. The number of investors is often limited to 10 or 20 investors in each fund. (Nyman, 2002) The typical investors in the private equity funds interviewed are pension funds, universities, charity funds, fund-of-funds and insurance companies. Commonly an investor base is consisting mainly of foreign investors which strengthens SVCA’s statistics that indicate that more than 80 per cent of the capital acquired the last years derives from foreign investors. The investors have according to CapMan typically a portfolio of private equity and alternative assets representing two to ten per cent of their entire portfolio.

5.5.1 Investor incitements - Why invest in Sweden?

Sweden is an attractive market for foreign investors and together with the United Kingdom in the lead of the European private equity industry (Svca, 2011). Segulah state that the Nordic region has a reputation of being transparent, well established, mature and comfortable. Comparing Sweden and the Nordic region to other private equity markets the
firms interviewed imply that the market has managed the financial crisis good and historically provided good returns. CapMan see the small market size as one of the keys to the Nordic countries success. Segulah believe that the success lie in how they operate and handle their portfolios, nevertheless their focus on adding value instead of the financial aspects. Naccess Partners agree upon the importance of the general partners and further indicate four historical factors that have had a successful impact on the Swedish market: international culture and decentralised operations, good educational level, modern bank system and an early acceptance for the industry.

The private equity industry should be known for a fairly low return volatility and this indicates good risk and return attributes (Emery, 2003). According to the private equity firms interviewed the main investor incitement is a return higher than the stock market. Both Ap-fund 7 and Skandia Liv strengthen this incitement further as they see it as an opportunity to receive a higher return than the public market for their investors. AP-fund 7 further state that it is their belief that they can receive at least five per cent higher annual return than the stock markets return.

There has been an on-going debate about the returns made by private equity firms and its capability to outperform other asset classes. However, Bain and Company (2011) has in a modified-IRR calculation method found supporting figures where on average, in a five-year period, private equity buyouts have outperformed public equity. AP-fund 7 is very positive to the buyout industry but explains that not all buyout funds provide sufficient high yields, although they have found a satisfying combination of funds that provide a higher return than the stock market yields over time. Skandia Liv is also very positive towards private equity with the belief that it has a good and efficient ownership model.

5.5.2 Investing in a private equity fund

By investing in a private equity fund the investor assign the labour-intensive responsibility of selecting, structuring, managing and liquidating private equity investments to the general partners (Prowse, 1998). The competence required to make successful investments is high. There are four common catalysts described by Segulah where initiatives to buyouts are given: in-house ideas, financial advisors, walk-ins and investment banks. Even though the amount of ideas provided by investment banks exceeds the remaining, it is the in-house ideas that are most frequently bought and become successful.

The process of adding value to the business requires resources and expertise in the area. The competence level of Segulah’s management team is of great value and consists of 35 advisors with a network of competence in most industries. Also CapMan have a large team of 23 people. Alter Equity Partners further describe that its team consists of members from all the Nordic countries with international experience in areas within private equity, investment banking, consulting and in different industrial sectors. It is the authors’ belief that the experience and ambitions of the general partners create the foundation of the industry.
5.6 Limited Partnerships

The study enfolds that it is common for private equity firms to implement limited partnership agreements. Limited partnerships allow the general partner to act as deals become aware to them, yet put certain frames that the general partner can act within. (Axelson et al., 2007) Gagliano and Olsen’s (2003) four standard requirements in a limited partnership being minimum commitment, investment period, term and diversification are apparent in the Swedish private equity industry.

5.6.1 Life Span

The life span of a fund is typically set to ten years with a possibility to extend the fund one to two years further (Prowse, 1998). This is apparent in all the objects interviewed and in Segulah it is rare to extend a fund beyond its lifetime as it is viewed as disciplinary to sell their buyouts in the portfolio as planned.

Theory describes an investment period of five years and a management period of five years where the portfolio companies are exited. The first half is by Gagliano and Olsen (2003), referred to as a commitment period and during this time the capital is invested. The remaining period is retained for managing existing investments made during the previous period and in the end the investments are liquidated.

The authors claim that the life span is differently phased than described earlier by theory. In the establishment of a new fund, capital will not directly be supplied into the fund, but rather through time and contributed when there is a need in the fund for new investments in companies (Nyman, 2002). Segulah explain that two or three investments are made each year in the investment period. Thus during the five years, investments are initiated each year and thus have different phases. The investment period still takes place during the first five years, yet the management and exiting period differs. The exiting period take place the following five years; however there is no set management period as each investment is managed from the point it is bought to its exit. In other words, the firms tend to exit the investments first introduced to the portfolio first, giving the typical buyout a lifetime of five years. The authors’ have thus adapted the original view of the life span in figure 7.

![Figure 7 The author's interpretation of a buyout fund's life span](image-url)
5.7 Diversification

Diversification covenant restrictions can decrease risk (Prowse, 1998). The most common risk experienced by the firms interviewed was the general economical risk. Nyman (2002) describe four ways of diversifying: by business industry, size of investment, investment phase and geographical focus. Altor Equity Partners diversifies through business industry by investing in different sectors and by types of transactions. In the firms interviewed the size of investments has a set restriction to what can be invested in a single firm. Segulah has today a restriction of 15 to 20 per cent that can be invested in a single object yet with the objective of 10 per cent. Implicit this depends upon the size of the fund, which often is smaller in Sweden compared to larger economies. Both Altor Equity Partners and Segulah diversify through investment phases. There is often a covenant on the geographical segmentation, yet the restriction is also a possibility to diversify. This is in CapMan made through investing in different Nordic countries. It is possible to discern that the four diversification measures stated by Nyman (2002) are of value to the firms interviewed.

Modern portfolio theory as described by Markowitz (1991) and Blume (1970) use diversification to optimise portfolio in regards to risk and expected returns. Segulah however state that the diversification in their fund not coincide with what is endorsed in the portfolio theory. Segulah view themselves as a controlling firm that do not analyse buyouts in regards to diversification, in their belief that a base of 150 possible investments decrease the risk of selecting similar investments inevitably.

Private equity is known for a low return correlation with other asset classes, which implies attractive portfolio diversification benefits (Emery, 2003). The investors in private equity have large capital bases and invest in several asset classes. As an investor Ap-fund 7 has a total of 7,5 per cent of private equity in their portfolio, including 5,5 per cent in buyout. Skandia Liv has an allocation of eight per cent of the balance sheet. Naccess Partners further describe the limitation of the amount allowed to invest in a single fund manager as diversification. Thus, diversification of the limited partner is made through investing in different asset classes, yet also through investing in different general partners. In other words, the diversification and optimisation of a portfolio is in the hands of the limited partner rather than in the general partner.

5.8 Valuable attributes in an investor

The information gained from the interviews indicates that a long-term perspective on the investments is the most essential feature a private equity firm search for in an investor. It can save the firm time and resources as an investor with a long-term perspective can consider investing in future funds. Also these investors may have a liquidity base that in addition of supporting present also support future investments. AP-fund 7 usually increases their investment commitments every year as they attempt to maintain the desired portion of capital invested in private equity. These investment commitments are most often made in firms already present in their portfolio, if it has good figures and no other
major changes have occurred. However, they can refrain from investing in a fund even though it has good future outlooks as they strive to have the right mix of underlying strategies and geographical distribution in the buyout segment.

Prowse (1998) has in earlier research stated that the long-term horizon current in private equity not is compatible with the stock analysts and public investors’ short-term investment nature. Private equity investments are illiquid for almost ten years and it is thus of further importance that the investor value the long-term operating perspective of the firm.

5.9 Private Equity firm versus Fund-of-fund

According to Naccess Partners it is difficult for individuals with limited capital to invest in a buyout fund without an intermediary, mainly as it would lack diversification and involve larger risk. Fund-of-funds makes the private equity industry available for a larger audience. Consequently, the investors present in fund-of-funds differs from those investing in the private equity funds.

AP-fund 7 explains that the investment process used to identify the mix of funds that have the right conditions is comprehensive. However, by investing in a fund-of-fund the investors do not need the required competence, since the fund-of-fund manager has the necessary expertise and experience. On the down side it requires an additional administration cost for the investor. Naccess Partners further explains one disadvantage; the capital committed in NAXS is not available for the investors during five years since NAXS has the cash waiting for the buyouts to be made.

The private equity firms interviewed experience the investors as professional with knowledge and are satisfied with their investors. Contrary, the fund of fund firm experience that many investors are inexperienced and not possess knowledge about the private equity industry. It is possible to assume that fund-of-fund investors can possess less knowledge as they consist of more private investors, whilst funds have more institutionalised investors. Even though investors in fund-of-funds may be provided with information the authors believe that there is a possibility that they do not comprehend it, which indicates that asymmetry of information can be more visible between fund-of-funds and its investors.

5.10 Limited- and General Partners’ Incentives

External costs related to the investments of the private equity firm will generally be a cost for the fund and the firm, which is visible as a management fee (Nyman, 2002). In addition to the management fee the general partner receive carried interest of the profit, as compensation for managing the fund (Sahlman, 1990). Segulah believes that it is of importance that the key people in the firm are compensated enough for their expertise and thus earn a good return. However, as the return becomes a cost for the limited partner charging excessive management fees can make investors retain from investing. Ap-fund 7
view prices as an important factor and when evaluating two similar funds the one with the most attractive pricing is chosen. Nevertheless, Segulah mean that the limited partners have an understanding for the compensation structure as the general partner could turn elsewhere if not compensated sufficiently for its work. It act as an incentive to get the general partners more invested and engaged in activities that can increase the value of carried interest, which in turn benefits the limited partners (Sahlman, 1990).

The limited partner has to actively be aware of how the general partner safeguards its interest, as the general partner can support it’s own interest at the expenses of the limited partner. This through spending too little effort of monitoring and advising portfolio firms, charging excessive management fees, taking undue investments risks and reserving the most attractive investment opportunities for themselves. The authors however believe that with the earlier findings concerning the importance of long-term investors, it is unlikely that the general partners would disregard the limited partners interests. This since trust and understanding according to CapMan is an important feature in a relationship. The authors do not find any occurrence of moral hazard in the firms interviewed.

When an investor invests in a buyout fund it is an active choice. Segulah mean that it is the investor that actively select the firm and team, thus agrees to the limited partnership agreement. CapMan further argue that an investor before investing endorses the power wanted into the partnership. The agreements are detailed and Segulah claim that it is inherent in the agreement that the general partner directs the fund. However, if the limited partner is dissatisfied with the general partner there exist possibilities to act. These possibilities differ among the firms, yet in general enclose that if the manager has mismanaged the fund there is a possibility to change the general partner. This happens in Europe at rare occasions and the threshold is set high. In Altor Equity Partners’ agreement the investor is not able to influence as long as the firm operates within the law and regulations.

The general partner has responsibility towards the limited partner to make value-increasing investments. Skandia Liv is positive towards limited partnerships and believes that the limited partner’s position is strengthened by the limited partnership agreement. On the other hand, Ap-fund 7 mean that it is difficult to generalise among limited partnerships as it differs from case to case. There is typically a negotiation with the general partners and if there are some aspects that cannot be agreed upon Ap-fund 7 refrains from investing in that particular manager.

5.11  The Informed Limited Partner

Most often an agent has the information advantage, which can create an asymmetry of information between the two partners. This can cause complication as the general partner can act in disadvantage of the limited partner to get individual gain. Furthermore, external financing is in accordance with the theory of finance more costly than internal financing as asymmetry of information can occur and the investors need to be informed (Ross, 1973).
In this study it is possible to discern the resemblance among CapMan, Segulah and Altor Equity Partners to seek long-term relationships with their investors, which should decrease the asymmetry of information. The firms interviewed believe that their investors are well informed. Their investors are provided with information alongside the investments and regular meetings are held when desired. It is common for private equity firms to have advisory boards where the largest investors, if interested, meet more regularly. According to Nyman (2002) this can work as a network to the different business sectors as advice in investments can be given.

Adverse selection can become adherent when a new investor who do not possess information of risks and the future of the firm invests in private equity. The firm will as a matter of course emphasise the positive attributes of the fund and to decrease the possibility of adverse selection it is of importance for the investors to look beyond the presentation given by the firm. Further, the investor meet with the managers of a buyout fund when interested which CapMan imply contributes with more informed investors.

Naccess Partners have a stable communication with its general partners where communication is held at least once a month. In addition, the firm receive information and material regularly to follow the progress, hence do not lack any certain information. Skandia Liv is confident that they have the information desired and believe the general partner is keen that they are satisfied with the information received as they invest large sums. Unlike the two investors mentioned, Ap-fund 7 feels both informed and uninformed. All the information requested is most often received yet own research will always make an important component. The information attained through the research contains everything from information of earlier buyouts to information about the managers. They imply that it is about assessing people and try to ensure that the investment process described is credible. This often requires a range of follow-up questions and own basis of judgement.

### 5.12 Fundraising in the future

In the past years the interest for the Swedish private equity industry has increased, especially from abroad since the private equity market in Sweden are outperforming other private equity markets in Europe. The firms interviewed indicate that the Swedish market is not yet mature, yet Segulah ask the question – how long can it go on? Due to the fact that the market has grown in private equity in Sweden CapMan consider the future fundraising critical. CapMan explains that the market has grown rapidly and the supply of capital for funds has been soaring. Naccess Partners further explains that if the market increases and get more mature the returns will decrease and unprofessional firms can be established in the future. Meanwhile, Altor Equity Partners and Segulah do not express any certain scepticism towards the future of fundraising.

Global general and limited partners interviewed by Bain and Company (2011) express concerns whether the high prices required paying for buyouts reap corresponding returns.
The industry had a hit-back during the financial crisis yet the firms interviewed have not changed their operations or strategies significantly since their objectives always been to invest with carefulness and discipline. Although, as a natural reaction, more careful analysis has been implemented by them.

From an investor's perspective Naccess Partners still have their interest in conservative teams who do not take on extensive risks. Further, as investors, Ap-fund 7 and Skandia Liv remain positive towards private equity as an asset class. In going forward CapMan see global investors as a key factor to evidently raise more capital.

It is of importance to take into consideration that private equity funds have a lifetime of 10 years where the first five years are the investment period. One of the reasons to general partners ability to raise funds in Sweden may have been the fact that Swedish firms had past their time of capital requirements and already had agreements with limited partners set up during the crisis. Thus, many private equity firms in Sweden will in the near future raise new funds.

5.13 The EU Directives future impact

Interim valuation is by limited partners viewed with scepticism and according to Bain and Company (2011) limited partners are concerned about the lack of transparency in the ability to view track records of general partners. The AIFM directive that will be implemented in Europe in the near future is according to CapMan coming from the need of additional transparency in the private equity industry. Segulah however mean that the Nordic region has a good reputation because of the already current transparency. CapMan’s view become somehow subjective as the firm is listed on the Helsinki Stock Exchange that obliges the firm to be open to all investors. Furthermore, it is the authors’ belief that the new EU directive is a consequence of the fact that one of the more common investors in private equity are pension funds.

SVCA (2011) is positive to a regulation of private equity on a EU level, although is concerned by the current directive as it disregards the differences among alternative investment funds. The EU directive will require a change in how the firms operate, which according to SVCA (2011) can be unbeneficial in fundraising to several aspects. One of the main criticised points of effect for fundraising is the new regulation concerning managers outside the EU. SVCA (2011) believe that the consequences from this particular legislation will depress private equity firms operating across boarders in their fundraising and investment operation. Several Swedish funds are based abroad in Jersey and Guernsery to avoid double taxation and allow for a more suiting legal structure, which is the case in Altor Equity Partners were their three funds are located in Jersey. Further there will be a change in the regulation regarding the independent valuation where it according to SVCA (2011) will result in large costs for the private equity investors. The directive will also involve a change in the independent valuation that according to SVCA (2011) in the end will result in large costs for the private equity investors.
6 Conclusion

The authors will in this section read upon the conclusion that have evolved from the analysis. Reflections will be made based on the findings and its validity. Lastly, the authors will make remarks of how further studies can contribute to the research subject.

The purpose of this thesis is to read upon the fundraising process implemented by private equity firms, nevertheless the relationship that emerges between the fund manager and the investor. The authors’ objective is to provide an adequate interpretation of the private equity industry in Sweden. The problem statement reads as follow:

**How do private equity firms certify capital to buyout transactions?**

Whilst the study evolved, it became evident that there is no specific model used for fundraising in Sweden. The sub questions however assisted in creating an understanding of the attributes concerned in fundraising. The findings are presented below.

Buyout investments made by private equity firms have the main purpose of optimising generated returns on capital invested. The investment process requires certain knowledge and is preferably done through direct investments. Thus, it is key to the limited partners that the general partner is experienced, ambitious and successful in selecting and managing buyouts. Typically, thorough due diligence processes are implemented and to recognise a successful buyout where active ownership can be implemented the following features are of value: management culture, development opportunity, market position, profitable business, and exit opportunities.

Limited partnership is standard in Swedish private equity firms. The life span is typically 10 years and in theory divided into to two phases; the investment period, and the management and exit period. The authors find the generalisation made biased since the study enfolds that different buyout processes are initiated each year in the investment period. Thus, the management period overlap both the investment period and the management and exit period. The diversification and optimisation of a portfolio is mainly in the hands of the limited partner. A limited partner can diversify its investments by commitment in different asset classes and different general partners. Still, it is possible for the general partner to diversify the fund and the findings of the thesis coincide with Nyman’s (2002) four diversification measures: business industry, size of investment, investment phase and geographical focus.

The authors find it unlikely that moral hazard problems occur in Sweden. The incentive structure is well built and limited partners have a genuine understanding to it. It is not possible for the authors to remark on the level of asymmetry of information. Investors typically meet with the buyout team and perform thorough due diligence processes to create an objective view, which should decrease the possibility for adverse selection. The findings prevail a disagreement in the debate of the level of transparency in the private
equity firms. Listed private equity firms are more transparent, yet the EU directive will bring more transparency to the market in the future.

When establishing a new fund there exists two opportunities of raising capital: extend or/and create new partnerships. The findings denote that it is the expertise of the general partner and how it manages the fund that is critical in fundraising. The attributes of value in fundraising is in accordance with the findings: reputation, history, team and experience of the general partner. The most common investors in private equity funds are pension funds, universities, charity funds, fund-of-funds and insurance companies. The investors are mainly from foreign countries. It is evident that the primary investor incitement is a return that is higher than the stock market.

The authors of the thesis have based upon the discussion conceptualised the findings in figure 8. The figure illustrates the current view of private equity and the parties involved.

![Diagram](image)

- Long Term
- Loyal
- Professional
- Capital Base
- Competent Team
- Reputation
- Past Performance
- Track Record
- Returns
- Management Culture
- Development
- Opportunity
- Market Position
- Profitable Business
- Exit Opportunities

Figure 8 The authors’ conceptualisation of the Private Equity firms’ fundraising

When institutional investors commit in a private equity fund instead of directly investing in a buyout they transfer the labour-intensive responsibly of selecting, structuring, managing and liquidating private equity investments to the general partners. Thus, the return
becomes higher as they do not need as much capital, experience, knowledge and time. In addition, the diversification becomes greater as the limited partner optimise its portfolio by diversifying its capital among different asset classes and general partners all over the world. In other words, the diversification is mainly in the hands of the limited partner beyond this frame.

Not all investors are invited to invest as the private equity firm has certain attributes valued in investors, professionalism, long-term perspective, loyalty and strong capital base. To attract investors the private equity firm must be successful in buying mature companies. In other words, experienced and ambitious general partners make successful buyouts, which appeal to investors. Thus, the process becomes unified.

6.1 Ending reflections

The authors believe that it is important to reflect on the process of the thesis and perform a critical study of the findings. This will declare the validity of the thesis. The empirical findings have been gathered from sources that the authors believed were accurate for the study. The findings thus reflect upon the perspective of three private equity firms, one fund-of-fund firm and two institutional investors. It is possible that the findings in the thesis not reflect the real world.

An aspect that could have affected the findings’ validity and reliability negatively is the frequent use of Nyman (2002) as a source, which is not up to date. This source is however frequently used in several studies of private equity and buyout, which should confirm its reliability.

Lastly, there is a possibility that the authors have affected the interview answers differently depending on the follow up questions that have been asked. In addition, some questions may have been guided towards certain answers. On the other hand, by meeting with the interviewee face to face it has been possible to get more thorough answers and capture the essence of the industry.

6.2 Further Studies

Swedish private equity firms are becoming increasingly popular, yet still buyout funds are a relatively unexplored area. Fundraising is a topic up to date and with the new EU directive the industry will be reformed. It would be of interest to perform a comprehensive research of the EU directive’s impact on the industry when implemented. The authors have in this study originated from the private equity firms perspective along with small elements from institutional investors in Sweden. Thus, the entire perspective of the investors would be required to get a more adequate view of the subject. Tentatively, this could involve foreign investors as the thesis suggests they constitute the majority of investors. Furthermore, it would be of interest to examine the correlation among the attributes valued in a private equity firm and the firms’ capability to raise capital.
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European Venture Capital Association (EVCA): www.evca.com (29.01.2011 - 15.05.2011)

Legislation


Interviews


Jansson M. Board member of Segulah Advisor AB, InfoCare, Almondy and Gunnebo Industrier. Interviewed by: Riahi L., Wilson A. Segulah, Stockholm. 30 Mars 2011


Appendix

Appendix 1 – Interview Questions in Swedish

Intervju Frågor

1. Vilka är de underliggande faktorerna bakom ett buyout

2. Vilka kriterier värdesätter ni i en potentiell buyout kandidat?

3. Är det något specifikt som genomsyrar en lyckad buyout?

4. Hur ser investeringsprocessen ut från identifieringen av investeringsobjekt till anskaffande av kapital hos er?

5. Vilka strategier använder ni er av när ni söker investerare?

6. Eftersom Private Equity firmor inte kan diversifiera sin risk på samma sätt som en vanlig aktieportfölj, hur försöker ni minimera risken och vilka risker är ni exponerade emot?

7. Vilka kriterier värdesätter ni och riktar ni er åt någon särskild typ av investerare?

8. Skiljer sig er strategi från andra konkurrenter på den svenska buyout marknaden?

9. Vilka är de vanligaste investerarna i era objekt?

10. Vad tror ni är investerarnas incitament när de går in med kapital i era fonder?

11. Har era strategier förändrats sedan krisen 2007-2009? Om Ja på vilka sätt?
Appendix 2 – Interview Questions in English

The Interview Questions in English

1. What are the main motives behind a buyout?

2. What criteria do you value in a potential buyout candidate?

3. Is there anything specific that pervades a successful buyout?

4. How do you describe your buyout process, from the identification of an investment object to the fundraising?

5. What fundraising strategies are used when searching for new investors?

6. Compared to investor portfolios, Private Equity firms do not have the same ability to diversify its risk. With this in mind how do you minimise risk and what risks are you exposed to?

7. What criteria do you value in an investor and do you target towards a specific type of investor?

8. How do your strategy differentiate from other competitors in the Swedish buyout market?

9. What types of investors are common in your objects?

10. What incitements do you believe that the investors possess when entering your funds with capital?

11. In what aspects have your fundraising strategies changed since the financial crisis in 2007-2009?
Appendix

Appendix 3 – the Questionnaire

Hur tillförsäkrar sig Private Equity bolagen kapital till sina Buyouts?

Det här formuläret har blivit till för att tillföra information till ett projekt om hur Private Equity firmor tillförsäkrar sig kapital. Projektet syftar till att huvudsakligen besvara frågor i de tre följande områdena:

● Vilka incitament investerare har i Private Equity bolags buyout fonder?
● Vilka motiv som ligger bakom ett buyout?
● Vilka kriterier som svenska private Equity bolag tittar på i deras potentiella investerare?

Vi är ytterligt tacksamma ifall Ni har möjligheten att ta er tiden att besvara frågorna i detta frågeformulär.

Tack På Förhand.

Vänliga Hälsningar,

Linda Riahi &
Amelie Wilson,

Studenter på Internationella Handelshögskolan i Jönköping
1. Markera med ett X på skalan nedan hur Ni ser på Private Equity marknaden och buyouts, där 1 menar att ni ser negativt till detta och 5 positivt?

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<td>Negativ</td>
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<td>Positiv</td>
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Kan ni specificera Ert svar ytterligare?

2. Markera med ett X på skalan nedan hur Ni ser på limited partnership avtal, där 1 menar att ni ser negativt till detta och 5 positivt?

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<td>Negativ</td>
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Kan ni specificera Ert svar ytterligare?

3. Hur stor del av er portfölj investerar ni i Buyout fonder?

4. Vilka incitament besitter Ni som en Investerare när Ni investerar i en Buyout fond?
Appendix

5. Har ni tillgång till all den information ni söker angående Private Equity firmornas investeringar av er general partner?

Ja:
Nej:

Om ”Nej” Kan ni specificera Ert svar ytterligare?

6. Vad sker vanligen när en buyout fond Ni investerat i avslutas? Investerar ni i en ny buyout fond inom samma firma, Investerar ni i en buyout fond i en annan Private Equity Firma, Avvaktar ni något år eller väljer ni att avstå från att investera? Alternativt något annat?