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Perstorp's Transition from Conglomerate to Focused Chemicals Firm

- A three factor model for explaining corporate change

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Abstract

- Title: Perstorp's Transition from Conglomerate to Focused Chemicals Firm
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- Key words: Exit and Voice, Capital market, Ownership structure, Industry and Perstorp
- Thesis Objective: *To construct a theoretical framework describing how the development of firms is affected by the capital market, the owners and the industry.*
- Methodology: Case study
- Conclusions: Many models explain the development of firms focusing on the firms' resources and the industry that surrounds them, and do not explicitly incorporate the role of the capital market and the owners. A need for a theoretical framework that includes all three aspects was therefore identified. The framework was constructed and tested against an empirical material comprising of the development of Perstorp during the second half of the 1990s. The analysis found that the theoretical framework had a high explanatory power concerning the events in Perstorp. The analysis also contributed to a revision of the framework increasing its explanatory power. It was also concluded that the framework might add to the understanding of other firms' development. The value of the framework would however benefit greatly from a test on a larger population of firms. The result of the study points at the importance for the society that the capital markets are efficient.

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Presented in alphabetical order:

Mr. Fredrik Arp
Mr. Åke Fredriksson
Mr. Christer Gardell
Mr. Tommy Hultman and Mr. Göran Odmalm
Mr. Karl-Erik Sahlberg
Dr. Bo Ursing
Mr. Gösta Wiking

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1. Introduction

1.1 Changes in the capital market, ownership structure and industry

During the past two decades there have been major advances in the markets for corporate control, and during 1999 the amount of worldwide mergers and acquisitions reached an all time high. One type of firm that has attracted a great deal of attention lately is private equity firms, specialising in the acquisition of mismanaged, or underdeveloped corporations. Their primary purpose is to buyout supposedly mismanaged firms, take an active ownership role and enhance the value of the firms through organisational restructuring and other strategic decisions. When the restructuring and other changes are implemented, and the valuation of the firm is satisfactory, the private equity firm makes an exit by listing the firm on the stock market. Though the private equity phenomenon often has been criticised for not improving the value of the firms, rather merely redistributing value, it remains an important regulating force on the financial markets.

During that same time period there have been developments in information technology, and an ever-increasing stream of other technological innovations. There is almost no industry that has been unaffected by these changes, and instead there has been an increasing trend for globalisation and consolidation. This consolidation trend has affected both ends of the value-chain and both customers and suppliers have become larger.

The last few decades have also seen a fundamental shift in the ownership structure of firms in regards to institutional investors replacing the individual households that earlier constituted a relatively larger group of owners.¹ The main reason for this development can be found in the popularisation of equity, that is, a large amount of individuals have become shareholders through mutual funds and retirement plans. Consequently, the number of institutions acting as capital managers has increased. When defining institutions it should be stated that even though all legal persons could be argued to be institutions, it is entities where the holdings do not constitute any part of their direct operations that is primarily regarded. For example, Ericsson in relation to its holding in SonyEricsson is not considered an institutional owner. Since the institutions represent a large amount of individuals, they tend to assume that the individuals unifying common denominator regarding their ownership objective is shareholder value maximisation. When defining owners in relation to the capital market it should be pointed out that the capital market is ultimately comprised out of the potential future owners as well as the current owners. It could further be argued that the owners and the ownership

¹ Hedlund G., Hägg I., Hörnell E., Rydén B., *Institutioner som aktieägare? förvaltare? Industrialister? Klippare?*, 1985, SNS, Stockholm

process include aspects that are not directly associated with the capital market and vice versa. These aspects could for example be the owners' individual objectives and capabilities as well as the capital market's normative preferences, and therefore a separation of the owners and the capital market is warranted. To conclude, the capital market can be seen as the owners' context.

There seems to be a more general turbulence in the ownership structure of many widely held corporations, and the SAX average share turnover rate has increased from 7 % in 1990 to 123 % in 2001.² These figures imply that the time the average shareholder holds onto his shares has declined from approximately 14 years to 9.6 months during the last eleven years. But there are also firms where the owners to a greater degree, tend to hang onto their equity holdings even though the expected future returns seems unsatisfying³.

One firm that has experienced all the above-mentioned developments is Perstorp AB. Mr. Wilhelm Wendt laid the foundation for Perstorp in 1881. Perstorp developed and expanded its businesses during the century to come whilst the whole time controlled by an ever-increasing number of Wendt family members. In the 1970s the firm started to follow a niche-strategy, focusing on profitable segments rather than bulk volume, something that was considered necessary for the relatively small firm's ability to compete effectively. There was also a demand from the owner family that the firm should diversify to minimise cash flow variations caused by business cycles and the risk for the family. The diversification strategy led the firm to develop a somewhat disparate organisational structure that could be described as a conglomerate.

Somewhere around the middle of the 1990s Perstorp's second largest owner, Custos AB drastically changed its ownership strategy, something that would affect Perstorp to a great extent. Custos became a more active owner, demanding board representation, and the emphasis on shareholder value increased.

At the same time a disagreement within the family started to be visible, grouping the family into two factions by the business press popularly called "traditionalists" and "modernists". The developments in Perstorp culminated in the summer of 2001 when Industri Kapital, a Swedish private equity firm, acquired Perstorp. The buyout attracted a lot of attention in the business press mostly due to the conditions that surrounded a previously made offer, which was abruptly withdrawn causing the Perstorp stock to plummet.

² Brodin, B, Lundkvist, L, Sjöstrand, S-E, Östman, L, "Koncernchefen och ägarna", Elanders Gotab, 2000

³ Hedlund G., Hägg I., Hörnell E., Rydén B., *Institutioner som aktieägare? förvaltare? Industrialister? Klippare?*, 1985, SNS, Stockholm

1.2 Problem overview

It seems like there have been major forces affecting Perstorp's recent development, namely changes in the capital market, the ownership structure and the industry.

There have been a lot of studies trying to explain the development of firms, as well as the construction of an extensive amount of theoretical models and literature. On a more philosophical level, it could however be argued that the models that have been constructed so far cannot fully explain the causes of the development. There are simply too many variables to consider and it is virtually impossible to give a complete explanation and consequently it could be argued that none of these models capture all relevant aspects. This implies that every bit of new information and knowledge is valuable since the research field is never to be fully understood.

Grant (1995) for example, presents one such model describing the creation of strategy in firms. This model is comprised of internal (firm specific) factors such as: goals, resources and organisational structure, and external (industry) factors such as: suppliers, customers and competitors. The task of business strategy is to determine how the firm should deploy its resources within its environment and consequently satisfying its long-term goals, and how the firm should be organised to implement that strategy.

The previous model explaining the development of firms, focuses primarily on industry and resources, and do not incorporate the capital market, something that seem specifically important since the capital market has evolved so extensively during the last decades. The model also takes little consideration to the people that actually own the firm. The owners could however be argued to be represented in the firm's goals and values, but that seems to be a somewhat simplistic description that does not consider different ownership objectives. Rather, the owners are treated like a homogenous group exerting similar ownership objectives. It could however be reasoned that the owners' of a firm represent different individual objectives depending on various factors, and therefore should be treated as a heterogeneous group.

As mentioned above, the traditional models, such as Grant (1995), do not explicitly turn much attention towards the capital market. Since the capital market could be reasoned to influence both the owners' objectives as well as the firm's strategy, it seems like these models do not consider a dimension with good potential for explaining the development of firms.

Both the owners and the capital market have undergone major developments during the last decades. It further establishes the need for models that describes the development of firms with a primary focus on these forces.

In describing the recent development in Perstorp the previous models, such as Grant (1995), do not seem applicable since they do not consider the capital market, and at the same time Perstorp's ownership structure is far more complex than captured in the above-mentioned models. Instead of focusing mainly on the traditional forces of industry and resources more understanding could be gained by focusing on the owners and their individual objectives.

Since the capital market and the owners seem to be able to explain aspects of the development of firms that are commonly overlooked when utilising traditional models, a construction of a model comprising these dimensions is justified. It should however be pointed out that a model incorporating the owners and capital market will not necessarily be able to explain more concerning the firms' development than the previous models. The angle of attack would however be different; hopefully capturing information that otherwise would not be visible and increase our knowledge.

The creation of a model comprised of the above-mentioned dimensions can further be motivated by the capital market's increased importance in our society, suggesting that its impact on the development of firms is important to examine further. There is for example a growing disgruntlement towards the capital market's focus on short-term financial returns, implying that the capital market influence the firms to pay more attention towards short-term returns, which could further lead to under-investments. From a social perspective it is also important that the firms' ownership structure are favourable to society's economical development as a whole, further implying that objectives other than shareholder value could be needed and influenced by the ownership structure. That is, an ownership structure emphasising primarily shareholder value could lead to an increasing number of firms being sold of to foreign owners, thus potentially affecting other domestic stakeholders negatively.

1.3 Thesis Objective

To construct a theoretical framework describing how the development of firms is affected by the capital market, the owners and the industry.

1.4 Disposition

Figure 1.1 below, is intended to give the reader an overview of the disposition of the thesis, where the numbers in the boxes are corresponding to the different chapters and sections.

Chapter 1. Presents the introduction, the problem formulation, the thesis objective and this disposition.

Chapter 2. Presents the course of action in the creation of the thesis.

Chapter 3. Presents the theoretical characteristics of the three dimensions: the capital market, the owners and the industry, and is concluded by the construction of a model.

Chapter 4. Presents the case: “Perstorp’s transition from conglomerate to focused chemicals firm”.

Chapter 5. Presents the analysis structured along the three dimensions: the capital market, the owners and the industry. The chapter is concluded by the creation of models describing the findings.

Chapter 6. Presents the conclusions of the analysis, as well as implications, possibility for generalisations and suggestions for future research

Chapter 7. Presents the references.

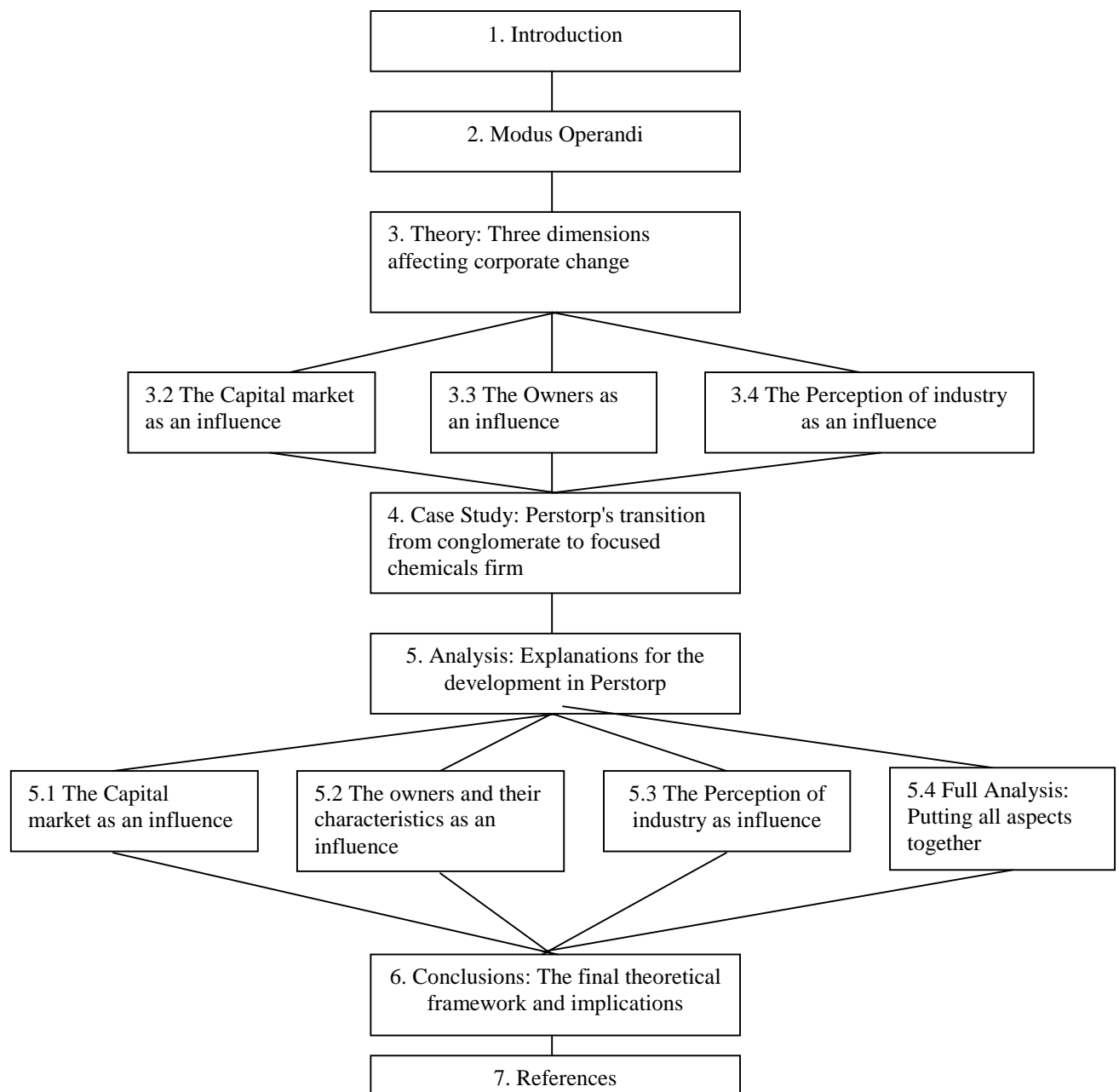


Figure 1.1: “Disposition”

2. Modus operandi

The following chapter describes how the thesis was constructed and which kind of methodological choices that was made. First is a discussion about the construction of the theoretical framework presented, and thereafter follows a discussion about case studies in general but also about the case study specific to this thesis. Finally the working order and the weaknesses of the thesis are presented.

2.1 Theoretical framework

As outlined in the thesis objective the purpose behind this thesis was to construct a theoretical framework describing how the capital market, the owner and the industry, affects the development of firms. It should also be stated that the authors define “theoretical framework” in the same sense as a model, further implying that terms will not only be discussed and explained but also related to each other. To further develop and revise the framework a case study was constructed where the theoretical framework was applied on the case.

Both the surrounding world as well as an organisation is too complex to be observed in all its nuances at a specific time. To be able to create a sufficient description of reality, the real world and its complexity has to be simplified in an efficient way. These simplified images of reality could be referred to as models or following the above-mentioned definition, theoretical frameworks. In the process of creating a model, it is important to decide which factors to omit and which factors to maintain. It should however be stated that the explanatory power of a model do not increase in relation to how realistic the model is. Rather, it is the how appropriate the simplifications are and how user-friendly the model is that constitutes if the model is suitable for its intended use.⁴

By integrating the three above-mentioned dimensions into a theoretical framework, it is argued that the framework will have a higher explanatory power than it would have if it only focused on one dimension. It could further be claimed that a model only focusing on one of the dimension that seem to affect a firm’s development could exert a tendency towards explaining too many changes using only that one dimension. For example, trying to explain the development of firms using only the owner dimension could lead to changes primarily connected to the capital market’s preferences being attributed to the owners and vice versa. By creating a model that takes the owners, the capital market and the industry into consideration, it could be reasoned that a more balanced explanation can be reached. A model

⁴ Eriksson, L T, Wiedersheim-Paul, F., “Att utreda, forska och rapportera”, 2001, Lagerblads tryckeri AB, Karlshamn.

incorporating the owners, the capital market and the industry could therefore be said to have a higher explanatory power than a model focusing only on one dimension.

2.1.1 Gathering of data concerning the theoretical framework

The theoretical framework was constructed out of input from both primary sources in the form of interviews associated to the case study, and secondary sources in the form of literature, research articles and business press. The primary sources will further be discussed in the section about the case study, but some comments about the secondary sources follow below.

When constructing the theoretical framework Hedlund & Hägg (1985) was found to be valuable due to their in-depth description of ownership behaviour and their use of the terms exit and voice in relation to that behaviour. Brodin & Lundkvist (2000) was also found to be valuable due to their down to earth description of the capital market's recent development, as well as their thoughts about the owners increasing influence on firms. Copeland & Koller (2000) gave further insight in the valuation process as well as the capital markets' development. Porter (1980) provided valuable information concerning industry and the different forces that interact within the industry, and Grant (1995) provided information about competitive advantages and their relation to the resources of the firm.

The articles were primarily found by using the ELIN@Lund search-engine and the business press articles through Affärsdata's search-engine, and some of the press releases were found on the homepages of different firms. Since a lot of information was found using AffärsData it could be argued that a journalist had already processed the information, and that could in turn be considered a weakness. When considering the alternatives, and that a lot of information was found in separate articles written by different journalists, that does not present any significant problem.

2.2 Case Study

A case study can be said to focus on a restricted system, and is consequently a study of a specific phenomenon such as a person, an institution or an occurrence. It could further be argued that a case study is a continuous process striving to describe and analyse a certain entity in qualitative, complex and holistic terms over a restricted time-period. When combining the above-mentioned characteristics a case study can be argued to comprise out of four fundamental concepts. The study of a **particular** phenomenon, and the final product is **descriptive** containing as many inter-relating variables as possible. The case study is **heuristic** and could enhance the readers understanding of the occurrence that is being studied.

Finally, a case study is primarily based around **inductive** arguments where concepts and hypotheses are created out of the information the authors have access to which in turn enhances the information content even more.

A case study is, by its very nature, used to gain significant knowledge concerning a specific situation, and not when the objective is to examine something that holds true for a general population. This argument implies that the generalisation value of a case study is low, but could on the other hand be increased if other cases concerning the specific situation (multiple case analyses) are used as a foundation. It could further be argued that a case study makes **naturalistic generalisation** possible, where profound knowledge about the specific case makes it possible to identify similarities and linkages in new situations. The possibility to generalise can also be left out to the final reader, who have to use his own judgment in deciding what aspects of the case fits his situation.⁵

2.2.1 Perstorp as a case study

As argued in the introductory chapter the last couple of decades has seen a great deal of different developments both concerning the capital market, the ownership structure of firms and the industry. In constructing a theoretical framework describing how these dimensions affect the development of firms it is important to apply the framework on a specific firm, thus improving and revising the framework to better reflect the dimensions' actual influence.

A firm that has seen a great deal of the above-mentioned developments is Perstorp. Perstorp had experienced a great deal of turbulence regarding the ownership structure during the late 1990s and early 2000s and received a lot of attention in the business press pertaining to the bids placed on the firm by Industri Kapital (Sweden's largest private equity firm). Despite all the recent turbulence the authors reasoned that the time was ready for shedding some light on; *what was it that really happened with Perstorp?*

The purpose of the case study is to describe the recent developments in Perstorp, focusing on the capital market, the owners and the industry. The intention has been to create an intriguing case for the reader, but also to provide enough information for uses surpassing the purpose outlined above. The ambition has consequently been to create a case that could be used in understanding aspects other than ownership, capital market and industry. The case study is also intended to revise the theoretical framework, as well further improve the authors' knowledge concerning the case itself.

⁵ Merriam, S B, "Fallstudien som forskningsmetod", 1994, Studentlitteratur, Lund

The case focuses on the most turbulent years in the firm's recent history, where two different eras have been identified. The case can further be divided into two parts with one part giving a balanced description of the development and another part presenting the authors' synthesised views of some central actors' opinions concerning the developments in Perstorp. The synthesised views should not be considered direct quotations of the interviewees, but are the authors' summation of what was said during the interviews. Since the synthesised views were intended to be balanced and to provide a broad spectrum of information they therefore tend to span over quite some time. In such a situation the content of the interviews could be divided and presented based on that dimension. One of the purposes of the interviews was to illustrate how different perspectives actors can have on the development of a firm. The authors therefore argued that these perspectives are easier for the reader to detect and the perspectives are easier to compare if the information from the interviews is presented per interviewee. Another presentation technique could be to present the information based both on the interviewees and the subject. The difference in perspective do however not only mean that the interviewees have different opinions about certain subjects they also have opinions about different subjects. In order to illustrate that difference as well, the authors decided to present all of the information from the interviews per interviewee. An exception was made for Mr Tommy Hultman and Mr Göran Odmalm whose opinions are presented together since they were seen to represent the same perspective. Some of the expressions used in the case might be difficult for the general reader to comprehend, and therefore a glossary is included in appendix A.

2.2.2 Gathering of data concerning the case

The empirical data can be categorised to comprise of two different sources of information, namely publications and interviews. The publications were in the form of annual reports, news articles, corporate press releases and a book specifically describing Perstorp's history. The news articles were found by searching AffärsData's database, and some of the press releases were found on the homepages of different firms.

As described in the introduction Perstorp's largest owner was the Wendt family. The family was however later on divided into two factions with incompatible ownership objectives, popularly called "modernists" and "traditionalists". Other owners were the investment firm Custos as well as more passive institutional owners.

The intention behind the interviews was to create a balanced view concerning the recent developments in Perstorp, consequently not favouring any faction, actor or aspect over the other. Since the purpose behind the thesis is quite broad, and the developments largely

associated with Perstorp's corporate strategy, the interviewees had to encompass a broad-spectrum of knowledge and information.

2.2.3 Practical aspects concerning the interviews

As previously described, the intention was to create a balanced case where no aspect or faction is favoured over the other. Consequently, central actors providing a balanced outlook were identified through the business press and the annual reports. The authors' advisor, Mr. Allan T. Malm also recommended one interviewee, Mr Tommy Hultman.

Choice of actors: A discussion concerning the logic behind the choice of the different actors is warranted and follows here.

To get a good view of the managements importance as well as its relation to the board of directors the authors felt that the CEOs during the relevant time-period should be interviewed. Mr. Karl-Erik Sahlberg was CEO from the early 1970s until 1991, when Mr. Gösta Wiking took over and managed the firm until 1997 when Mr. Åke Fredriksson became CEO. As Mr. Sahlberg left as CEO he became chairman of the board, and he resigned in 1997 when Mr. Wiking took over as chairman. Mr Wiking was chairman until 1999 when he resigned and Mr. Urban Jansson took over.

Mr. Christer Gardell was CEO in Custos, Perstorp's second largest owner and was therefore seen by the authors to be an important actor. Mr. Gardell also became board member in 1997 and played a large role in the board of directors.

Mr. Fredrik Arp was chosen since he was one of the actors replacing the last "traditionalists" on the board, as well as for his current position as a board member in Sydsvenska Kemi.

Mr. Tommy Hultman was chosen since he would possess knowledge more closely related to the firms operations as well as represent an employee perspective, and Mr. Göran Odmalm's views could be seen as a bonus since he was also available to be interviewed at the same time as Mr. Hultman.

Dr. Bo Ursing was chosen as he was a member of the family, a former board member and a participant of the "protest group". It was argued that he could give valuable information regarding the different factions.

Other aspects: All interviews were conducted in the same manner and with all three authors being present. No recording-device was used, but instead every author took notes. After every

interview was completed, the authors took some time to discuss what had been said making sure consensus was reached. Some of the questions that were asked can be found in appendix B, but it must be pointed out that not all these questions were asked and as the interviews went on a lot of other questions were asked instead. Table 2.1 below, depicts information concerning the interviews, but it should further be pointed out that the titles are referring to the time period 1996-2001 unless otherwise stated.

Date	Name	Title	Place	Length of interview
Dec 13, 2002	Mr. Christer Gardell	CEO of Custos, Perstorp board member	Amaranth Capital, Stockholm	2 hours
Dec 16, 2002	Mr. Tommy Hultman	Present day Market Area Manager of Formica-PSM	Formica-PSM, Perstorp	2 hours
-“-	Mr. Göran Odmalm	Present day CEO of Formica-PSM	-“-	-“-
Dec 18, 2002	Mr. Fredrik Arp	CEO of Trelleborg AB, Perstorp board member, Sydsvenska kemi board member.	Trelleborg AB, Trelleborg	1 hour
Dec 18, 2002	Dr. Bo Ursing	Wendt family member and former member of the board	His home, Lund	1,5 hours
Dec 19, 2002	Mr. Åke Fredriksson	CEO of Perstorp and member of the board	Kontorshotellet, Helsingborg	2 hours
Jan 15, 2003	Mr. Karl-Erik Sahlberg	Former CEO of Perstorp, Chairman of the board	His home, Lund	1,5 hours
Jan 22, 2003	Mr. Gösta Wiking	CEO of Perstorp, Chairman of the Board	Mannheimer & Swartling, Malmö	1,5 hours

Table 2.1: “Interviewees”

Not all interviewees wanted to participate directly to the case, reasons being amongst others secrecy constraints and a wish to be able to speak “freely” about the development in Perstorp. These were Mr. Fredrik Arp and Mr. Gösta Wiking, and consequently their personal views are not represented in the case. These interviewees have on the other hand contributed to the authors’ general knowledge concerning the developments in Perstorp, and have consequently affected the theoretical framework. The interview with Mr. Arp gave the authors more knowledge about Perstorps board composition and the interview with Mr. Wiking served as a confirmation of the previously encountered aspects as well as further insight concerning the role of the capital market.

To ensure that the synthesised views were valid representations/interpretations of the interviews, they were returned to the interviewees so that they could alter any faulty information and give their approval. Mr. Christer Gardell has however not yet commented on the synthesised views which might indicate that he did not find the need to alter any information.

2.3 Approximate working order

To give the reader some insight in the practical aspects of how the thesis was created a rough description of the working order follows below.

- Step one:* Information search
- Step two:* Identification of possible theories.
- Step three:* Extensive information search, mainly through AffärsData, to grasp the recent development of Perstorp.
- Step four:* Identification of relevant interviewees. Conducting the interviews.
- Step five:* The case was written.
- Step six:* Further identification of theories
- Step seven:* Creation of theoretical framework.
- Step eight:* Analysis.
- Step nine:* Follow up, and revision, of the above-mentioned steps.

The above-mentioned steps more or less speak for themselves, but step eight could use some explanation hopefully giving the reader an idea of how the analysis was conducted.

2.3.1 Analysis

The analysis is constructed using the theoretical framework and the empirical data. It could however be argued that an initial analysis is performed already by the creation of the theoretical framework. During the interviews the authors identified the capital market, the owners and the industry as dimensions explaining the development in Perstorp. The framework, and the conclusive model, is subsequently the product both of the authors' identification of relevant theories, and the convergence of these theories into a model.

The analysis has been a continuous process that was initiated by the first interview. Due to the fact that a lot of additional information was gained by every interview it must be pointed out that the analysis was more of an internal process than an external combination of theory and empirical data. The internal process can be described as an iterative process where ideas were tested and revised and eventually resulted in the material presented in this thesis.

2.4 Weaknesses

The authors argue that the interviewees possess a great deal of knowledge and information concerning Perstorp's recent development. It could however also be argued that, contrary to the authors' beliefs, the developments were not ready for examination yet and that the interviewees had reasons to withhold information. But if that was the case, they would probably not have been interested in participating in an interview.

When reading table 2.1 above, it can be concluded that the "modernist" faction of the Wendt family is not represented. Making an interview with for example Karl Lennart Wendt or Wilhelm Wendt (both representing the "modernists" faction of the family) would increase the reliability of the thesis. The authors do however reason that their point of view can be represented quite well by some of the other interviewees, sharing the same ownership objective.

3. Theoretical framework: *Three dimensions affecting corporate change*

In this chapter, a theoretical outline of the three dimensions affecting corporate change will be presented. The emphasis of the theoretical input will lie in the capital market, the owners and the industry.

3.1 Introduction to the development of a model for explaining corporate change

This chapter will be an outline of the theoretical framework that is used in the analysis of the development of Perstorp. The chapter should be seen as a discussion where the structure of the framework/model is motivated. The model is constructed out of four dimensions or factors, of which three are explanatory factors and one is the dependent factor. The three explanatory factors are the capital market, the ownership structure as well as the industry. The capital market and the ownership structure are closely related where the capital market is seen as the context in which the ownership structure could be found. The industry is seen as how the decision-makers of a firm perceive the industry and the limitations that the industry sets for the firm. The dependent variable, the consequences, is strategy where strategy is defined very widely. Strategy should in the framework be seen as strategy on the corporate level as well as on the business level. Furthermore strategy should be seen as both intended and realised strategy on all levels.⁶ The corporate level is also divided into two different levels, one level where the decision of the degree of diversification is made and one level where the decision of which specific industries the firm should be in, is made.

The explanatory variables will be dealt with one by one along with its relationship with the dependent variable. First, the capital market dimension will be presented including an examination of the developments and characteristics of the capital market where the term capital market is mainly intended to represent the stock market. In this section the capital market and its characteristics and developments will be discussed in relation to the effects it could have on corporate strategy as regards to the degree of diversification.

Next, when the context surrounding the owners has been described, an examination of different aspects of the ownership structure will follow. In this section it will be argued that the ownership structure, especially if measured as control behaviour and interests of owners,

⁶ **Grant R. M.**, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, second edition, 1995, Cambridge

have an effect on the corporate strategy of a corporation. These different aspects will be related to the degree of diversification, that is, one of the levels of the dependent variable. The section that follows will commence where the first two sections ended. Given the *number* of industries and businesses a firm should be involved in, it becomes a question of *which specific* industries a corporation should operate in and how the corporation should behave in that industry. The third dimension is therefore concerned with the decision-makers' perception of industries and how that perception might influence the decision of the industries to operate in and the firm's strategy in each industry.

If the three explanatory factors and their relationship are put together a complete illustration of the model could be presented. At the end of the chapter such a model is depicted in detail but for now only an overview of that model is presented in figure 3.1. In this model each variable, explanatory or dependent, is depicted with a specific colour, which will follow the variables in all models throughout this thesis. This is done to clarify which parts of the framework that belongs to which variable. The explanatory variables are all depicted inside an arrow to visualise that they are influencing the dependent variable. The aspects of the dependent variables that affect another aspect of the dependent variable are also depicted inside an arrow to visualise the relationship between the different aspects of the dependent variable. Furthermore the ownership aspect is depicted inside the capital market arrow to visualise that the capital market defines the context of the ownership.

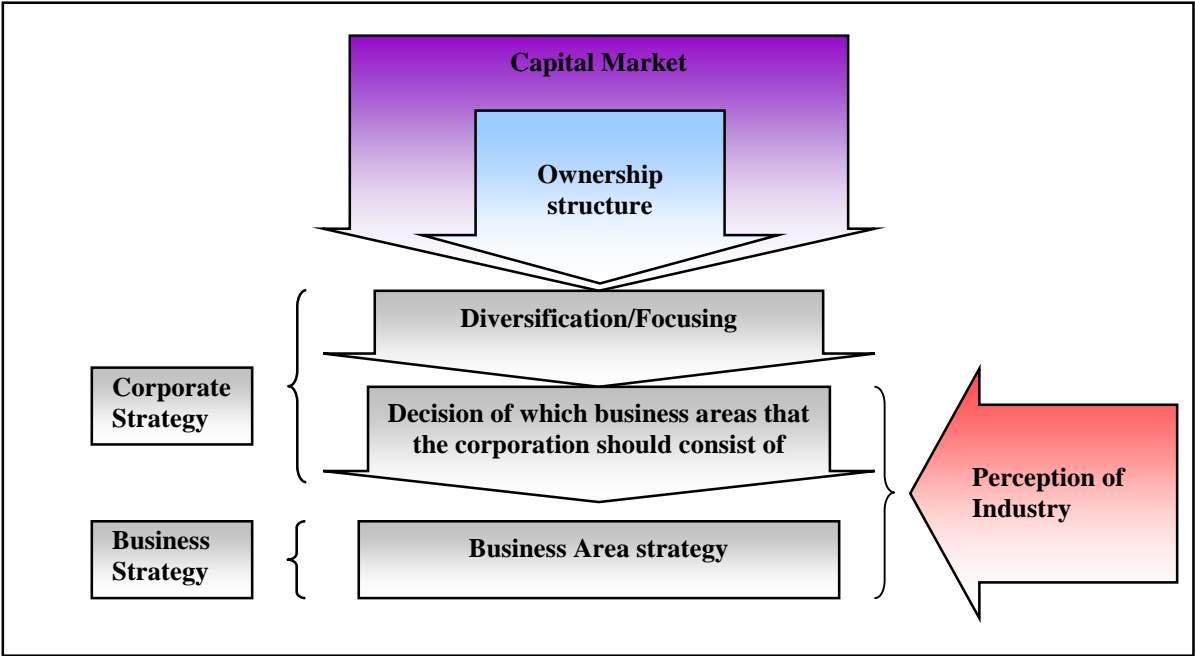


Figure 3.1: “An overview of the framework”

3.2 The capital market as an influence

In this section of the chapter the capital market aspect will be examined. The behaviour and the development of the capital market regarding its importance for firms and its view on how the firm should be managed will be the primary purpose of the section. The section of the chapter will end with a summary and a graphical illustration of the conclusions that can be made from the aspects examined.

3.2.1 Importance of the Capital Market

3.2.1.1 Increasing indirect ownership

During the last decades there has been a significant increase in the amount of capital invested on the equity market. This development can largely be contributed to the households, but this is not to say that many households have become active investors in individual equities. The explanation can rather be found in the increasing segments of the population that have become shareholders by participating in retirement programmes and mutual funds.⁷

These mutual funds and retirement programmes, representing thousands of shareholders, subsequently constitute a major part of the capital market's total size. It could further be argued that the ownership process due to the new kind of ownership has been mechanised and industrialised and are enforced by capital managers⁸. These institutional representatives, (hereafter called indirect owners) are representing the large amount of individuals (hereafter called direct owners) that have transferred their money into the care of institutions. The indirect owners represent the direct owners' objectives, and since the objectives of the direct owners often are unspoken, the indirect owners tend to focus on the single objective common to all the direct owners; shareholder value maximisation. The concept of shareholder value was of course also a main objective earlier, but the increase in indirect ownership can be argued to have put all emphasis concerning owner objectives on shareholder value, thus making it the dominant objective.⁹

⁷ Copeland, Koller, Murrin, "Valuation", John Wiley & Sons, Inc. 2000

⁸ Brodin, Lundkvist, Sjöstrand, Östman, "Koncernchefen och ägarna" Elanders Gotab 2000

⁹ Ibid.

3.2.1.2 Shareholder and Stakeholder perspective¹⁰

The Anglo-Saxon attitude concerning ownership has traditionally been that the shareholders are the exclusive owners of the firm, the board of directors their elected representatives and the function of the firm is to maximise shareholder value. In continental Europe and Scandinavia the objective of the firm has explicitly encompassed more than solely maximising the value for shareholders. The continuity of the corporation has for example been one important aspect guiding the corporations.

Assuming that the increased indirect ownership has been a major influencing factor concerning the capital market's recent development it can further be argued that the increase in indirect ownership affected the emphasis put on shareholder value. Consequently, the direct importance of other stakeholders' needs has diminished. In spite of this, there are findings indicating that stakeholders are better off in a shareholder-oriented economy, since any excessive utilisation of shareholder value will result in reactions that regulate the balance. For instance, if a firm would try to increase its profits by spending less money on both employee benefits and work environment, it would be impossible for the firm to attract and retain high quality employees.

3.2.1.3 Increasing amount of professions connected to the capital market¹¹

The increase in indirect ownership through funds and similar institutions primarily emphasising shareholder value, has created a new large group of actors whose prime objective is managing other peoples' money. As a result of the differing objectives amongst the direct owners, resulting in emphasis on shareholder value, the capital managers focus on a more active portfolio management, measured as the average turnover rate, of their holdings. The average time the capital managers held on to their shares declined, and the focus on financial objectives was enhanced even more. The increased focus on financial values acted as a foundation for other professions connected to the valuation of firms, such as analysts, stockbrokers, economics journalists and people specialising in corporate finance.

3.2.1.4 Vertical shift¹²

It can be argued that two different value chains surround a firm. The vertical value chain illustrates the relationship between the owners and their subordinates where the owners can appear both directly in the form of individual owners, or indirectly represented by organisations and their representatives. The representatives thus act as a proxy for other peoples' money. The horizontal value chain illustrates the flow of the firm's operations and is

¹⁰ Copeland, Koller, Murrin, "Valuation", John Wiley & Sons, Inc. 2000

¹¹ Brodin, Lundkvist, Sjöstrand, Östman, "Koncernchefen och ägarna" Elanders Gotab 2000

¹² Ibid.

a central part in describing the processing of raw materials into the final product. As described before, the increased occurrence of institutional owners has affected the ownership objective leading to an increased emphasis being put on shareholder value. Consequently, the owners require information about the firms' performance and want to influence the decisions being made. There seems to have been a shift in the vertical value chain, giving the owners more power relative to the other stakeholders as well as the management, as a result of the institutional owners getting larger and focusing primarily on financial objectives.

3.2.2 Change in Preferences

3.2.2.1 Preference of focused firms

The dominant trend of the last century has been for firms to broaden their product, geographical and vertical scope. During the 1980s and 1990s the diversification trend was reversed and the amount of mergers and acquisitions soared. The new logic was to divest the unrelated businesses and concentrate on a few businesses around the core competence.¹³

The increased occurrence of professions concerned primarily with the valuation of other firms, as well as greater emphasis of shareholder value, could be argued to be one explanation for the increasing pressure on firms to focus. Another reason could be that the shareholders believe that they are better at portfolio diversification than business managers.¹⁴ This can be attributed to the fact that the financial markets have become more dynamically efficient. This term refers to the innovation ability of a financial system or market and the degree to which the market or system has a sufficient amount of financial instruments to span the entire state-space of risk and return outcomes.¹⁵ With time, innovations will fill in the gaps that exist in this state-space of risk and return outcomes and with more instruments it becomes easier for the investors to diversify their investments and construct a portfolio reflecting their own attitude towards risk. With time it thus seems like individual investors would have a greater possibility to diversify their risks. The innovations that increase the possibility to diversify risks also increase the possibility for the managers of a firm to diversify the risks on behalf of the owners. The managers do however have an informational disadvantage compared to the owners regarding the owners' risk preferences.

Furthermore, analysts have difficulties analysing a firm with a disparate organisational structure due to low transparency and that fact that a disparate structure makes comparisons

¹³ **Grant R. M.**, *Contemporary Strategy Analysis: Concepts, Techniques, Applications, second edition*, 1995, Cambridge

¹⁴ **Dr. David Ingles**, "Critical mass versus focus", *Speciality Chemicals* June 2000

¹⁵ **Oxelheim L.**, *Financial Markets in Transition*, year 1996, International Thomson Business Press, London

with other firms difficult. As a consequence, conglomerates and other firms displaying a disparate structure tend to be under-valued by the capital market since some values are difficult to detect.¹⁶ This under-valuation gives the firm with a disparate structure a higher cost of capital and thus a competitive disadvantage.

There is also a tendency for diversified firms to invest in more negative net present value projects than they would if being operated independently. Consequently, it could be argued that an independent business cannot have a value below zero, but if it is part of a conglomerate that cross-subsidies, it could display a negative value thus contributing to over-investments.¹⁷

There is also a tendency for diversification to affect management resources negatively since it could be difficult to manage a large amount of unrelated businesses.¹⁸

3.2.2.2 Preference of larger firms

Another consequence of the increased emphasis on shareholder value is the shareholder's preferences towards larger, more liquid, international firms. The size of a firm can bring disadvantages in the form of diminishing synergies and consequently loss of focus, but also benefits such as:¹⁹

- Greater financial muscle and greater visibility in the financial markets.
- The ability to take bigger risks when entering markets.
- The opportunity to spread central costs across a range of businesses.
- Opportunities for cross-selling products into big consuming industries.

It could further be argued that smaller firms are more difficult to value due to information asymmetries, price-impact and trading cost, but also since the information acquisition cost for institutional portfolio managers is high relative to the economic benefits.²⁰

¹⁶ **P. Berger, and E. Ofek**, "Diversification's effect on Firm Value", *Journal of financial Economics*, vol. 37 (1995), pp. 39-65.

¹⁷ **Ibid.**

¹⁸ **Palich, L. E., Cardinal L.B., Miller C.C.**, "Curvilinearity in the diversification-performance linkage: an examination of over three decades of research", *Strategic Management Journal*, year 2000, vol 21, issue 2, pp 155-174

¹⁹ **Dr. David Ingles**, "Critical mass versus focus", *Speciality Chemicals* June 2000

²⁰ **Chan, Z and Jindra, J.**, "A valuation study of stock-market seasonality and firm size", *Yale School of Management*, 2001

3.2.3 Summary

In conclusion, it could be said that the increasing household ownership in mutual funds and the like has increased the occurrence of indirect ownership. This has led to an increase in the focus on shareholder value and an industrialisation of the ownership process and eventually an increased influence that owners have over the management on the benefit of the other stakeholders' influence. Therefore the managers seem to be forced to listen more to the opinions of the capital market than before. The opinions of the capital market also seem to have changed; now preferring focused firms as well as large firms indicating that large firms as well as focused firms are rewarded with higher valuations and therefore a competitive advantage. Subsequently the capital market might have an affect on a firm's strategy in a diversification/focusing sense, something that can be illustrated as in figure 3.2 below. The different aspects of the capital market that was found most important has been written inside the purple arrow. Furthermore one of the aspects, *Indirect ownership*, was found to influence another aspect, *Increased importance of the capital market*. *Indirect ownership* has therefore been written inside an arrow that points at the box where *Increased importance of the capital market* is written, to visualise that influence.

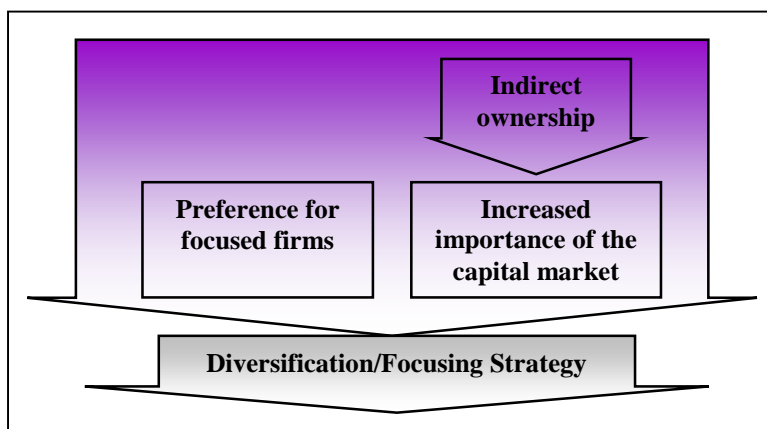


Figure 3.2: “The Capital market’s influence on Corporate Strategy”

3.3 The owners and their characteristics as an influence

In this third section of the chapter, ownership aspects and its effect on corporate strategy will be discussed. The section will start by outlining the agency problem that the separation of ownership and control might create. The ownership structure will then be discussed in relation to the control of the management and the effect it has on the size of the agency problem and the behaviour of the firm regarding their corporate strategy. Two important control dimensions, exit and voice, will then be outlined and discussed as well as the difference that can exist between owners as regards their interests. The owners' potentially different abilities and propensity to use the two control mechanisms will then be presented together with the influence that can have on the firm. Finally, a model built on the different theories put forward, will be presented that might have the potential for explaining a part of the behaviour of firms.

3.3.1 Separation of ownership and decision-making and the agency problem

In many firms there is a separation between those who are owners and those who are decision-makers. The rationality behind this is mainly that it enables a specialisation of the roles where the owner specialises in being the risk-bearer and the decision-maker specialises in making the decisions.²¹

However, there are also disadvantages with the separation of ownership and decision-making. The disadvantage has its root in the problem that arises in the relationship between managers and owners. The relationship can be described as being an agency relationship where the owner is the principal and the manager is the agent. In an agency relationship the principal delegates a task to the agent who performs the task. In such a relationship a problem arises when there are conflicts of interest between the principal and the agent, and when it is costly or difficult for the principal to verify that the agent is performing the task in a proper manner.²²

In the owner-manager relationship such a conflict of interest often exists. The owner is interested in having his well-being maximised which is often associated with shareholder

²¹ **Fama E. F., Jensen M. C.**, "Separation of ownership and control", *The Journal of Law and Economics*, year 1983, vol 26, issue 2, pp 301-325.

²² **Eisenhardt K. M.**, "Agency Theory: An Assessment and Review", *Academy of Management Review*, Year 1989, vol 14, issue 1, pp 57-74.

value maximisation²³. Consequently, conflicts between owners and decision-makers arise when there are conflicts between the managers' well being and shareholder value maximisation. Most often, the managers' well-being is dependent on the level of pay, other pecuniary compensation, status, prestige and power²⁴. The amount of pay and other pecuniary compensation is, *ceteris paribus*, associated with higher costs for the firm, which is usually in conflict with the owners' interest and shareholder value.

Power, prestige and status are something that the manager can create by growing the firm past the optimal level, eg. by unrelated diversification²⁵. Diversification also increases the negotiation position of the manager by making the manager more indispensable. This, in turn, means that the compensation to the manager increases. Diversification is also a way to decrease the variability of the managers' income further showing the propensity for managers to diversify.²⁶

Since diversification, at least unrelated diversification, has shown to be negatively associated with the market value of the firm, the interest of the managers seems to be in conflict with the owners' interest²⁷.

Subsequently there appears to be an interest for the owner to control the behaviour of management or align the manager's interest with the owner's. How successful the owners are at performing this task also seems to affect how the firm that the manager is set to run, is performing and behaving in relation to diversification. In explaining the development of a firm the changes in ownership structure regarding different aspects of control mechanisms therefore seems to be interesting to look into.

²³ **Ramaswamy K., Mingfang L., Rajaram V.**, "Variations in ownership behaviour and propensity to diversify: a study of the Indian corporate context", *Strategic Management Journal*, year 2002, vol 23, issue 4, pp 345-358.

²⁴ **Gedajlovic E.R., Shapiro D.M.**, "Management and ownership effects: evidence from five countries", *Strategic Management Journal*; year 1998, vol 19, issue 6, pp, 533-553.

²⁵ **Ibid.**

²⁶ **Ramaswamy K., Mingfang L., Rajaram V.**, "Variations in ownership behaviour and propensity to diversify: a study of the Indian corporate context", *Strategic Management Journal*, year 2002, vol 23, issue 4, pp 345-358.

²⁷ **Palich, L. E., Cardinal L.B., Miller C.C.**, "Curvilinearity in the diversification-performance linkage: an examination of over three decades of research", *Strategic Management Journal*, year 2000, vol 21, issue 2, pp 155-174

3.3.2 Ownership structure, control and development of firms

In the literature it is often argued that the ownership structure, measured on a concentration/diversification scale, influences how effectively the control mechanisms are used and subsequently determine the discretion of managers. The argument suggests that the more dispersed the ownership structure is built, the more discretion on behalf of the managers and therefore, according to the discussion in section 3.3.1 about the interest of managers, the higher the potential for unrelated diversification. The argument for this view is that an owner that owns a major part of the firm has both the incentives and the possibility to control the managers.²⁸

This operationalisation of ownership structure is however, according to Hedlund and Hägg (1985), not rich enough to cover the different aspects of ownership structure, and should therefore be expanded. They suggest that two terms, exit and voice, introduced by Hirschman (1970), could be used to analyse the relationship between managers and the owners of a firm. The interest of owners is another aspect that has been suggested by Collin (2001). It therefore seems to be aspects of ownership structure other than the concentration ratio that affects firm performance and behaviour. Consequently exit, voice and interest will lie in the heart of our discussion of aspects that affect the degree of diversification. The two mechanisms for control, voice and exit, will first be given an outline of their potential form and function. Thereafter a discussion of owners' different interests will be made followed by an examination of what causes differences in owners' ability as well as their propensity to use the different mechanisms. That examination will then result in a model that might describe some aspects related to the development of firms.

3.3.3 Exit and voice²⁹

Exit and voice are two mechanisms that have certain functions related to the performance of firms. The two mechanisms could be used to counteract sluggishness as well as support the firm's ability to renew itself. The term sluggishness refers to bad quality, laziness, negligence and indifference to customers and owners. The ability to renew itself includes a firm's research and development, strategic development and general adaptation to a changing environment.

²⁸ Demsetz H., Lehn K., "The Structure of Corporate Ownership: Causes and Consequences", *The Journal of Political Economy*, Year 1985, Vol 93, issue 6, pp1155-1177.

²⁹ Hedlund G., Hägg I., Hörnell E., Rydén B., *Institutioner som aktieägare? förvaltare? Industrialister? Klippare?*, 1985, SNS, Stockholm

The exit mechanism, which is used when an owner exits the firm by selling shares, sends a message to the firm about its performance compared to the performance of other investment alternatives. This exit sends a signal that affects the firm's ability to attract financial investors as well as the prospect of emitting new capital. The exit also affects the management directly if the manager is an owner of the firm or if the manager's compensation is tied to the development of the stock. This control mechanism is primarily concerned with short-term profitability and counteracting sluggishness and does not send a signal about what is wrong merely that something is wrong.

The voice mechanism, in its original form, consists of different ways to express dissatisfaction to managers or anyone who cares to listen. In relation to the relationship between owners and managers the voice function can take different forms: participation in the annual meetings, making their voice heard at the annual meeting, representation in the board of directors, contacts with the management, employment in the firm's management, participation in different forums speaking on behalf of the firm's best interests and contacts with other owners.

The voice function can also be divided on the basis of what measures the use of the voice mechanism is expected to generate: Information about the firm's situation, changes in management and decisions of structural changes. The voice mechanism is especially important when there are impediments for the use of the exit mechanism, i.e. when there are taxes on transactions or the ownership is based on loyalty.

The voice function is also especially important when the transparency is low making it hard for outsiders to evaluate the performance of the firm. Compared to the exit function this mechanism does not solely imply when a problem exists, it also gives guidance about the appropriate reaction.

Whether the two mechanisms are used in combination or in separation also affect the efficiency of the specific mechanism since they both have their separate advantages and managers learn to protect themselves from the effect of the mechanism.

To conclude, it seems like the two mechanisms, if used, could affect the firm in several ways. Therefore it would be interesting to see which endowments those affect how well owners can use the mechanisms. Knowing the capacity to use the mechanism will give an indication of the discretion of managers that the ownership structure implies. In the following, aspects that affect the capacity to use the different mechanisms will be outlined. First, a description of some of the different interests that an owner can have will be made since the interest of owners will play a major role in the development of a firm, assuming of course that the owners have an influence on the management of the firm.

3.3.4 The different interests of owners³⁰

Different owners can have different interests with their holdings. The business of portfolio managers, for example, is to manage funds in an efficient manner. They want to have a high and stable return on their investments, spread their holdings and try to avoid being locked into positions. They also compete with other portfolio managers and consequently the relative return on investments becomes important.

There are also those investors who can be described as “restructurers”.³¹ These investors want to acquire shares in firms, restructure firms in order to realise potential profits and then sell the firms. Therefore the time horizon on the investment is limited. These restructurings can be in the form of changing the management, the corporate structure or change the financial structure of the firm. Other sorts of owners are the investors. The time horizons in their investments are long but they do require a minimum return on their investment to stay as an owner of the firm.

There are also owners that have business relations with the firm that they own. Their interest may not lie directly in a desire for return on investment. Instead they may see it as a strategic investment where the return on the investment will show up somewhere else. Other owners are characterised by the fact that their ownership is motivated by reasons not linked to financial or economic performance. Instead the motivation could stem from tradition or ideology. These owners can also be locked in for constitutional reason.

The different interest of owners can have an effect on how the firm is performing and how it behaves. Whether the owners’ interest is based on the short- or the long-term profits seems likely to affect the behaviour of firms, at least if the capital market is not completely efficient since then there will be a trade off between short and long term profits. Had the capital market been efficient such trade-offs between short and long-term profits would not exist. Any sentiments expressed or imposed by the owner could also affect the behaviour and financial performance of the firm. The interest may also set the boundaries for what corporate governance mechanisms that can be used which leads us into how different owners have different endowments for utilising voice and exit. This aspect of the ownership structure will be outlined in the next section.

³⁰ Hedlund G., Hägg I., Hörnell E., Rydén B., *Institutioner som aktieägare? förvaltare? Industrialister? Klippare?*, 1985, SNS, Stockholm

³¹ *Ibid.*

3.3.5 The ability and propensity of owners to use exit and voice

In this section different issues related to owners' propensity to use exit and voice, will be presented. First this will be discussed in relation to exit and then in relation to voice. Under voice, some general aspects will also be outlined and a model, in which the owners can be categorised depending on their propensity and ability to use voice and exit, will be suggested.

3.3.5.1 Exit³²

The different aspects of interests, which are discussed above, can set limits for the mechanisms available. The possibility to make an exit could be limited if the owners have strategic purposes other than value maximisation. Another example of how the purpose or objective with the ownership limits the possibility of exit is when the purpose is built on tradition or ideology. The alternatives may then be much more limited than if the purpose had been of a financial character. A dedication to the long-term perspective can also be seen as limiting.

Different legal aspects can set boundaries in the use of the exit mechanism. One example is the taxes on realised profits. These taxes are also discriminating since some institutions are exempted from such a tax implicating that some owners are better endowed to use the exit mechanism.

As have been discussed in section 3.3.3 an exit is a signal of how well investing in the firm is seen, compared to alternative investments. The ability to evaluate alternative investments then becomes essential and since owners can differ in their competence to evaluate, this aspect further adds to the causes of differences in endowments to use exit as a mechanism. Furthermore, low liquidity of the firm's stock can also set the boundaries for the exit mechanism even though this aspect is essentially the same for all investors.

3.3.5.2 Voice³³

In general a few things can be said about the ability to use voice. First, the purpose and objective of the ownership affects the use of voice. A strategic holding almost requires an active use of voice. Secondly, the larger the size of the holding in an absolute sense the larger the incentive as well as the ability to use the voice mechanism. The ability to use voice is positively correlated to the size of the holding since it enhances the negotiation position of the

³² Hedlund G., Hägg I., Hörnell E., Rydén B., *Institutioner som aktieägare? förvaltare? Industrialister? Klippare?*, 1985, SNS, Stockholm.

³³ *Ibid.*

owner against the other owners as well as the management. Furthermore, with a concentrated portfolio of stocks the possibility of having deep knowledge in contrast to shallow knowledge about one's holdings increases. The credibility of the use of the exit mechanism also matters and the more credible the threat is the more power can be put behind the words.

Participation at the annual meeting is one of the ways to use the voice mechanism. However, the ability to make one's voice heard at the annual meeting appears to depend on whether or not the owner is part of the dominating circle of owners. Obviously the formal power, manifested in the voice rights, also matters when it comes to what decisions are taken. When it comes to representation in the board of directors several aspects are important to discuss. If the share of the firm is large it is easier to be offered a position in the board of directors. Furthermore, there can be restrictions in the competence, precluding participation in the board or at least affecting the ability to influence the decisions in the board. Legal aspects are also important when it comes to board representation due to regulations on insider trading.

Ability to analyse as well as the competence to analyse has been discussed and claimed to be important and therefore a further exploration of this aspect is warranted. The ability can be divided into two parts: the information basis and the competence. The information can come from several sources among which representation in the board and contacts with management is seen to be the more important ones. Other important sources are firm visits and the press. Reports from analysts are yet another source. Different owners have different access to these sources and the ability to exert power through both exit and voice therefore differs even if the competence to use the information would be identical. There are however large differences in the competence to use the information. Aspects that influence the competence are the strength of the personality of the owner or the owner's representative, their industrial knowledge, their experience in earlier roles as an active owner as well as their independence from others.

After the discussions above it should be clear that owners differ in their ability as well as their propensity to use exit as well as voice. Every owner could therefore be categorised depending on that ability and propensity yielding an image of the ownership structure. If many of the owners could be categorised to have high ability and propensity to use voice and exit it would indicate that owners' control over management is high and that there is little potential for managers to diverge from the interest of the owners. The opposite is true if many of the owners could be categorised to have low ability and propensity to use voice and exit and assuming the conflict of interest discussed earlier this ownership structure indicates that a conglomerate is likely to be found.

The concept of these terms could also be argued, to be used to analyse the relationship between the different owners and not only between owners and managers. As outlined before different owners can have different objectives or purposes with their ownership. This

implicates that there can be a conflict of interest in the relationship between the owners. The question is then which objective is the dominant one in influencing the corporate strategy. The voice and exit terms could then be useful as they can be used to describe the potential for exerting power that the different owners have.

3.3.6 Summary

This section started with the identification of the agency problem that exists when ownership and control is separated. If no control is exerted over managers, the managers have the discretion to act in line with their own interest. That interest is often associated with an increase in their status, power and prestige and creating conglomerates is one way to achieve that interest. The owner's interest is often about maximising their wealth and since unrelated diversification has been shown to be negatively correlated with the market value of a firm, conglomerates seem to be in conflict with the owners' interest. Consequently the owners have an interest in controlling the behaviour of management. Different ownership structures, measured as a concentration ratio, have been argued to affect the control that is exerted on behalf of the owners and consequently affects the development of the firm. It has also been argued that the measure of concentration is not enough to explain the control of management. Aspects related to the ability and the propensity to use exit and voice has therefore been introduced into the theoretical framework. The terms exit and voice have also been argued to be useful when analysing the dominant objective when there are several owners with different objectives. These control aspects have then been related to the development of the firm as regards diversification and development into conglomerates. The result of this section of the chapter as well as the first section of the chapter about the capital market is a model, shown in figure 3.3 below.

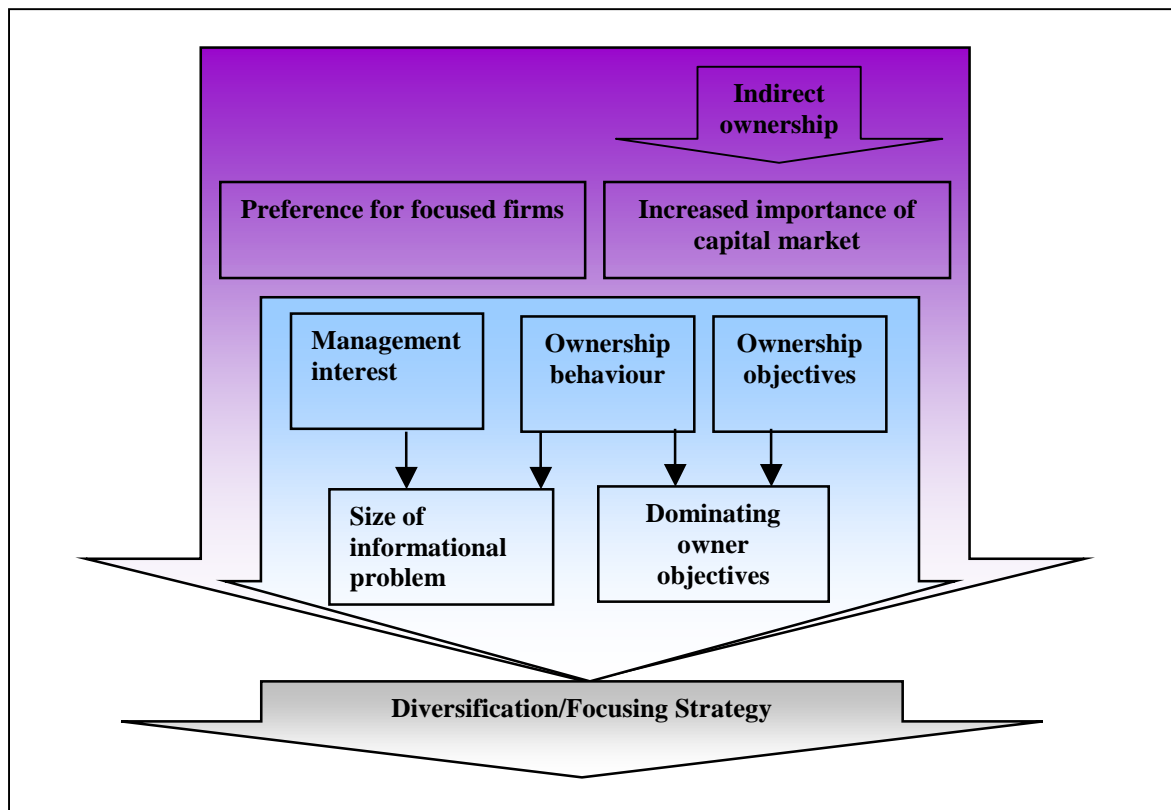


Figure 3.3: “How ownership and the capital market influences the degree of diversification”

Apart from the aspects that were found in the section about the capital market, the model includes the aspects of ownership structure found to be the most important ones. These aspects have been depicted inside the blue arrow. As in figure 3.1 and 3.2 the arrows symbolises that the aspects inside the arrows influences the aspect that the arrow points at. Furthermore the thin black arrows are meant to symbolise that the box where the arrow originates influences the box that the arrow points at. For example *Ownership behaviour* is written inside a box that has an arrow that points at *Dominating owner objectives*. This is meant to symbolise that the specific owners’ behaviour influences the dominating owner objective.

3.4 Perception of industry as an influence

The two last sections of this chapter have been dedicated to creating a theoretical base, from an owner and a capital market perspective that could be helpful when answering the question of why firms choose to be in a certain amount of businesses. In this part of the chapter there will be an attempt to build a base that could provide the tools to analyse the choices of the specific industries to operate in and the strategic choices made in the specific businesses areas that operate in those industries.

3.4.1 Introduction and distinction between levels of strategy

When deciding upon the corporate strategy, several dimensions have to be considered. One of those dimensions has been examined in the two earlier sections of this chapter, namely diversification. Other aspects related to corporate strategy are the degree of vertical integration, the degree of geographical coverage and the role of corporate parents.³⁴

This section of the framework will focus on issues related to diversification in terms of how decisions are made about the allocation of resources between industries. The decision-makers' perception of the industry should then be interesting since that perception would probably affect the decisions that are made. The discussion of how the decision-makers' perceive the industry will consequently help explaining the development of firms in terms of the industries that the corporation decides to be engaged in. Furthermore, some business strategy aspects will also be examined in relation to the developments within the separate business areas of a corporation. This section will not discuss the decision between a diversification strategy and a focused strategy since this was examined in the two earlier sections; rather the decision of which industries to engage in will be discussed taking the degree of diversification as given.

In the decision of allocation between different industries some kind of industry analysis is likely to be used.³⁵ Therefore an outline of some aspects that determine industry attractiveness will be made. However, firstly, a description of common factors affecting the decision of capital allocation made in the corporate headquarters will be presented.

The industry analysis may be helpful for decision-makers when determining an appropriate business strategy and the discussion of industry will therefore also be related to the formation

³⁴ **Grant R. M.**, Contemporary Strategy Analysis: Concepts, Techniques, Applications, second edition, 1995, Cambridge

³⁵ **Ibid.**

of a business strategy. When deciding the industries to be in and the appropriate business strategy, the resources of the firm and how those resources can create competitive advantages may play an important role in the decisions and that aspect will therefore be discussed briefly.³⁶ An overview of the discussion that will follow can be described in a model such as in figure 3.4. As in earlier figures the arrows symbolise that the aspect written inside the arrow has an influence on the aspect that the arrow points at.

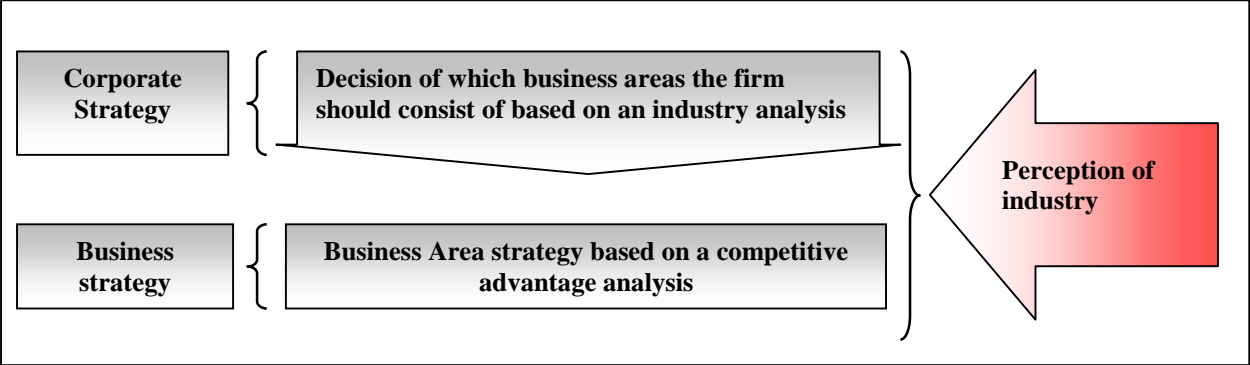


Figure 3.4: “How the decision-makers’ perception of the industry affects corporate and business strategy”

3.4.2 Factors affecting capital allocation decisions³⁷

The role of the corporate headquarter has much to do with managing a portfolio of strategic businesses and opportunities. In doing that they decide on the allocation of resources in which the portfolio balance and the profitability are important factors. When deciding on the allocation of resources an assessment of the profitability of the businesses’ industry as well as the competitive position in that industry might be made. The headquarter can also decide on whether the business area should grow, hold or harvest and help in formulating strategies relating to strengthening the position of the business area. Analysing the balance of the portfolio is concerned with three main dimensions, the balance of the cash flow (so that independence from the external capital market is achieved), the balance of the life cycle stages of the different business areas as well as the diversification of risk that different businesses contributes to.

³⁶ Grant R. M., Contemporary Strategy Analysis: Concepts, Techniques, Applications, second edition, 1995, Cambridge

³⁷ Ibid.

3.4.3 Industry analysis and competitive advantage

3.4.3.1 Substitutes

One aspect that is important to consider when analysing the attractiveness of an industry is the effect that substitutes have. If the substitutes are many, the firm's products' relative prices performance are low and the buyers' propensity to substitute is high, then the threat from substitutes is high. The threat constrains the pricing of the industry and its incumbents leading to a decrease in profitability levels.³⁸

Substitutes can sometimes have quality or functional requirements that are different than in the minds of the firms, something that, Christensen (2001) discusses in his article "Skate to where the money will be". In his article a situation is presented where the technological leaders sometimes do not notice substitute products because of the substitutes inferior technology. The substitute products are however a large threat especially when the quality or functional characteristics of the dominant and leading technology supersedes the demands of the consumers. Subsequently the technologically higher performance does not carry any value for the consumer and the relative price performance of the incumbents' product is therefore low, assuming that the superior technology is associated with higher costs.³⁹

3.4.3.2 Customers and suppliers⁴⁰

Certain aspects related to the customers and the suppliers are also considered vital to include in an analysis of the industry. The following examination will apply equally for the relation between the incumbents and the customer and the incumbents and the suppliers, only in opposite ways. Therefore only one relation will be discussed, namely the incumbent-customer relation.

First of all the bargaining power of buyers affect the profitability of the industry since the customers compete with the industry firm over the value created between the firm and the customer. The bargaining power depends principally on two factors; the sensitivity and the relative bargaining power of the customer. Moreover, the sensitivity is dependent on the proportion of the customers total cost that the incumbents' products constitutes, the switching cost, the importance of the incumbents' products for the quality of the customers' product as

³⁸ **Porter M. E.**, *Competitive strategy techniques for analysing industries and competitors*, 1980, Free Press, New York.

³⁹ **Christensen C. M., Raynor M., Verlinden M.**, "Skate to Where the Money Will Be", *Harvard Business Review*, year 2001, Vol. 79, Issue 10, pp 72-81

⁴⁰ **Porter M. E.**, *Competitive strategy techniques for analysing industries and competitors*, 1980, Free Press, New York.

well as the competition in the customers industry. The relative bargaining power on the other hand is dependent on the credibility and efficiency of the threat of not dealing with the other party. The relative size of the parties as well as the concentration of customers affects this credibility. The higher the concentration of customers the harder it is for the incumbents to find substitute customers, hence the more considerable is the bargaining power of customers. The larger the share of the incumbents production that goes to the customer, the more bargaining power the customer will have since the effect of losing the customer increases with the size of the share of the firm's products that the customer consumes.

Related to customers, it is also important to analyse their demand and what they need. The demand of the customers is one of the two ingredients related to the concept of Key Success Factors. If the firm does not have the ability to supply the goods or services that the customer wants then the firm will soon disappear.

3.4.3.3 Threat of entry⁴¹

If there are no barriers to entry the profit levels of an industry should be at the competitive level. If the profit levels would be higher, then the industry would attract new entrants increasing the level of competition and consequently putting pressure on the profit levels. The fact that the incumbents know that high profit levels will attract new entrants acts as a constraint on the price levels set by the incumbents and thus lowers the profits to competitive levels. On the other hand, if barriers to entry are present higher profit levels than the competitive levels can be sustained. The barriers to entry can for example exist in situations where there are economies of scale or large capital requirements. Economies of scale exist especially in industries that are research intensive.

3.4.3.4 Industry rivalry

The rivalry between the incumbents are often the most important determinant of the attractiveness and profitability of an industry. The important aspect of rivalry is the nature of rivalry, in other words whether the incumbents compete in the price dimension or other dimensions such as advertising and innovation. Factors that determine the nature of competition are among others concentration, excess capacity and exit barriers. If the concentration is low the dominant firm has significant discretion to set its prices and subsequently the profitability will stay above the competitive levels. High market share is thus associated with market power and higher profits.⁴²

⁴¹ **Porter M. E.**, *Competitive strategy techniques for analysing industries and competitors*, 1980, Free Press, New York.

⁴² **Ibid.**

Excess capacity can on the other hand affect the profitability levels negatively since it leads to unused capacity and price cuts.⁴³ Excess capacity is often created when there are large promises of capital gains and the entry barriers are low.⁴⁴ The excess capacity will often disappear over time depending on whether the barriers for exiting are low. If the resources that are used are highly specialised the resources have no alternative use and there will be incentives to cut the prices.⁴⁵

3.4.3.5 Maturity of the industry

Business cycles of an industry could affect a firm's decision process and therefore analysing the different stages of business cycles are relevant. Different stages of an industry's business cycle have different levels of growth. In mature states there is often over-capacity, shakeouts and a need for consolidation. The potential for establishing competitive advantages is also lower and the success factors are different. The lower potential for establishing competitive advantages stems from the fact that there is less scope for differentiation since the buyers at this stage are better informed and the products are more standardised.⁴⁶

3.4.3.6 Competitive advantage

The factors that have been discussed so far are important to consider when choosing industry to participate in. These factors can however also be used when designing a strategy for an already existing business. These factors can actually be changed and a business strategy can be designed to change them in a way that increases the attractiveness of the industry. The industry analysis could also be used to identify the aspects that are important in order to obtain a competitive advantage. In mature industries for example cost advantages such as economies of scale becomes more important.⁴⁷

The competitive advantage can also be related to internal aspects, namely the firm's resources. One important concept when using a resource-based view on competitive advantage is core competence. Core competencies are capabilities that are distinct and can separate the firm from its competitors; it is competencies that make the firm do things better than their competitors. The core competence can stem from any of the firm's functional areas such as research and development or sales. The core competence can also stem from intangible resources such as culture. In order for the core competence to create a sustainable

⁴³ **Grant R. M.**, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, second edition, 1995, Cambridge

⁴⁴ **Enis, M. B., Cox K. K., Mokwa P. M.**, *Marketing Classics: A selection of influential Articles*, year 1991, 25th edition Prentice Hall

⁴⁵ **Grant R. M.**, *Contemporary Strategy Analysis: Concepts, Techniques, Applications*, second edition, 1995, Cambridge

⁴⁶ **Ibid.**

⁴⁷ **Ibid.**

competitive advantage for the firm, some conditions have to be fulfilled, namely that it must be valuable, rare, hard to imitate and the firm must be organised to support it⁴⁸.

3.4.4 Summary

This section of the chapter has included a discussion about what affect the decision-makers' perception of industries could have on a firm's profitability. It has also been argued that the perception of the characteristics of an industry not only affect the profitability of an industry and thereby the allocation of resources but also affects what strategies that can be appropriate in changing the profitability of an industry that the firm is already engaged in. Furthermore, it has been said that the perceptions of the characteristics of an industry can also affect the view on key success factors and the appropriate strategy that can strengthen the firm's position and create a competitive advantage.

⁴⁸ **Barney J. B.**, "Firm Resources and Sustained Competitive Advantage", *Journal of Management*, issue 17, pp 99-120

3.5 The theoretical framework extended

As a conclusion of this chapter an extended model shown in figure 3.5, is presented that is somewhat more detailed than the one that was introduced at the start of this chapter. The different dimensions have been deepened and important aspects of the dimension are written inside of the boxes and arrows. The larger arrows and the black arrows still represent an influence of a dimension on another dimension or an influence of an aspect of a dimension on another aspect of that dimension.

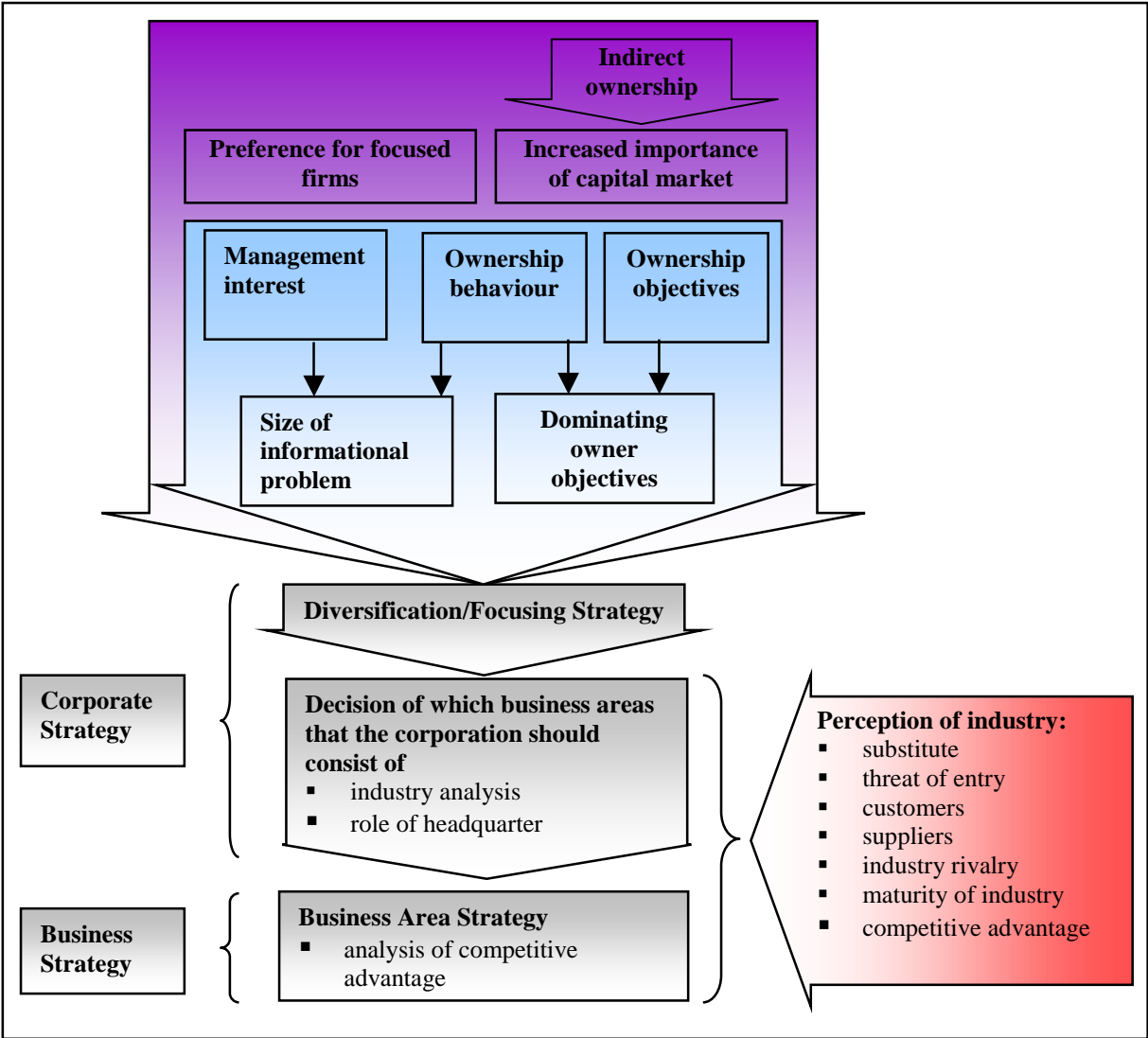


Figure 3.5: “The theoretical framework extended”

4. Case Study: *Perstorp's transition from conglomerate to focused chemicals firm*

As briefly described in the methodology chapter, the case can be described as consisting of two different parts. The purpose of the first part is to give the reader a balanced description, in terms of the capital market, the ownership structure and the industry, of the recent developments in Perstorp. The second part is the synthesised views by important actors concerning these developments. The purpose of this second part is, amongst others, to convey how their opinions differ, and hopefully give the reader a balanced insight to Perstorp's recent development.

4.1 Introduction

When examining the development of the Perstorp Group certain events that seem vital in forming Perstorp's past, present and future can be discovered. The firm's development can in a description be categorised into four main eras, illustrated below in Figure 4.1. The first era is called history and includes the period from the foundation of the firm in 1881 up until late 1995. The second era begins when Öresund takes control of Custos, thus transforming the formerly somewhat dormant investment firm into a more active owner. The annual meeting in 1999 is the beginning of the third era in which one side of the dominating owner family, the Wendts' loses board representation. The fourth era, which marks the end of this case, begins when Perstorp is finally sold to Industri Kapital and the share is de-listed from the Stockholm and London Exchange.

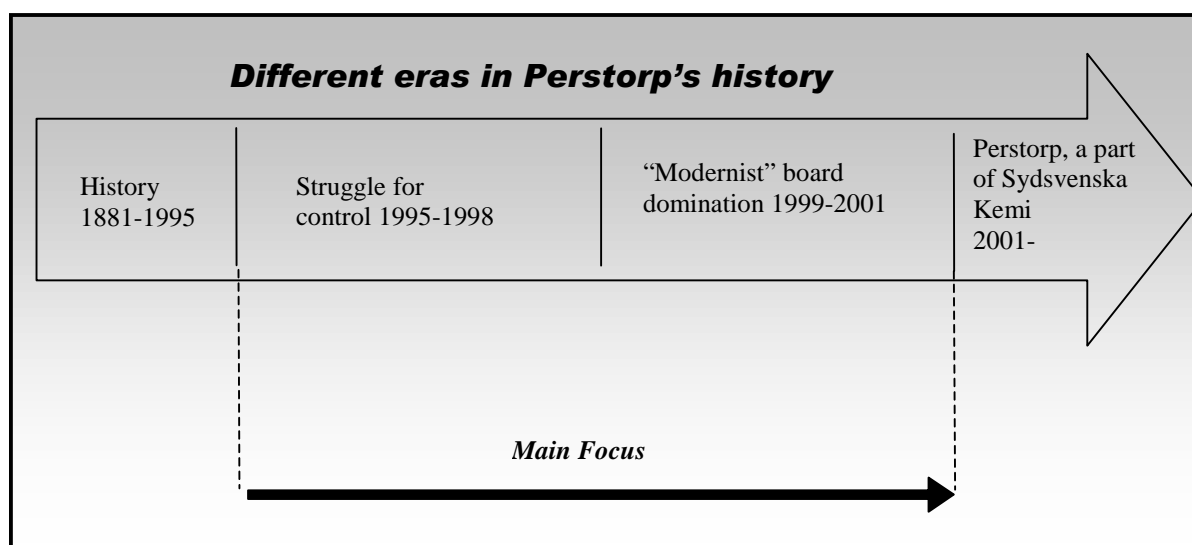


Figure 4.1: "Different eras in Perstorp's history"

The focus of this case study will range from the point in time when Custos became more of an active owner and up until the point when Industri Kapital acquires Perstorp and de-lists the firm from the Stockholm and London Stock Exchange. The case will be presented through an objective description of events that are important to Perstorp, and through the synthesised views of important actors concerning these events.

4.2 The first era – History 1881-1995

Wilhelm Wendt was born in 1854 at Gustafsborg close to where the headquarters of future Perstorp Group lies. Mr. Wendt was sent to study at the Royal Institute of Technology in Stockholm and after graduating at Sweden's premier technical university, he sought to perfect his skills within areas such as fish farming and agricultural techniques.⁴⁹ Failing in his desire to be successful, he returned to Perstorp where he concentrated his efforts on chemical experiments. In the year 1881 Mr. Wilhelm Wendt founded Stensmölla Kemiska Tekniska Industri, and with his technological know-how started to produce acetic acid, tar, charcoal and wood alcohol. Through financing from his uncle Mr. Wilhelm Wendt found the means to expand production and invest in new areas of speciality chemicals. Three years after his founding of Stensmölla Kemiska Tekniska Industri Mr. Wilhelm Wendt was able to produce acetic acid for commercial purposes. It was at that stage that he changed the firm's name to Skånska Ättikfabriken⁵⁰. In 1924 after a tragic accident at one of the firms' plants, Mr. Wilhelm Wendt died and left the control of the firm to his eldest son Otto Wendt. During the early 1930s to the mid 1940s Mr. Otto Wendt successfully expanded the application areas of acetic acid. In that same period the firm invested funds into Lund University within the field of development of polyalcohol or polyols, which are chemicals mainly used for the production of resins⁵¹. In the late 1940s the first polyol plant for pentaerythritol (penta) was constructed. Although there were signs of infancy problems the plant managed to survive the late 1940s and during the course of the 1950s Mr. Otto Wendt saw through improved production process and new application fields the plants commercial value. The firm found new polyol, which was known as TMP (trimethylolpropane) a form of polyol that is widely used as a raw material for the paint industry. Within a couple of years the Wendt family had built a firm that was one of the world's leading manufacturers of polyols⁵².

Over the years Perstorp grew to become one of the worlds leading specialty chemicals firms. The firm's modern history began in the 1970s when it got listed on the Stockholm Stock

⁴⁹ Press release www.perstorp.com 2002-12-28

⁵⁰ Press release www.perstorp.com 2002-12-28.

⁵¹ **Ibid.**

⁵² Press release www.perstorp.com 2002-12-28.

Exchange, and the strategy in those days was to diversify into many fields outside of speciality chemicals, to invest in new production techniques and to be innovative. During the 1970s and the 1980s, Perstorp acquired a large number of firms, both in the US and in Europe. The firms that were acquired were to some extent in the same business areas but others operated in industries that were new to Perstorp. There was a saying in those days amongst the Wendt family “thou shall not lay all your eggs in one basket”. Although Perstorp was at its core a specialty chemical firm, it was active for example in biochemistry and plastic products for materials handling. In 1984 the Perstorp Group launched one of its most important products – Pergo. Pergo, which focuses around laminate floor, is built on the technological know-how in the areas of laminate and chemistry.

Over the years the Wendt family grew, and in the 1990s the family consisted of approximately 150 members, which were consequently also owners⁵³. The family members consist of several generations of the Wendt family, which are scattered around the world from Perstorp to Stockholm to the United States. Their professions also differ, from CEO’s to other forms of occupation such as farmers.⁵⁴ Up until sometime in 1996 there was a consensus within the family concerning the purpose of owning Perstorp. The ownership was founded on a family fulfilment to run a firm and to be an important and positive part in the surrounding society and community. One member of the family expressed his view this way: “*Think about all the jobs that we have created!*”⁵⁵ The family saw themselves as industrialists and there was a spirit of “*continuing the legacy of granddad*”. The goals of making the firm survive together with the fact that most of the owners had the larger part of their fortune in Perstorp was a reason to implement a strategy diversifying the firm into different business areas. One conceived way to release funds (for the modernisation and internationalising of Perstorp) was to issue new series B shares. During that time an investment firm, Custos, bought a fair amount of shares. The family’s position as dominating owner was protected by a certain a clause that restricted the sale of series A shares to individuals or institutions outside the family sphere. That clause made it difficult for family members to sell their holdings as only other family members could buy them. The acquiring member usually valued the share price to be equivalent to the series B share, thus not paying any premium for the inherent voice power in the series A share.⁵⁶ The same clause also constrained the family members from holding any operative position within the firm, consequently restricting the family’s formal control mechanism to comprise only of board representation.

⁵³ interview Dr. Bo Ursing

⁵⁴ **Ibid.**

⁵⁵ **Ibid.**

⁵⁶ *Affärsvärlden* 1996-10-16

4.3 The second era – Struggle for Control 1995-1998

The second era can be said to commence at the turn of 1995/1996, and is characterised by disagreements within the family as well as an increasing interference from the other owners. Perstorp's financial status at the period 95/96 is illustrated in table 4.1 below, the firm's operating revenues reaching SEK 12,928 million and the average yearly number of employees 10,236.⁵⁷

Consolidated (amounts in SEK m unless otherwise stated)	1995/96
Operating revenues	12,928
Earnings before taxes	716
Return on total capital, %	10
Return on shareholders equity, %	13
Equity ratio, %	40
Investments	1,262
No. of employees, (average for year)	10,236
Share ratios	
SEK per share	2.5
Earnings per share after full conversion, SEK	6,10
P/E ratio (B-share)	17

Table 4.1: “Financial status at the beginning of the second era”

4.3.1 Custos changes strategy

In December 1995 the investment firm Öresund increased its holdings to 12.6 % of the capital and 16.2 % of the voices in Custos and consequently took control of the firm, one of the larger owners in Perstorp. The consequence was a change in strategy concerning all of Custos' ownership stakes. After the takeover the focus of Custos became “to invest in firms with significant potential for value enhancement”⁵⁸ and furthermore “the objective is to create absolute value appreciation for Custos' shareholders, while containing risks.”⁵⁹ Important elements of the strategy to attain that objective were said to be⁶⁰:

- Be a sufficiently large owner to enable active ownership and active board representation
- Industrially right measures suited for the demands of the capital market
- Create growth beyond what the market has already discounted in the portfolio firms
- Increase the productivity and the margins of the portfolio firms

⁵⁷ Perstorp Annual Report 1995/1996

⁵⁸ www.custos.se 2002-12-27 (annual report)

⁵⁹ Ibid.

-
- Corporate restructuring of the portfolio firms
 - Make the capital structure more efficient

4.3.2 Diminishing family consensus

Up until sometime in 1996 there was an agreement within the family, which has been outlined in the section about the first era, concerning the purpose of owning Perstorp. However, sometime in 1996 the family started to be divided into two factions. One faction was in favour of modernisation and sold shares in Perstorp to other owners in order to diversify their wealth as well as advocating for a change in Perstorp's corporate structure. The other faction felt that it was important to keep the control of the Perstorp Group within the family and resisted major changes in the corporate structure. At this time the family lawyer, that had kept the family in tune with each other in the past, was no longer able to mediate and as a result the disagreements were not resolved.⁶¹

4.3.3 Characteristics of the “institutional owners”

The institutional investors during both periods have been Nordea, The First, Second, Third, Fourth, Fifth and Sixth National Insurance Pension Funds, SEB Funds, Alecta, Trygghansa, Skandia and Oktogonen.

These owners are quite alike in the sense that they have the same objectives and purposes of their ownership and they participate in about the same way. When interviewing central actors in Perstorp's development, the term “institutional owners” have been used as a common term when referring to the above-mentioned owners. The objectives of these institutional investors are almost always related to maximising the value for its shareholders. In most cases the way they try to achieve this objective is by selection of firms to invest in and not by participating actively in the creation of value in each firm. They can however participate actively in the election of the members of the board. The institutional owners did not change their ownership objective during the two eras, but it could be argued that the emphasis on the objective increased.⁶²

The ownership structure during the second era is illustrated in figure 4.2 below, and it can be concluded that the Wendt family and Custos were the largest individual owners.⁶³ The family did however represent approximately 60 % of the formal voice power and was consequently

⁶⁰ www.custos.se 2002-12-27 (annual report)

⁶¹ Interview Dr. Bo Ursing

⁶² www.skandia.com, www.alecta.com, www.nordea.com

⁶³ *Perstorp Annual Reports* 1995/1996 and 1997

the dominating owner, of course assuming that consensus regarding the ownership objectives was established.

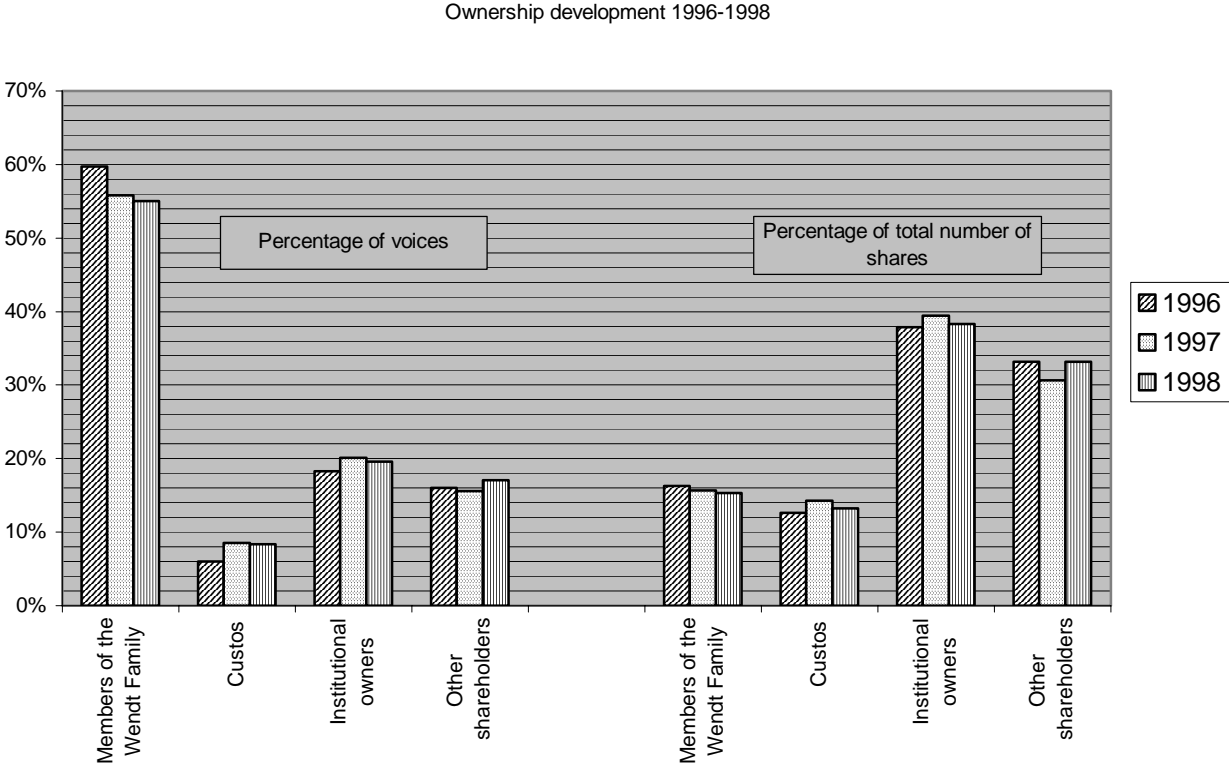


Figure 4.2: “Ownership development 1996-1998”

Between 1996 and 1997 Custos increased its holdings by approximately 1 million shares, resulting in an increase in the formal voice power of 2.5 % to 8.52 %. In January 1998 Custos made a hostile bid for 2 million series A shares at SEK 180 crowns, consequently giving the bid a total value of the SEK 360 million. The bid included a 31 % premium in comparison to the actual share price at the day of the bid, but the offer was however rejected by the owners.⁶⁴

⁶⁴ Nyhetsbyrån Direkt 1998-01-29

4.3.4 The need for consolidation increases

Perstorp's external environment was characterised by an ever-increasing pace of different developments, for instance resulting in shorter product life cycles and globalisation. The changes in combination with more efficient information technology led to consolidation on both ends of the value chain, that is, both customers and suppliers became larger entities.⁶⁵

When customers consolidate and globalise they want to be supplied by equally global firms with broad product lines, thus increasing the need for consolidation among the suppliers.⁶⁶ In the 1995/1996 annual report Perstorp presented its vision for the future concerning the structural changes affecting the industry. The vision was to make Perstorp a global actor in the areas of speciality chemicals and material technology by focusing on the business areas with greatest potential for long-term growth. Following the above-mentioned logic Perstorp would sell-off unattractive business units for the benefit of strengthening and expanding the above mentioned core businesses.⁶⁷

4.3.5 The first major sell-off and a new organisation

At the beginning of 1996 Perstorp consisted out of eight different subsidiaries: Analytical, Chemitec, Components, Flooring, Plastic Systems, Speciality Chemicals, Surface materials and Pernovo. It was argued that the majority of these divisions supported each other and that there were visible synergies between them.

At the end of 1996 there was a major change in Perstorp's corporate structure. Components, the business area that produces acoustic products for the automotive industry was sold for an amount of 1200 million SEK to Collins and Aikman, an American firm with complementing products for the automotive industry⁶⁸.

According to the CEO of Perstorp the reason was that the automotive industry was to a higher degree looking for larger suppliers with a wide product range. In order to be competitive Perstorp would therefore have to add products to the current product range that would not be in line with the firm's long-term strategy. The CEO has further stated that the sale of Components would give Perstorp a platform for aggressive ventures in the firm's core businesses.⁶⁹ Poor profitability was yet another reason for the disposal of the business area.⁷⁰ The operating earnings and operating margin, as well as net sales and investments, is

⁶⁵ *Perstorp Annual Report 1995/1996*

⁶⁶ *Chemical Market Reporter*, April 19, 1999

⁶⁷ *Perstorp Annual Report 95/96*

⁶⁸ *TT Nyhetbanken*, 1996-12-12,

⁶⁹ *Press release from Perstorp 1997-01-28*

⁷⁰ *Interview with Åke Fredrikson, 2002-12-19*

illustrated in Table 4.2 below, and it can be concluded that even though the net sales kept increasing the operating earnings never did.⁷¹

SEK (m)	90/91	91/92	92/93	93/94	94/95	95/96
Net Sales	1045	1423	1654	2051	2452	2443
Operating earnings after depreciation	8	25	35	42	7	-51
Operating margin, %	0,7	1,7	2,1	2,0	0,3	neg
Investments	96	316	222	178	315	187

Table 4.2: “Components”

A new organisational structure with four divisions was set up: Chemicals, Surfaces, Plastic Systems and Pernovo, followed the sale of Components (Figure 4.3 below). Chemicals consisted of three business units, Specialty Chemicals, Chemitec and Construction Chemicals. The Surfaces division included the business units Surface Materials and Flooring. The third division, Plastic Systems contained only one main business area, involved in thermoplastic-based material handling systems. Pernovo, the fourth division, was involved in the identification and development of new business operations⁷².

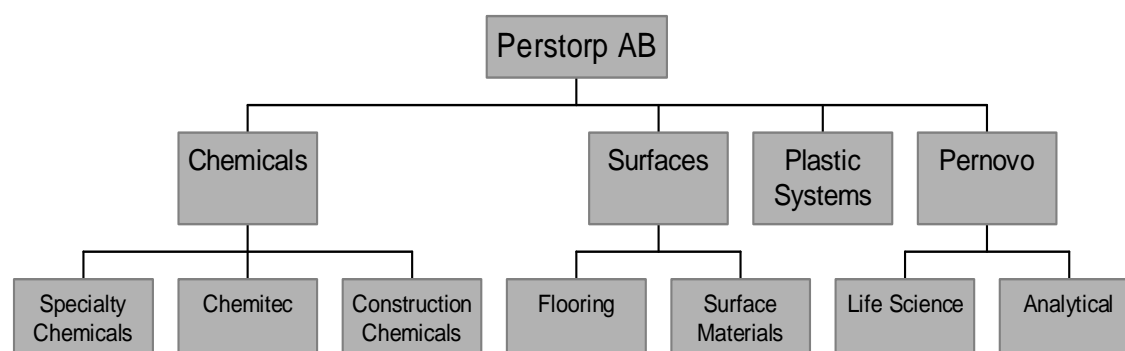


Figure 4.3: “Organisation Chart I”

Specialty Chemicals was involved in the production and sales of formalin and polyols. The formalin part of the operations involves the production of formalin as well as the production of plants and catalysts for other producers of formalin. Formalin is used in the production of plastics and adhesives. Formalin is also used in the production of polyols, which are used in the production of paint, lubricants, plastic additives and lacquer systems. Specialty Chemicals had in 1996 its primary production plants in Italy, Sweden and the United States.⁷³

Chemitec manufactured amino moulding compounds, phenolic moulding compounds and advanced resins as well as composites. The compounds are used as raw material in the production of electrical compounds and various types of household products. Composites on the other hand are fibre-reinforced plastics that can replace metals in the automotive,

⁷¹ Perstorp Annual Reports 1990/1991, 1991/1992, 1992/1993, 1993/1994, 1994/1995 and 1995/1996

⁷² Perstorp annual report 97

⁷³ Ibid.

aerospace and sports industry. In 1996 Chemitec's major production plants were located in Belgium, Brazil, France, Italy, Indonesia, Sweden, United Kingdom and the United States.⁷⁴

Construction Chemicals manufactured concrete admixtures and seamless thermo-set based industrial flooring mainly for the construction industry. Construction Chemicals had in 1996 production in China and Sweden.⁷⁵

Flooring was involved in the production and sale of high pressure laminate flooring used in residential and industrial environment. The business area's strongest brand was Pergo, which is sold in Asia, Europe, and the United States. Production sites (in the year 1996) were in Sweden and the United States.⁷⁶

Surface Materials was involved in the manufacturing of decorative laminate, decorative foils and printed-paper primarily to customers in the construction, interior design and furniture-related industries. Surface Materials productions were concentrated to Brazil, Finland, Germany, Spain, Sweden, Thailand and the United Kingdom.⁷⁷

Plastic Systems was involved in the market for plastic based logistic systems primarily for materials handling applications in the manufacturing and distribution industries. Manufacturing plants was in Austria, Estonia, Finland, France, Germany, Malaysia, Spain, Sweden, Thailand, United Kingdom, and in the United States.⁷⁸

Pernovo was the business development division of the firm responsible for identifying and developing platforms for growth in areas connected to the firm's core competencies. The operations were mainly concerned with biotechnology and medicine related operations and were divided into Life Science and Analytical where Life Science incorporates the activities related to Pierce Chemical Firm (products used for separation and analysis of proteins), Atos Medical (polymeric products used in medical treatments) and HyClone Laboratories (cell-cultivation sera) and Analytical the activities related to food and feed analysis.⁷⁹

At the annual meeting in 1997 Perstorp's chairman of the board, Karl-Erik Sahlberg resigned, and he's views concerning the firm's development are as follows below.

⁷⁴ **Ibid.**

⁷⁵ *Perstorp annual report 1997*

⁷⁶ **Ibid.**

⁷⁷ **Ibid.**

⁷⁸ **Ibid.**

⁷⁹ **Ibid** and *Perstorp press release 97-04-10*

4.3.6 Interpretation of interview with Mr. Karl-Erik Sahlberg (former CEO of Perstorp and Chairman of the board)

The niche strategy: During the seventies there were a lot of problems in the economic environment, the oil crisis led to high inflation and it was hard to do business. We reasoned that Perstorp was quite a small firm without the ability to compete efficiently against the larger players on a volume base. This view resulted in an examination of the different types of businesses and in the identification of those businesses that were profitable and those that were not. After that, we isolated the “good businesses” and positioned ourselves in niches where the potential profitability seemed good.

It is very important to have a “*golden egg*” that generates a steady state of capital to be invested in businesses with large potential. Traditionally charcoals, and later on “*Perstorps Plattan*”, were two such examples that contributed a lot to the chemical business.

Chemical firms show a similarity with pharmaceutical firms concerning long lead times since it takes considerable time to develop new products. That was not a problem though since the owners were supportive and realised that it was a long-term investment.

The Capital Market: There was a major change around 1995 when the capital market started to focus more on shareholder value. The capital market demanded more information, and we had to publish reports more often. It also resulted in a diminishing patience towards investments that did not generate any positive returns in the near future. The role of the management declined on behalf of greater board influence, and the capital market started to demand representation in the board of directors. I would say that the capital market’s development is the single most important factor in explaining the corporate restructuring of Perstorp.

The owners: The family was sensitive to fluctuations, and wanted to reduce variability by diversification. The family took great pride in Perstorp and its history, and they wanted to continue the legacy of their forefather. The family was however historically grouped in different “blood lines”, and they were also experiencing a generational shift. Some of the owners were more accessible to the increased pressure from the capital market, others took a more long-term view.

Substitutes: Surface Materials (Perstorp Plattan) was an extremely good product that historically generated large amounts of capital. After some time the competition started to increase and suddenly we were competing with cheap and technologically inferior products, which were sold in bulk volumes. We then reasoned that our competence in surface materials could be used in other markets and started use that competence in the market for floors. The

flooring business did however run into the same problems as Surface materials; increasing competition from inferior products that were sold in bulk volumes. The problems were also related to the difficulties associated with positioning such products and building a brand.

After this interpretation of the interview with Mr. Karl-Erik Sahlberg has been presented information regarding the sale of Analytical follows in section 4.3.7.

4.3.7 Analytical is sold to Foss and Chemicals and Surface Materials sells subsidiaries

Further changes were made in the corporate structure when the Analytical business was sold to its biggest competitor, Foss Electric Holding, in April 1997.⁸⁰ To be competitive within the industry the business had to reach a certain critical mass. That meant that either Foss would have to buy Perstorp Analytical or Perstorp Analytical had to buy the relevant businesses of Foss.⁸¹ Since Perstorp's effort was to focus on its core chemistry and materials technology applications the result was that Foss ended up being the buyer.⁸² The historical development in the Analytical business concerning net sales, operating earnings, operating margin and investments is shown in Table 4.3 below.⁸³ The figures for the period 1992-1994 should be attributed to the former division, Biotec, which consisted of both Analytical and Life Science. The operating margin has historically been around 3-5 percent but due to major restructuring and rationalisation being made during 1995/1996 the operating earnings rose significantly⁸⁴.

SEK (m)	92/93 (Biotec)	93/94 (Biotec)	94/95	95/96
Net Sales	999	1194	743	763
Operating margin, %	5,2	3,2	2,8	13,3
Investments	59	39	33	20

Table 4.3: "Analytical"

In August and September that same year two other changes in the corporate structure was carried out when the German subsidiary, Perstorp Elemente, within the Surface Materials division and the US subsidiary belonging to Perstorp Chemicals was sold off. The Surface Materials subsidiary used laminate from Perstorp to produce bonded components for the furniture industry and the Perstorp Chemicals subsidiary was involved in the production of plastic dinnerware. The sale of both subsidiaries was motivated by rationalisation of the production structure and concentration on Perstorp's core business.⁸⁵

⁸⁰ Perstorp press release 97-04-10

⁸¹ Interview with Åke Fredriksson 2002-12-19

⁸² Perstorp press release 97-04-10

⁸³ Perstorp Annual reports 92/93, 93/94,94/95 and 95/96

⁸⁴ Perstorp Annual Report 95/96

⁸⁵ Perstorp press release 97-08-25

At end of the year the CEO of the firm, Mr. Gösta Wiking, resigned and was elected chairman of the board, leaving Perstorp in the hands of a new CEO, Mr. Åke Fredriksson.

4.3.8 Life Science expands

The Perstorp group was not only selling off subsidiaries during this era, they were also making several acquisitions. In late 1997 they acquired a firm based in New Zealand involved in the Life Science segment, or more specifically, a firm producing cell-cultivation sera. The acquisition was meant to strengthen Perstorp's operations, via the subsidiary HyClone, in the Life Science area and also provide a production base for the group close to the Asian market.⁸⁶

One person involved in the Life Science division was Dr. Bo Ursing. He was a board member, and later involved in the "protest group". His views concerning Perstorp's development follows in section 4.3.9.

4.3.9 Synthesis of interview with Dr. Bo Ursing (Wendt family member and board member)

The condition of Perstorp at the start of the second era (1996): It was a good firm. During the years, Perstorp has created a lot of job opportunities for the community. It was an international firm that had been successful almost since the day it started. It was a true success story.

The Wendt family and Perstorp: In the 1990s there were quite a lot of shareholders within the family. Some of them needed to liquidize capital, especially the younger generation. When Custos changed its strategy the family was split a part. The main problem for the family was that there was no natural leader.

There had of course been different views in the family before but they had always been solved. There was a lawyer, Göran Linders, who had acted as a mediator. Unfortunately he suddenly died. Maybe Perstorp had looked differently if he had been able to mediate between the family members.

The driving force behind the firm was the joy of running a firm. The family also felt that it wanted Perstorp to be an important part of the society. But most of all it was seen as very important to run grandfathers firm and make it survive. The family also wanted Perstorp to be involved in different businesses; they did not want to have all eggs in one basket. There was,

⁸⁶ *Perstorp press release 97-11-03*

in the 1980s, a concern that the firm did not have enough “businesses for the future”. Some divisions of the firm were therefore acquired, such as Components, Analytical and Perbio for example. Other divisions had however grown naturally out of the firm’s core competence.

The different roles of the management, the family and the board: From the beginning, Custos had been supportive and loyal to the family. When Perstorp issued new shares to raise capital Custos were of great help. When Öresund bought their way into Custos that loyalty disappeared though.

Before Öresund took control of Custos, the management of Perstorp played a larger role. The management designed the strategies and ran the firm, and the board was fed with very good reports and information on how the business went. The family was also involved in a more informal way since the CEO and the management often asked for individual family members’ view. That also changed when Custos changed its behaviour and the role of the board became larger.

There was also a difference in the way the firm was run when Karl-Erik Sahlberg left as CEO and Gösta Wiking took over. Karl-Erik Sahlberg was a very wise and secure man. Gösta Wiking was more curious and expansive. That affected how the firm was run. Wiking did not enjoy the same kind of confidence and not all agreed when Wiking became the chairman of the board.

After the synthesis of the interview with Dr. Bo Ursing has been presented information regarding the sale of Plastic system follows in section 4.3.10.

4.3.10 Plastic Systems in the hands of Industri Kapital and formation of a new organisation

In 1998 Perstorp made yet another dramatic change in its corporate structure when it sold off a whole division, Perstorp Plastic Systems, to Industri Kapital. The reason for the sale of the division was that the Plastic Division was, according to the CEO of Perstorp, different in nature compared to the rest of the businesses. The division was not a natural product of the competencies of Perstorp; rather it was a division that had been bought into the groups’ structure.⁸⁷ This was not in line with Perstorp’s focus on selected areas of chemistry and materials technology and a sale was therefore logical.⁸⁸ Another reason was, according to the CEO of Perstorp, the poor profitability of the division.⁸⁹ The developments in profitability, measured as operating earnings and operating margin as well as investments and the

⁸⁷ Interview with Åke Fredriksson, 2002-12-19

⁸⁸ Perstorp press release 98-06-03

division’s net sales is shown in Table 4.4 below.⁹⁰ The division’s net sales kept increasing during the time period but the operating margin was quite disappointing, and in 1996/1997 the business area made a SEK 110 million loss.

SEK (m)	90/91	91/92	92/93	93/94	94/95	95/96	97
Net Sales	551	707	1064	1092	1294	1396	1434
Operating earnings after depreciation	46	60	46	36	1	90	-110
Operating margin, %	8,3	8,4	4,3	3,2	0,07	6,4	neg
Investments	164	86	130	83	168	154	251

Table 4.4: “Plastic System”

Furthermore the CEO of the Plastic Division saw the need for restructuring in the industry that the division operates in, and that the sale of the division increased the possibility for Perstorp Plastic Systems to work actively for that restructuring⁹¹.

Following the sale of Perstorp Plastic Systems the group made yet another adaptation of its organisation, illustrated in Figure 4.4 below. First the Surfaces division was divided into two separate divisions, Perstorp Surface Materials and Perstorp Flooring. Secondly the Life Science part of Pernovo was to become a division of its own.

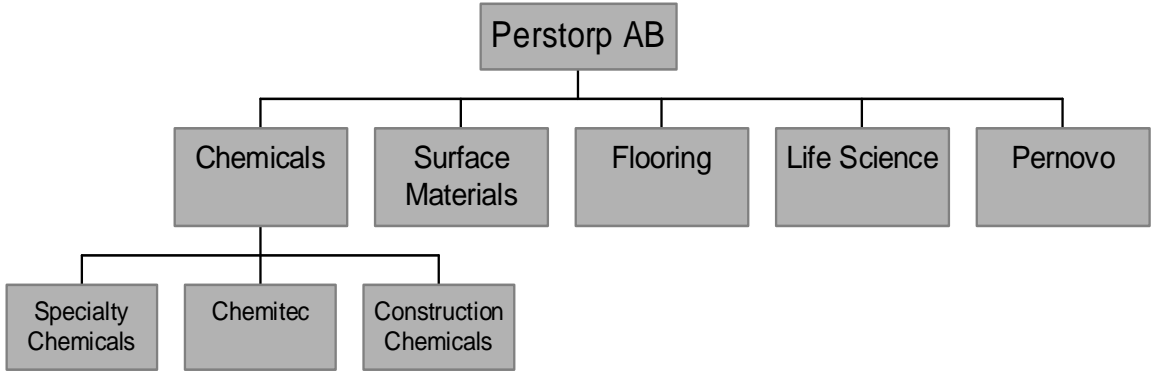


Figure 4.4: “Organisation Chart II”

4.3.11 Characteristics and development of the Perstorp share during the second era

During the second era the Perstorp share was slightly outperformed by the SAX index, as can be seen in figure 4.5 below. A part of the explanation might be found in the fact that amongst the financial analysts, Perstorp has historically been regarded as one of the most difficult Swedish firms to value. The valuation difficulties originates both in the firm’s organisational

⁸⁹ Interview with Åke Fredriksson, 2002-12-19
⁹⁰ Perstorp Annual Report 1990/1991, 1991/1992, 1992/1993, 1993/1994, 1994/1995, 1995/1996 and 1997
⁹¹ Perstorp Press release 98-06-03

structure with widely dispersed business units, and in the optimistic forecasts that many times failed to live up to the expectations.⁹²

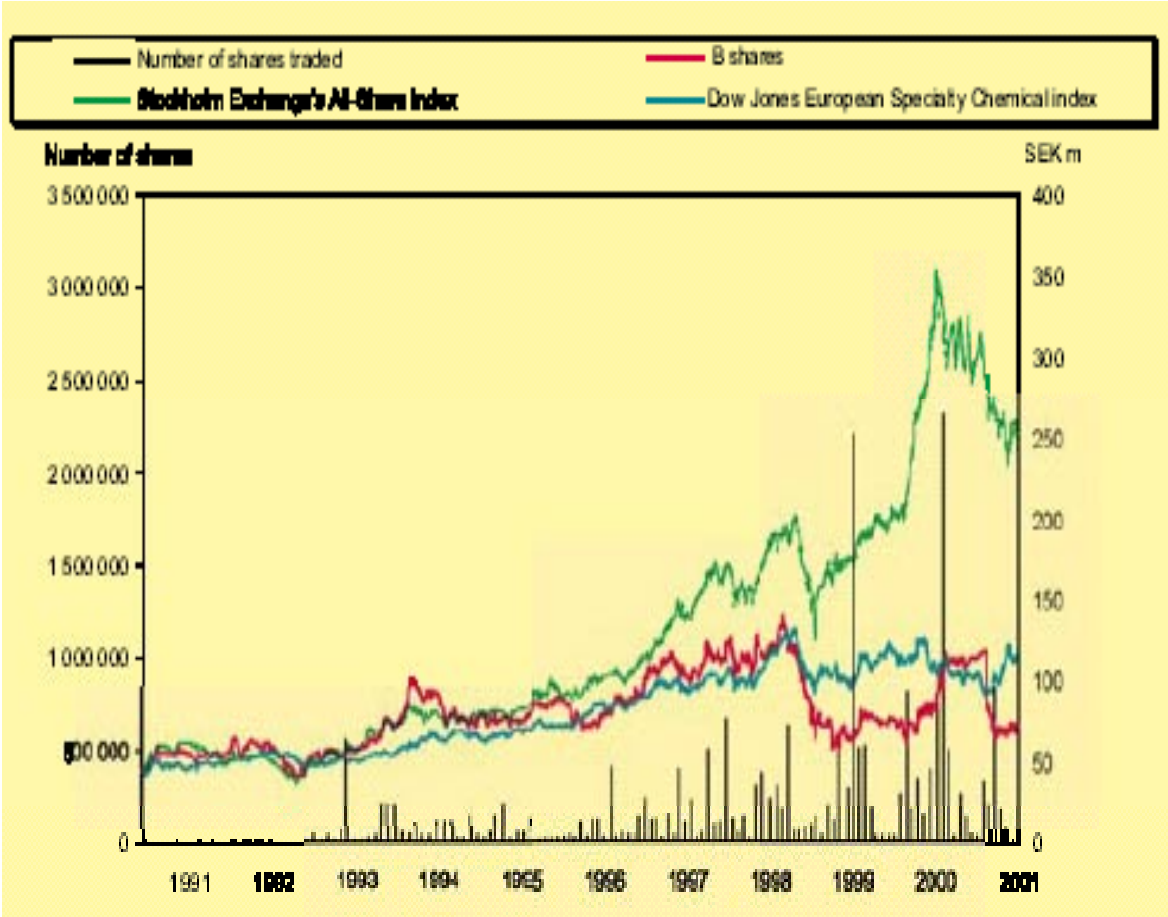


Figure 4.5: "Historical data on Perstorp's B shares"⁹³

However, the liquidity of the series B share had a positive development, as can be seen in figure 4.6 below. In 1995 the turnover rate was 7% compared to a turnover rate in 1998 of 25 %, which is an increase of about 250%. Even though the average turnover rate increased drastically it is still significantly lower than the average SAX turnover rate.

⁹² Affärsvärlden 1999-11-17

⁹³ Perstorp Annual Report 2000

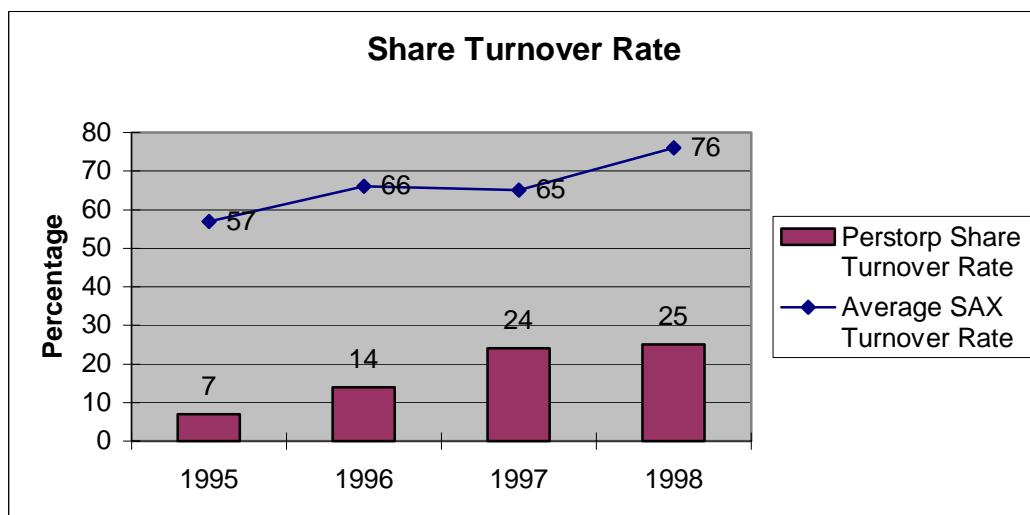


Figure 4.6: “Share Turnover Rate – Second Era”

Other characteristics concerning the Perstorp share is illustrated in table 4.5 below.⁹⁴ One interesting development that can be seen from this table is how the beta value has developed during the second era. This value describes how much the Perstorp share varied in relation to the SAX index, and reached levels almost comparable to the SAX average (1,0) in 1997.

	94/95	95/96	1997	1998
Earning per share, SEK	6,98	6,27	5,49	4,68
Free cash flow, SEK/share	-	5,00	-1,40	4,90
Dividend, SEK/share	2,33	2,50	-	-
Market price as percentage of shareholders' equity	200	210	238	117
P/E ratio (B share)	14	17	27	16
EBIT multiple	11	13	16	11
Beta Value	-	0,69	0,94	0,80

Table 4.5: “Per share data – second era”

In January 1997 the series A shares of Perstorp was listed on the Stockholm Exchange A list. The official reason was that the owners wanted a more exposed ownership structure, which in turn would result in greater attention from the stock market and a higher valuation of the firm. Other, more unofficial, reasons could have been the large inheritance (series A shares valued at SEK 140 million) left by Marie-Louise Wendt, but also that an increasing number of family members wanted to sell their shares.⁹⁵

⁹⁴ Perstorp Annual Report 1994/1995, 1995/1996, 1997 and 1998

⁹⁵ Dagens Nyheter 1996-10-22

4.4 The third era – “Modernist” Board Domination 1999-2001

The third era begins at the time around the annual meeting in 1999 when the family members that represented the “traditionalists” were voted out of the board, consequently leaving the “modernist” faction and the other owners in charge of Perstorp. The firm’s financial status in 1999 is illustrated in table 4.6 below, and from a comparison with the financial status at the beginning of the second era (table 4.1) it can be concluded that the operating revenues decreased somewhat, but the most dramatic decrease was in the total number of employees.⁹⁶

Consolidated (amounts in SEK m unless otherwise stated)	1999
Operating revenues	10,352
Earnings before taxes	551
Return on total capital, %	8
Return on shareholders equity, %	7
Equity ratio, %	47
Investments	906
No. of employees, (average for year)	5379
Share ratios	
SEK per share	4
Earnings per share after full conversion, SEK	3,84
P/E ratio (B-share)	25

Table 4.6: “Financial status at the beginning of the third era”

4.4.1 Custos increases its position in Perstorp

In January 1999, Custos acquired 2 million series B shares from Nordea for a total sum of SEK 153 million or SEK 76.50 per share. This resulted in Custos strengthening its capital representation by 2.9 % to a total of 16.2 %, and its number of voices by 1.4 % to a total of 9.8 %.

The ownership structure during the third era is illustrated in Figure 4.7 below, and it can be concluded that Custos made further increases in its holdings during 1999. Even though Custos became the largest shareholder the family was still the dominating owner thanks to the difference in voice rights between series A and B shares. Between 1999 and 2000 Custos somewhat increased their holdings but the family holdings was more or less unchanged, further implying that the listing of the series A share in 1997 did not lead to shares being sold

⁹⁶ Perstorp Annual Report 1999

by the family members.⁹⁷ For a complete description of the ownership development see appendix C.

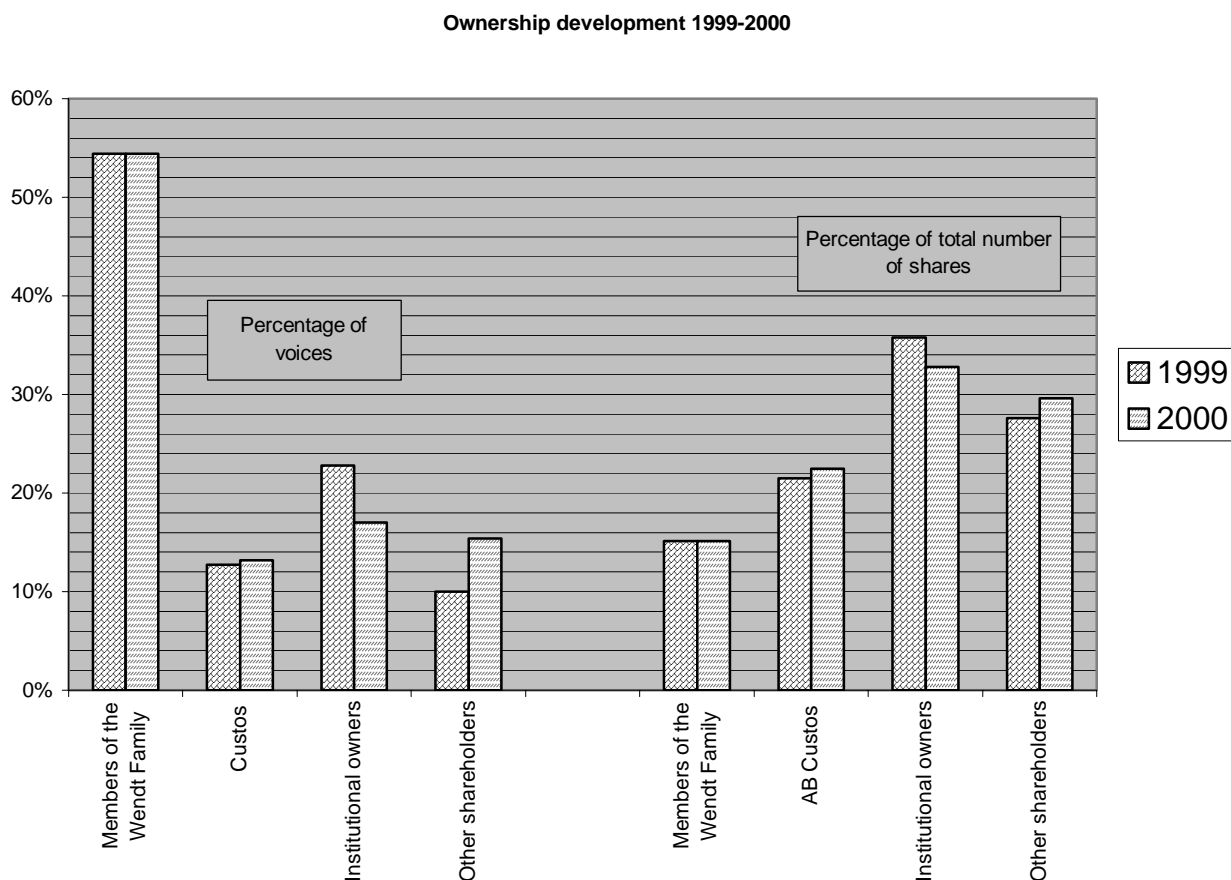


Figure 4.7: “Ownership development 1999-2000”

4.4.2 Changes in the ownership structure and the board

At the annual meeting in 1999, the faction of the Wendt family that wanted to keep the control of the firm within the family as well as keep the corporate structure unchanged, lost board representation. Another important person that resisted changes in the form of a focusing strategy, Gösta Wiking the former CEO of Perstorp, resigned as chairman of the board at that same annual meeting. The board now consisted of external representation, the members of the modernist faction of the family as well as the CEO of Custos, Christer Gardell who had been a member since 1997. The changes in board composition between 1998-1999 are illustrated in tables 4.7 and 4.8 below.⁹⁸ In 1998 the board consisted of both family factions, the “modernists” was represented by Mr. Karl Lennart and Mr. Wilhelm Wendt. Mr. Carl Johan Wendt and his son, Erik Wilhelm Wendt (not presented below since he was a deputy), on the other hand represented the “traditionalists”.

⁹⁷ Perstorp Annual Reports 1999 and 2000

⁹⁸ Perstorp Annual Report 1999 and 2000

Year 1998	Role	Year of entry	Other information
Mr. Gösta Wiking	Chairman since 1997	1991	Former CEO
Mr. Bo Bergren		1991	Represents employees
Mr. Gunnar Brock		1996	
Mr. Ingolf Christoffersen		1991	Represents trade unions
Mr. Christer Gardell		1997	Custos representatives
Mr. Lars Hansson		1996	
Mr. Finn Johnsson		1997	
Mr. Carl Johan Wendt		1968	“Traditionalist”
Mr. Karl Lennart Wendt		1974	“Modernist”
Mr. Wilhelm Wendt		1996	“Modernist”
Mr. Åke Fredriksson	CEO since 1997	1997	

Table 4.7: “Board composition 1998”

At the annual meeting in 1999 the number of board members decreased significantly, Mr. Gösta Wiking resigned and Mr. Urban Jansson replaced him as Chairman of the board. Mr. Carl Johan Wendt also resigned and consequently no one longer represented the “traditionalists”. Mr. Fredrik Arp, known for his effective “restructuring” ability in both PLM and Trelleborg AB, was also elected as member of the board.

Year 1999	Role	Year of entry	Other information
Mr. Urban Jansson	Chairman	1998	
Mr. Fredrik Arp		1999	
Mr. Gunnar Brock		1996	
Mr. Finn Johnsson		1997	
Mr. Christer Gardell		1997	Custos representative
Mr. Karl Lennart Wendt		1974	“Modernist”

Table 4.8: “Board composition 1999”

After the changes in the composition in the board of directors the representative of Custos, Mr Christer Gardell became a central actor in the board of directors. His views concerning Perstorp and its development follow below.

4.4.3 Synthesis of interview with Mr. Christer Gardell (CEO of Custos and Perstorp Board Member)

The condition of Perstorp at the start of the second era (1996): Perstorp’s core business was Chemicals, but it had been neglected for a long while. The family was heavily invested in the firm and wanted to spread its risk through diversification. Consequently, money was taken from the core businesses and invested in non-core businesses and they ended up with the disperse structure that could be found in Perstorp in the middle of the 1990s.

There were no synergies between the different parts and it was hard to manage all the parts together. It is difficult to organise synergy and that is why it most often is best to focus. With many divisions like in a conglomerate, a problem in one of the divisions will often spread like cancer to the rest of the organisation. The management tends to focus only on the division with the problem and neglects the other divisions until they too get problems. Furthermore, many of the industries that Perstorp was involved in were unattractive industries.

At this point in time the family started to get worried, and some owners were quite discontent with the management. The value of the Perstorp stock had not had a favourable development during the 1990s and that diminished the value of the family's holdings.

The Perstorp corporate culture: Perstorp also had the worst corporate culture ever seen; there was no profitability orientation, complete tolerance for underperformance and the management on some levels in the organisation was mediocre. There were so many changes needed though, that it was not viable to change management. Another problem with the culture was that there was no focus on the balance sheet. Furthermore, problems were solved the same way as in old Russia, where they tried to plan their way out of trouble. The plans looked like hockey sticks. The high expectation plans resulted in distrust from the capital markets since the expectations were never met. Furthermore, the owners did not have any influence, they were “merely spectators” and it was a firm run by executive officers.

Obstacles and problems: The constitution of the board, and its historical linkage to the firm's operations, resulted in difficulties in getting the necessary changes done, since some members tried, deliberately or not, to protect their previous works. There was also a branch of the Wendt family that resisted change, which were known as the “Protest group”. When Gösta Wiking (chairman) and the representatives of the “Protest group” left the board in 1999 it became easier to force the changes through. Another simplifying event was the offer for 2 million series A shares that Custos made well above the market price. Custos did not expect the bid to be accepted but it was expected to “stir things up”. It was meant to create a consciousness of shareholder value.

There were a lot of problems and it would have been better if Perstorp had been de-listed. It is difficult to make such changes when a firm is listed. It was actually a part of Custos' plan to buy-out Perstorp. The size and the number of problems are indicated by the fact that there were 30-35 board meetings a year compared to the 4-5 meetings they had before. Custos also put in a lot of resources in the form of option programmes issued on Custos' stocks, strategic analyses and ideas.

The low valuation that the capital market ascribed to Perstorp was also a problem when it came to consolidation. There was a need for consolidation in some of the industries that

Perstorp operated in and with the low multiples and low profit levels that Perstorp exerted it was nearly impossible to make the necessary acquisitions.

Industri Kapital: Industri Kapitals bid for Perstorp and its intention to create a large speciality chemicals firm was a good thing for everybody, but the synergies between the different firms should not be exaggerated.

After presenting the synthesis of the interview with Mr. Christer Gardell, some information of the acquisitions made by Life Science and Surface Material will be presented.

4.4.4 Life Science and Surface Materials shops around

In the end off 1998 the Life Science division made further acquisitions. The acquisition of a US plant would enable the Life Science Division to offer a broader range of products to the customers in the biotech sector. The acquisition was to be co-ordinated with another Perstorp subsidiary in the US, Pierce Chemical Firm, but HyClone Laboratories was also supposed to benefit from the acquisition.

In February 1999 Perstorp Surface Materials made an acquisition of a Brazilian firm's decorative papers and finished foils operations. The acquisition was made to complement Perstorp's range of thin foils products as well as provide Perstorp with local production in Brazil.⁹⁹

Following the organisational restructuring, Perstorp also started to turn all of its divisions into independent corporate entities. The reasons being amongst others: to make internal and external valuation easier, to enhance capital awareness and to improve strategic developments. The changes were initiated in 1999 and completed in the first quarter of 2000 at a total cost of SEK 200 million.¹⁰⁰

4.4.5 Life Science acquisitions and the Perbio spin-off

In May and June 1999 the Life Science division of Perstorp made yet another acquisition in the biomedical sector. They acquired Endogen, an American firm developing and manufacturing biomedical research products. The acquisition was made primarily to strengthen the division's know-how in the biotechnology field.

⁹⁹ Perstorp press release, 99-02-04

¹⁰⁰ Perstorp Annual Report 1999

A major change in the corporate structure took place when the firm spun-off its Life Science division to the shareholders in October 1999. Before the spin-off the division also changed the name to Perbio Science. According to one press release the objective was to enable shareholders to benefit directly from the future value growth in the operations and to more rapidly release the inherent growth potential.¹⁰¹ Furthermore, the division was seen to have little synergy with the rest of the groups' operations.¹⁰²

As illustrated in Table 4.9 below, Perbio's sales and operating earnings kept increasing during the late nineties, as well as its investments.¹⁰³ When Perbio was spun off to Perstorp shareholders in October 1999 it was valued at SEK 1500 million at the date of introduction and only one series of shares was emitted.¹⁰⁴

SEK (m)	95/96 (Pernovo)	1997	1998
Net sales	554	549	706
Operating margin, %	11,1	10,6	12,2
Investments	27	48	79

Table 4.9: "Perbio"

4.4.6 The sale of Surface Materials and the new corporate structure

The next major change occurred about a year later, in March 2000, when Perstorp sold the Surface Materials division to an investment firm formed by the owners of Formica and Laminex Industries, two leading suppliers of surface materials. The reason for the sale was to increase Perstorp's focus on chemicals and flooring (later to be known as Pergo), areas where they saw major growth opportunities.¹⁰⁵ Another reason for the sale was that division had been an underperformer for some time. The division's products faced competition from cheaper substitutes and the market was mature as well as in the need for restructuring and consolidation.¹⁰⁶ The sales price of approximately SEK 1500 millions generated a capital gain of SEK 89 millions. The financial figures for the business area are depicted in table 4.10 below, and it can be concluded that the operating margin had been quite poor over the time period.¹⁰⁷

SEK (m)	94/95	95/96	1997	1998	1999
Net sales	2484	2464	1947	1921	2763
Operating margin, %	5,4	5,4	0,5	2,1	6,7
Investments	201	211	55	115	232

Table 4.10: "Surface Materials"

¹⁰¹ Perstorp press release 99-04-07

¹⁰² Interview with Åke Fredriksson

¹⁰³ Perstorp Annual Report 1995/1996, 1997 and 1998

¹⁰⁴ Dagens Industri 1999-10-14

¹⁰⁵ Perstorp press release, 00-03-02

¹⁰⁶ Interview with Åke Fredriksson, 2002-12-19

¹⁰⁷ Perstorp Annual Report 1994/1995, 1995/1996, 1997, 1998 and 1999

The new corporate structure, illustrated in Figure 4.8 below, now only consisted of three divisions; Chemicals, Flooring and Pernovo. The Chemicals division still comprised the Specialty Chemicals business, the Chemitec business and the Construction Chemicals business.

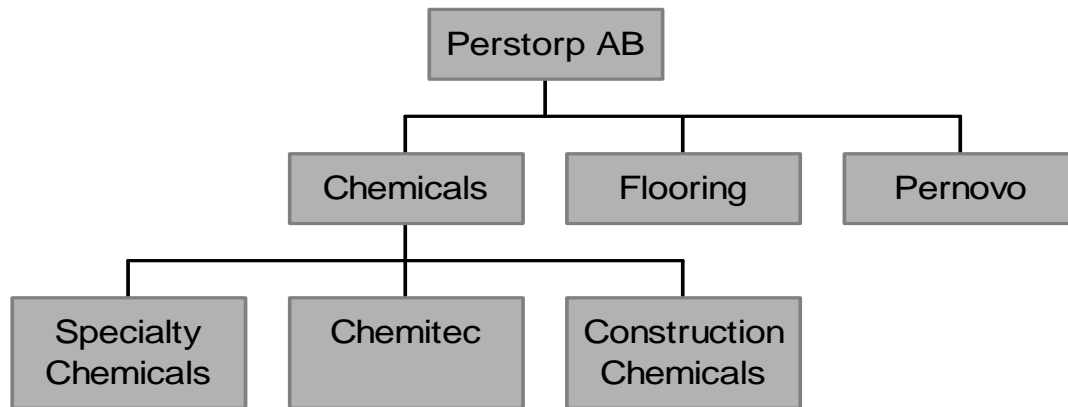


Figure 4.8: “*Organisation Chart III*”

The opinions of two persons involved in the Surface Materials division, Mr. Tommy Hultman (present day market area manager) and Mr. Göran Odholm (present day CEO), regarding the development of Perstorp follows below.

4.4.7 Synthesis of interview with Mr. Tommy Hultman (Present day Market Area Manager, Formica-PSM) and Mr. Göran Odholm (Present day CEO Formica-PSM)

The condition of Perstorp at the start of the second era (1996): The firm had for a long time followed a splendid strategy, a niche strategy. Perstorp was to be involved in several different niches but only in the ones where it was or could be at least the third biggest player. Perstorp never made any real losses nor did it make those spectacular gains either, it was a stable firm that could ride out the swings in the economy. Perstorp’s reputation was immaculate; you felt pride when saying that you worked for Perstorp.

There was as a bit of a problem with the capital budgeting process though, all money was collected in a corporate pot and distributed to different projects and the flooring project was always the first priority. Flooring did however not perform very well; they had problems with a production technology that was too old and not competitive. If any business should have been sold it should have been Flooring. It was like cancer leading to all other areas being neglected.

There were also a lot of new visions and ideas about the organisational structure that was influenced by the “management gurus” of that time. For example a matrix organisation was implemented that led to a lot of conflicts and no one taking responsibility.

The results of Custos’s involvement: When Custos entered the picture Mr Christer Gardell started to characterise the firm. All of a sudden the niche strategy was not a good idea anymore and a lot of employees had a hard time understanding that. The reputation of Perstorp started to sink. The new strategy was short-sighted and a fashion thing. The short-sightedness in the new economy, dominated by the capital market which Mr. Christer Gardell represents, leads to under-investment.

An example of the lack of seriousness of the events concerning Perstorp is that only one week after Perstorp sold Surface Materials to Formica a new business competing with Surface Materials was started. It did not last long though, half a year maybe.

The focus changed during this period from the stakeholder perspective that Perstorp had always had to a pure shareholder perspective. The family’s objectives, that included social goals and a focus on the survival of the firm, governed the firm until Christer Gardell entered the scene. After that there were no longer room for customers and the society, only money mattered. It was not about running a firm just making money.

The management with Åke Fredriksson in front did not really comply with the new ideas but decided that either you leave the ship or you carry on and follow it through. They decided to carry on. Others did not agree but were thrown juicy pieces of meat to “tag along”.

After the synthesised views of the interview with Mr. Tommy Hultman and Mr. Göran Odmalm has been presented, information concerning different expansions will follow.

4.4.8 Expansion

At the time when Surface Materials was sold Perstorp also made three acquisitions, two to strengthen the Chemicals division and one to strengthen the laminate flooring business. The first acquisition, Plasta Erkner GmbH a European leader in the production of phenol-based resins, further increased Perstorp’s position as a one of the larger European phenol-based resins producers. The second acquisition was the polyol operations of Degussa-Hüls. That acquisition was expected to, apart from strengthening Perstorp’s position as a producer of penta and di-penta (a kind of polyol), generate considerable synergetic effects through an increased efficiency in the production of polyols. Furthermore, the acquisition broadened Perstorp’s product range through the introduction of calcium formate. The third acquisition

was Witex, a German laminate-flooring producer. This acquisition was made to broadening Perstorp's technology base for producing laminate to also include direct laminate flooring which is a cheaper method of production than Perstorp's original high pressure technology. The acquisition of Witex was also expected to generate serious synergetic benefits in areas of product development, purchasing and logistics.¹⁰⁸

4.4.9 Bid for Neste and Dyno¹⁰⁹

After seemingly well-devised plans Perstorp made an offer for the Finnish chemicals firm Neste in the summer of 1999. Perstorp valued Neste to approximately FIM 3000 million, and there were said to be clear synergies between Neste Oxo and Perstorp Speciality Chemicals. Industri Kapital, the Swedish private equity firm, did however place a FIN 3200 million offer for Neste. When Perstorp increased its offer Neste was no longer interested, and consequently, Industri Kapital won the bidding.

Perstorp also made an initial offer for the Norwegian chemical firm Dyno, the synergetic effects being more questionable though, and Industri Kapital finally bought that firm as well.

4.4.10 Industri Kapital's offer for all the shares in Perstorp

In April 2000 Industri Kapital made a cash offer for the whole Perstorp group. The offer was made for the whole group even though Perstorp had well devised plans for spinning off its flooring division, now called Pergo. The offer was recommended by the board with the motivation that Perstorp's modest valuation made it difficult to make large acquisitions, something that was seen to be of great importance in order to "*hold its own in its markets and create increased value for its shareholders...*"¹¹⁰. The bid was however not well received by the holders of B shares due to the large difference in the offer between A and B shares, resulting in an increased bid for the B shares.

In September 2000 the bid was withdrawn due to a very poor result from the Pergo division.¹¹¹ The withdrawal caused public outcry and both parties threatened to sue each other, and as a result the regulations on the Stockholm Exchange was altered to inhibit this kind of behaviour.¹¹² As shown in Table 4.11 below, Pergo had experienced quite disappointing operating margins for some time and even a negative margin for the year 2000.

¹⁰⁸ Perstorp press release 2000-03-27 and 2000-03-29

¹⁰⁹ Veckans Affärer 2001-03-12

¹¹⁰ Perstorp press release 2000-04-10

¹¹¹ TT Nyhetsbanken, 2000-09-28,

¹¹² Finansstidningen 2001-02-06

The operating loss of SEK 74 million should partly be attributed to the high restructuring costs (SEK 186 million) associated with a change in production technology made the same year.¹¹³

SEK (m)	94/95	95/96	1997	1998	1999	2000
Net sales	1788	2022	2909	3267	3627	3699
Operating earnings	176	92	265	52	184	-74
Operating margin, %	9,8	4,5	9,1	1,6	5,1	neg
Operating earnings adjusted for items affecting comparability					209	107
Investments	127	149	201	97	87	263

Table 4.11: “Pergo”

The board did however continue their discussions with Industri Kapital to find a solution and reach a new revised bid.¹¹⁴ In spite of the effort the discussions were fruitless and Perstorp continued the streamlining strategy and the intention to spin-off and list the Pergo division.¹¹⁵ The result of this streamlining was a new organisation, illustrated in Figure 4.9 below, with three divisions in the chemical sector and the soon to be listed Pergo. The divisions in the chemical sector was: Perstorp Specialty Chemicals which mainly contained the polyol operations, Perstorp Chemitec which was comprised of resins and moulding compound operations, Perstorp Composites involved in composites and Perstorp Formox with a focus on Formalin technology. The activities earlier carried out in Pernovo were also transferred to the separate divisions.¹¹⁶

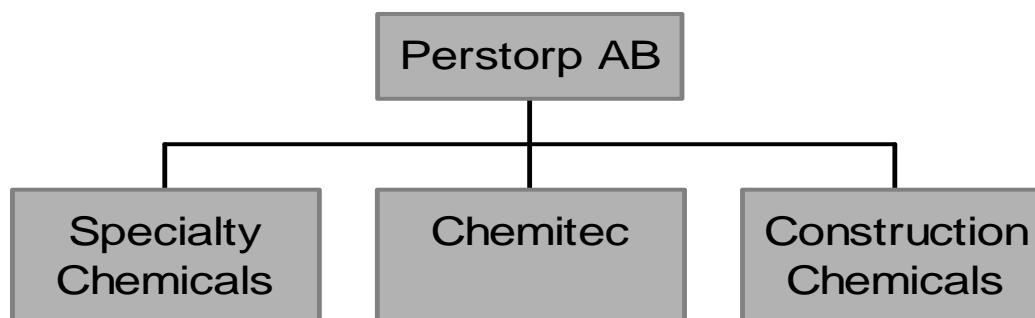


Figure 4.9: “Organisation Chart IV”

¹¹³ Perstorp Annual Report 1994/1995, 1995/1996, 1997, 1998, 1999 and 2000

¹¹⁴ Perstorp press release 2000-10-04

¹¹⁵ Perstorp Press release 2000-11-07

¹¹⁶ Perstorp Press release 2000-12-13

4.4.11 The new offer, spin-off of Pergo and the delisting of Perstorp

Another offer from Industri Kapital (SEK 122 per series A share, SEK 111 per series B share¹¹⁷) was made for all shares in Perstorp (with the condition that Pergo was first spun-off) in March 2001. At the same time Industri Kapital also made a partial offer (about 15%) for Pergo. The board of Perstorp recommended the owners to accept this offer as well. The recommendation was motivated by the fact that Perstorp's potential to increase the value of the firm to the levels of Industri Kapital's offer in a foreseeable future was low. The major shareholders also expressed their intention to accept the offer.¹¹⁸ The offer was eventually accepted and Pergo was spun-off and listed on the Stockholm Exchange ending on a price of SEK 58 per share on the date of introduction, giving the firm an approximate value of SEK 1000 million.¹¹⁹ Since Sydsvenska Kemi, a firm controlled by Industri Kapital, now owned Perstorp its shares were de-listed.¹²⁰

After Perstorp was acquired by Sydsvenska Kemi, Mr Åke Fredriksson resigned from the position as CEO after having guided Perstorp through turbulent times. His views concerning Perstorp and its development are as follows below.

4.4.12 Synthesis of interview with Mr. Åke Fredriksson (CEO Perstorp 1997-2001 & member of the board)

The condition of Perstorp at the start of the second era (1996): Perstorp was a firm with a lot of different businesses with operations all over the world. Some of them were however not that profitable and did not meet the corporate financial objectives. Several of the businesses were operating in mature and global markets, and a consolidation could be foreseen. The synergetic benefits were not obvious between the different businesses; rather, in some cases it was obvious that there were only limited benefits. Some of the businesses had come from Pernovo, whose role had been to find new businesses with growth potentials and by doing so risk diversification was also a result.

The streamlining strategy: Perstorp's strategy during the late 1990s was to get rid of those businesses with limited synergetic benefits. It started with Components, a business that did not meet the corporate financial targets and needed to be developed both in a size and technology sense. Analytical was sold to Foss in Denmark, a competitive firm within the same industry, which strengthened the two units. The next business to be sold was Plastic

¹¹⁷ *Ekonomi24* 2001-03-30

¹¹⁸ *Perstorp Press release* 2001-04-24

¹¹⁹ *Ekonomi24* 2001-06-19

¹²⁰ *Perstorp Press release* 2001-06-08

Systems that were alien to the rest of the business. Furthermore Plastic Systems had a large need for capital and they showed low profit-levels as well.

Next followed the spin-off of Perbio, another subsidiary with limited synergetic benefits with the core business. In this way the shareholders could keep the diversified structure of their portfolios that Perbio had contributed to.

The next subsidiary that was sold was Surface Materials. This business could take advantage of some positive effect of being in the same corporation as Chemical and Pergo since Chemicals was a supplier of Surface Materials and Surface Materials was a supplier of Pergo. Surface Materials was however in a mature market with low margins. To be profitable it had to go for a more global expansion and a broader product base.

The role of the board: The speed of development into a focused firm were advocated in varying degrees by the board members, some of them were in very much of a rush. An expansion of the businesses left in Perstorp was also advocated in varying degrees by the board members. During the focusing process the board was also more active, which is completely natural, when so many businesses are sold.

The capital market: It is important to distinguish between capital market aspects, industrial aspects and ownership aspects. These developments happened in a period where the capital markets had changed. It had become more short-sighted and more demanding. The capital market had started to prefer well-defined (focused) firms since they are easier to value and review. Larger firms with higher multiples were also favoured.

After the synthesis of an interview with Mr. Åke Fredriksson has been presented information concerning the development of the Perstorp share will follow.

4.4.13 Characteristics and development of the Perstorp share during the third era

The price paid by Industri Kapital for Perstorp was SEK 111 per series B share, and can be compared to the price of Perstorp shares on the Stockholm Exchange during the past years. The stock price during the last years is illustrated in figure 4.10 below, and when comparing the development of the SAX index (green line) and the Perstorp share (red line) it can be concluded that Perstorp has been seriously outperformed by the SAX index.

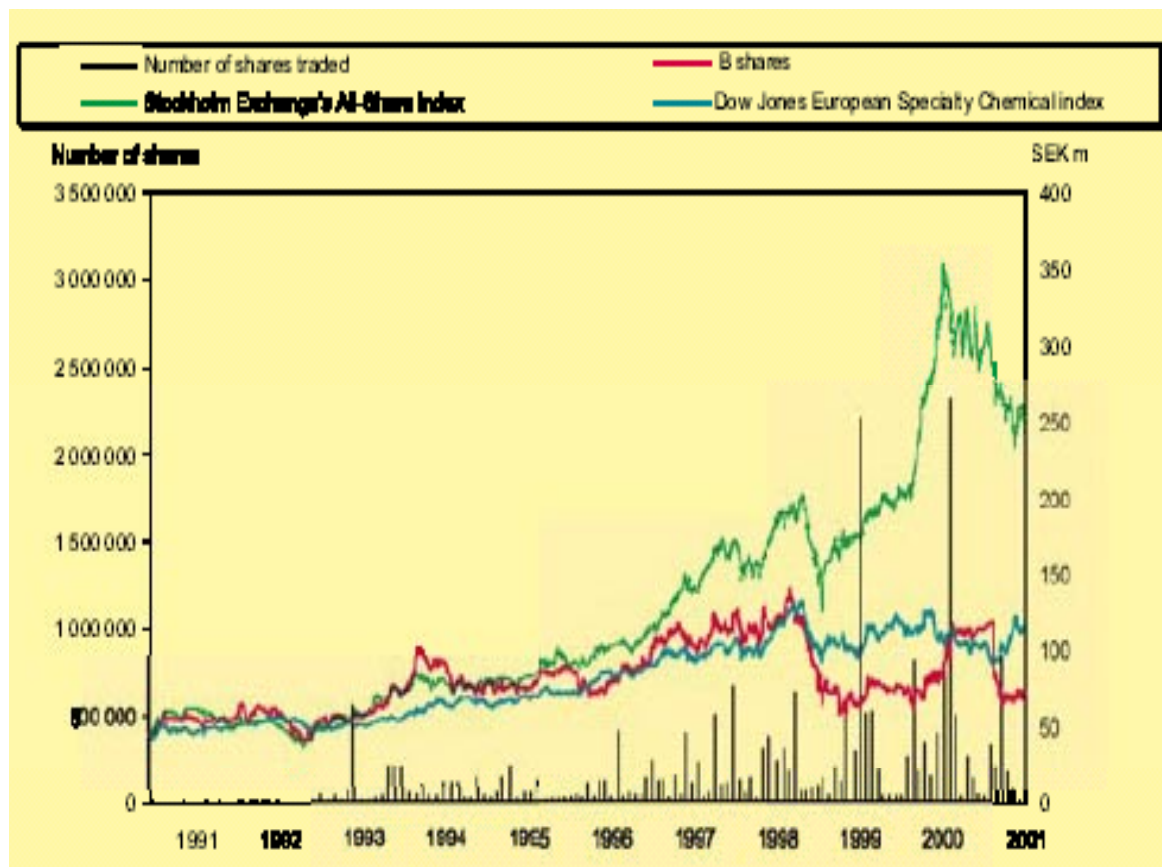


Figure 4.10: “Perstorp share trend”¹²¹

Other characteristics of the Perstorp share can be seen in table 4.12. During this period the development of the value of beta is again interesting, since it keeps declining even though the firm is focusing on fewer business areas.¹²²

	1999	2000
Earning per share, SEK	3,93	3,17
Free cash flow, SEK/share	13,06	3,14
Dividend, SEK/share	4,00	2,00
Market price as percentage of shareholders' equity	149	120
P/E ratio (B share)	24	21
EBIT multiple	11	15
Beta Value	0,78	0,68

Table 4.12: “Per share data – third era”

The liquidity of the Perstorp share kept increasing during the third era, reaching levels of approximately 50 %, which should be compared with the average turnover rate on the Stockholm Exchange that were; 98 % in 1999 and 123 % in 2000. Figure 4.11 below illustrates the share turnover rate during the third era.

¹²¹ Perstorp Annual Report 2000

¹²² Perstorp Annual Report 1999 and 2000

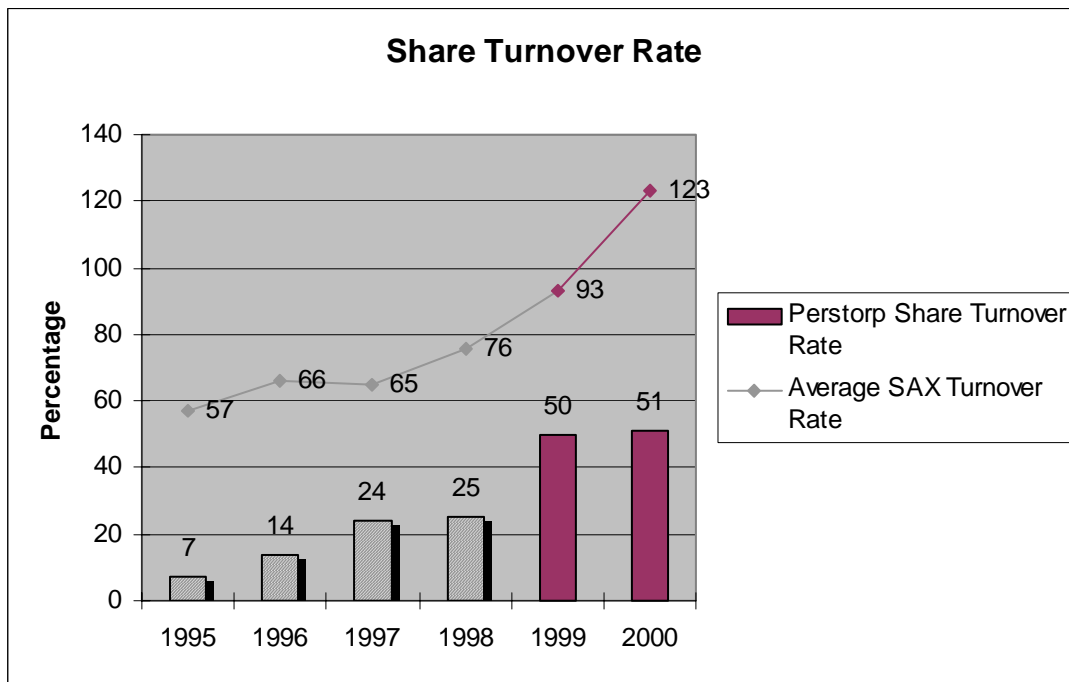


Figure 4.11: “Share Turnover Rate – third era”

In table 4.13 below, operating performance measures for the past six years can be seen for the only division left in Perstorp, Chemicals. The business area had historically shown a satisfactory operating margin and one presumable effect of the focusing strategy could be observed in the increase of investments.¹²³ (The figures for 1994/1995 and 1995/1996 have been constructed by adding the figures for Speciality Chemicals and Chemitec).

SEK (m)	94/95	95/96	1997	1998	1999	2000
Net Sales	3696	3399	4117	4124	4157	5246
Operating margin, %	14,7	13,5	12,3	12,0	9,4	9,3
Investments	247	344	261	388	401	867

Table 4.13: “Perstorp Chemicals”

¹²³ Perstorp Annual Report 1994/1995, 1995/1996, 1997, 1998, 1999 and 2000

5. Analysis: *Explanations for the development in Perstorp*

In this chapter an analysis of the course of events in Perstorp will be made using the theoretical framework developed in chapter three. The analysis will start with a partial analysis where each explanatory variable is used one at a time. The same structure, formulated in chapter three, will be used and the capital market and its potential effect on the course of events in Perstorp will constitute the first section of the chapter. Next, the effect that the ownership structure might have had on the development will be analysed followed by an analysis of the extent to which the decision-makers' perception of the industry can explain the course of events. The chapter will end with an analysis where all the explanatory variables are used at the same time.

5.1 The Capital Market as an influence

When analysing different aspects that have affected Perstorp's corporate strategy during the second and third era, one critical factor seem to have been the increasing importance of the capital market and its preferences. These aspects of the capital market put forward in the third chapter will here be related to Perstorp. Other aspects not mentioned in the theoretical framework but discovered when analysing the course of events in Perstorp will also be pointed out.

5.1.1 The importance of the capital market

Historically, the capital market has been of little concern for Perstorp. The firm acquired capital through a few new-emissions but other than that it was quite unaffected. Both the historically low liquidity of the stock and the concentrated ownership structure is signs implying that the Perstorp share was seen as a long-term investment delivering a stable flow of returns. This constituted a situation where Perstorp did not pay much attention towards the capital market nor did the capital market play a vital role in affecting Perstorp's choice of strategy.

5.1.1.1 Importance of corporate valuation

As outlined in chapter three, the increased emphasis on financial values such as shareholder value, created a large amount of professions associated with the valuation of firms. Since the valuation of Perstorp would affect its possibility to raise capital further described below, it could be argued that the increase in the number of various analysts and the resulting tougher control from the capital market, increased the capital market's significance for Perstorp.

It could be further argued that the increasing information demand by the capital market puts firms' managers under greater psychological pressure since analysts are constantly evaluating them. Subsequently it might feel as if analysts, with limited knowledge about the firm's operations, immediately evaluate a manager's decision resulting in a higher or lower value of the firm on the stock exchange.

5.1.1.2 Importance of equity

One development that made the capital market more important to Perstorp was the growing trend of using equity as the primary form of financing capital or acquisitions. The firm, mostly due to its disparate organisational structure, was often under-valued by the capital market. Consequently, when making any acquisitions using their own stocks as payment Perstorp would forfeit some of the inherent share value, thus paying the seller with shares that were worth more than the actual cost of the other firm. The above-mentioned problem inhibited Perstorp from expanding its businesses through larger acquisitions since Perstorp would always pay a greater premium than competing bidders, and subsequently its chances to reach any considerable size diminished. This can explain why Perstorp did not succeed in making any larger acquisitions even though expansion was an important part of the firm's strategy. The same problem was also inhibiting Perstorp's possibilities to raise capital through emitting new shares because the depressed value of the firm means that the buyers pay less for the new emitted-shares and consequently the cost of capital increases.

Another problem related to capital resources was the fact that the family in middle of the 1990s only represented about 55 % of the voices. Additional new-emissions would dilute the family's voice power even further and since control was one of the objectives for the family, risk capital could only be obtained by issuing shares with low levels of voting rights. In a situation where a large part of the voting rights are already in the hands of owners with a relatively small capital stake in the firm, the capital market usually want a discount on new shares issued increasing the cost of capital for the firm.

5.1.1.3 Increasing efficiency of the capital market

One of the family's historical owner objectives was to construct Perstorp into being a diversified firm, which would be less sensitive to industrial variations than a more focused firm. The main explanation behind this strategy was that the owners had their wealth locked-up in Perstorp out of constitutional and sentimental reasons, and therefore they were not able to diversify on the stock market.

The capital market's increased efficiency, in terms of the holdings being more accessible, less time-consuming to transfer and the increased amount of information available, made

diversifying simpler for the family and the capital market more important to Perstorp. Presuming of course that the historical owner objective was not dominated by the intent of controlling the firm. The increased efficiency in combination with the series A share being listed (1997) created the opportunity for the family members to diversify their holdings on the stock-market, and position their wealth in a portfolio that better reflected their attitude towards risk and return. Consequently, the increased shareholder value emphasis could lead some family members, in an attempt to maximise value, to sell their holdings in Perstorp and creating an individually optimal portfolio. To conclude, it could be argued that the increased efficiency of the stock market coupled with the listing of the series A share made investing on the capital market a decent alternative to diversification through the firm.

5.1.2 The capital market's preferences

When the importance of corporate valuation increased, two primary factors affecting the optimal corporate strategy could be identified; namely the capital market's changed preference for focused and large firms.

5.1.2.1 Preference for focused firms

The increasing interest from the capital market resulted in corporate valuation gaining a greater importance for firms. A conglomerate is amongst analysts considered difficult to value since its dispersed structure has a tendency to "hide" some of the firm's value and consequently analysts prefer focused firms over diversified.

5.1.2.2 Consequences

In Perstorp's case, the organisational structure seemed to be hiding some of the shareholder value, thus leading to a continuous under-estimation of the firm's value. Implementing a strategy where Perstorp's business areas were split up would expose any hidden values. Consequently it could be assumed that the increased importance of shareholder value maximisation affected some of the owners' view concerning Perstorp's organisational structure. Since Custos' prime objective was to maximise its shareholders' absolute value they would benefit from using their voice power to make the hidden values visible, rather than making an exit and investing in another firm. This is under the assumption that the cost of making the values visible would not exceed the difference between the exit share price and the future share price. It is therefore not surprising that Custos was one of the main proponents for dividing Perstorp into individual units, thus increasing shareholder value only by the investment associated with using voice power. The institutional owners would also benefit financially from a focusing strategy that would increase the overall value of Perstorp. But since their policy inhibits them from being much of an active owner they were obliged to

follow Custos' lead. Historically, there had been a consensus regarding the family's owner objective that comprised of sentimental values, risk diversification, the survival of the firm as well as financial goals. The emerging shareholder value approach caused some of the family members to reconsider their owner objective to primarily focus on shareholder value maximisation. The revision of the objectives amongst these owners led them to function much like the other previously mentioned owners, thus favouring a focused firm that ultimately would lead to an increase in personal wealth.

5.1.2.3 Preference for larger firms

There was also evidence that the "new" capital market favoured larger, more liquid, and international firms over smaller ones, thus acting as a proponent of consolidation. However, for a firm to meet the capital market's demand concerning expansion large amounts of capital are required.

5.1.2.4 Consequences

Conglomerates were faced with two interconnected dilemmas regarding expansion due mainly to the dispersed organisational structure that they exhibit. Firstly, as a consequence of limited capital supplies, it is rarely possible for a conglomerate to expand all of its businesses thus making some businesses inferior to its competitors. Depending on how the capital market values the increasing size of the expanding businesses compared to the relative declining size of the other businesses, shareholder value is affected. Secondly, if a conglomerate decides to expand in some business areas it is quite likely that the expansion is financed by a reallocation of capital from the non-expanding businesses, resulting in a similar effect on shareholder value as discussed above. The subsidising of one business on the behalf of another could however be a very important part of a firm's investment strategy, since the sensitivity towards initial losses declines, thus increasing patience concerning potentially profitable investments.

A focused firm does however not exhibit the above-mentioned problems concerning growth since it only includes one business, and is consequently able to concentrate all of its capital and other resources to that specific business. Subsequently, the conglomerate structure is not to be considered optimal if shareholder value is seen as an important owner objective and the capital market prefers larger firms.

For Perstorp, the prospect of acquiring other firms in the speciality chemicals area was however quite limited due to the fact that few synergies were visible, but also due to the problems associated with using equity as means of payment. Neste Oxo could have contributed somewhat to Perstorps core competence, but since the major part of that firm comprised of high-volume bulk chemicals it was considered unattractive.

5.1.3 Effects on corporate strategy

The increasing importance of the capital market coupled with the preferences favouring focused and large firms made Perstorp's previous diversification strategy unfavourable. The organisational structure was hiding the firm's value and therefore the valuation of Perstorp estimated by the analysts was constantly low, making it more expensive for Perstorp to acquire either capital or other firms. As a result Perstorp failed to live up to the capital market's preference for larger firms, and did not gain any size-premium. The capital market had also become more efficient and enabled individuals to diversify through the capital market rather than through Perstorp. It can therefore be concluded that the capital market's increased importance and preferences consequently made focusing the optimal structure. In Perstorp's case, the ambition to streamline the firm and using the excess capital to expand in the area of chemicals can therefore be seen as a consequence of the capital market's preference for larger and more focused firms. As previously mentioned, a focusing strategy would make hidden values visible and lead to a relatively higher valuation of the firm. If the costs associated with the focusing strategy did not exceed the profits associated with an improved valuation of the firm, it could be argued that the relative value of the firm would increase even though the expected future revenues do not.

A greater emphasis on shareholder value compared to other stakeholders' values could be explained by both the capital market's increased importance and the capital market's preference for certain types of firms. Consequently, the shareholders demand increased transparency and more information concerning the firm's performance in order to be able to identify hidden shareholder value. Furthermore it results in less approval of hidden values since the shareholders could rightfully claim them and benefit from an increase in their personal wealth.

It should be stated though, that both the importance and the preferences of the capital market worked interdependently in affecting Perstorp. For example only a change in the capital market's preferences, and not in the importance of the capital market, would not have affected Perstorp's corporate strategy. If Perstorp would be under-valued as a consequence of not being focused, it would not affect the firm's ability to acquire other firms if equity would not play a big role as a means of payment. If on the other hand, only the importance had increased and there would be no changes in preferences Perstorp would have to use equity as means of payment. But since the preference for focused firms would not be present Perstorp would not be under-valued, and using equity would not be a problem.

The analysis of the capital market's increased importance and the changed preferences on the capital market can be concluded by claiming that the declining value of the Perstorp share

gave the family an indication of the costs associated with fulfilling the “other” objectives. When that cost reached a certain level the corporate strategy was altered, thus making shareholder value more important than historical and stakeholder values.

5.1.4 Time horizon, attention and the vertical value chain

In analysing the change in capital market’s character, issues that do not affect the corporate strategy directly have been identified that nonetheless deserve to be mentioned.

5.1.4.1 Shorter time horizons

The family as well as the capital market had previously shown patience with Perstorp’s long investment horizons, thus comprehending the special characteristics associated with developing new chemicals and surface materials. The capital market, coupled with the emerging shareholder value approach, did however not express the same patience, requiring faster results. One of the explanations behind the preference of a shorter time horizon could be found in the way that many analysts value firms. Since it is not uncommon for analysts to use a valuation horizon of approximately two years and thereafter presuming a steady state of future development, investments with long lead-times are unfairly treated. Analysts tend to base their calculations on easily accessible information and on tangible dimensions that are unproblematic to process and consequently missing a considerable amount of information that could be found in “softer” dimensions. The shift in appropriate time horizon gave rise to an increasing dissatisfaction with subsidiaries that were unprofitable and the pressure from some of the owners to sell them off accelerated.

5.1.4.2 Increasing attention from the capital market

The capital market’s growing preference for shareholder value as the dominating method of valuation quite naturally led to firms becoming more frequently scrutinised. One of the changes that soon became apparent to Perstorp was the capital market’s increased interest in the firm’s operations and performance. There was a sharp escalation in the demand for reports that covered shorter periods of time and the capital market saw it insufficient to only provide an annual report. To meet with the change in capital market’s characteristics, a firm’s management had to create new communication channels. These interaction with the capital market where in the form of board of directors meeting with analysts, bankers, business journalists and so forth.

5.1.4.3 Shift in the vertical value chain

As previously described the increasing emphasis on shareholder value as the primary ownership objective further increased the owners' demand for controlling the operations of the firm. In Perstorp's case it resulted in additional owners demanding board representation in an attempt to influence shareholder value, and therefore shifting the decision making balance from the management to the board of directors. This shift in the vertical value chain could be illustrated by the number of board meetings; which were approximately five meetings a year up until 1995, culminating in about 30-35 board meetings in the most recent years.

5.1.5 Summary

Traditionally Perstorp had been quite independent from the capital market, financing most of its growth from internal resources. This meant that the management did not have to listen that much to the desires of the capital market. Even if they had to listen extensively to the desires of the capital market the capital market did not have that much to say, they were quite silent.

Eventually the firm started to depend more and more on the capital market especially since a low valuation makes acquisitions expensive. At the same time the indirect ownership increased and with it a focus on shareholder values arose. As discussed in the third chapter the stronger focus on shareholder value led to more power and control on behalf of the indirect owners. The institutions, analysts and business journalists started to demand more information and the market started to react more to that information. The increased focus on shareholder value made the cost of fulfilling other objectives than shareholder value visible thus influencing the owner family's view on the appropriate objectives.

Perstorp found itself in a situation where it was more dependent on the capital market. At that same period the capital market started to express more of an opinion and the nature of the expressed opinion changed. In the past, diversified firms had been celebrated but now focus was the word of the day. Furthermore, the capital market started to prefer large firms, which they rewarded with higher valuations.

In such a situation being a diversified firm gives you a competitive disadvantage. The disadvantage has both a direct cause in a higher cost of capital (due to the lower valuations that diversified firms suffer from) but also an indirect disadvantage in the difficulty that a diversified firm has to grow in all of their businesses. Because of the difficulty to grow the firm will not be able to enjoy the valuation premium that are given to large firms.

Consequently the strategy that Perstorp had followed in its past now seemed less appropriate. Earlier, the cost of the strategy was lower and some costs were not visible. It therefore seemed

likely that the capital market did influence the changes that were made in Perstorp during the two eras that this study focuses on. The capital market's influence on Perstorp's corporate strategy is illustrated below in figure 5.1.

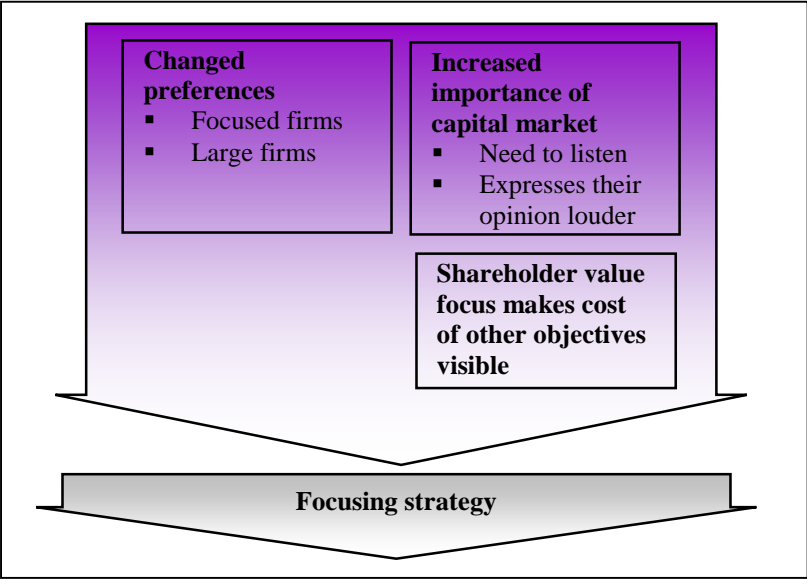


Figure 5.1: “The Capital Market’s influence on Corporate Strategy”

5.2 The owners and their characteristics as an influence

In the first part of this section the important characteristics that have been identified in the theoretical framework will be described for each owner. Furthermore a description of the changes in these characteristics of the owners, if any, will be made. These descriptions of the owners will then be used to analyse what the dominating objective in Perstorp was and how it changed. In the second part of the section an analysis will be made of the consequences that ownership structure and its characteristics had on Perstorp. First, the effect of the dominant objective and the change in the dominant objective will be analysed. Secondly the effect of the change in the voice/exit behaviour of the owners will be discussed. At the end of the section a summary of the result of the previous analysis will be made both expressed in words as well as graphically.

5.2.1 The family

5.2.1.1 Interests/Objectives

Traditionally and at least up until the 1990s the objective for the family concerning their ownership of Perstorp was multidimensional. There was some type of social objective where Perstorp, according to the family, should be an important part of community. The family also seemed to have a sense of pride in the fact that Perstorp had created numerous jobs for a lot of people. Another dimension of the family's goal was concerned with the survival of the firm. The family felt that it wanted to continue the legacy of granddad and that the control of the firm should stay within the family.

In the middle of the 1990s, a disagreement about the objectives for owning Perstorp started to arise within the family. Roughly described, the family members were divided into two factions, which were based on their view on the objectives. One faction of the family, known as the "modernists", seemed to put a greater emphasis on shareholder value and other financial aspects. Some family members also wanted to liquidate some of their assets that were tied in Perstorp and that wish was in conflict with the objective of keeping the control of the firm within the family. Furthermore the family members were discontent with the management indicating that the management did not perform in line with the family's expectations. The other faction that was known as the "traditionalists" were more reserved on implementing the shareholder value as an ultimate objective. To some extent there were family members who totally resented any forms of change in Perstorp's corporate structure.

5.2.1.2 Voice/exit behaviour

The different mechanisms available to the family to exert power can be categorised as being voice and exit. The degree to which the specific owners can actually exert power is dependent on the capacity to use these mechanisms.

In the case of the Wendt family's ownership, utilising exit as a mechanism for control was restricted by their objectives. A part of the Wendt's main objective was to maintain full ownership and control of the firm consequently restricting the family's capacity to use exit. It was obvious that the only means available for the family to exert power was to use voice mechanism. The term loyalists seem to be appropriate to describe the family's behaviour.

Voice can take different forms such as representation in the board of directors, direct contacts with the firm's management, contacts with the other owners and participation at the board meeting. The family, who had the majority control, were keen on utilising the different forms of the voice mechanism. Therefore discussing mechanisms of voice, it is important to highlight and analyse the power of using such mechanism. The capacity to exert power through voice is dependent on the access to information about the firm's plans and the competence to evaluate the firm's plans. This capacity can also be seen as dependent not only on the absolute access and competence but also the access and competence relative to the management's competence. The relative access and competence is therefore a measure of asymmetries of information. In Perstorp, the firm seemed to be run by the executive officers. They designed the strategies and went forward implementing new strategies. The board seemed to depend totally on reports from the management and did not seem to interfere with the firm's daily routine. Furthermore the board, where the family was represented, had only 4 to 5 meetings a year. In those few meetings it seemed to be a difficult task to discuss all the relevant issues. Such circumstances indicate that there were informational asymmetries between the board of directors and management.

5.2.2 Custos

5.2.2.1 Interests/Objectives

Between the years of 1995 and 1996 turbulence arose in Custos resulting in Öresund taking control of the firm. Before the takeover, Custos had been a firm without a strong focus on creating shareholder value and the goal seemed to be more about controlling other firms. Once Öresund took helm control Custos objectives became more focused on maximising absolute shareholder value aimed at satisfying shareholders.

5.2.2.2 Voice/exit

Before Öresund gained control Custos' behaviour was passive and silent without any demands of having board representation. The passiveness resulted in the fact that voice was not used in any material way to exert power. The other mechanism, exit, was however, available to Custos. The power of that mechanism comes from both the threats of an exit as well as the signal that it sends if an exit is executed. The power of the threat does however seem to be limited due to the passive history of Custos' portfolio. Once Custos adapted a new strategy, there was a change in the use of voice and exit mechanisms for control. The new strategy was to be an active owner that introduced voice as an important mechanism. Custos applied different voice mechanisms through forms such as representation in the board of directors, direct contacts with the firm's management, contacts with the other owners and participation at the board meetings. Although Custos was a minority owner, they found that the capacity to exert their power with voice seemed to be considerable. Custos put in a lot of resources in making strategic analysis that were used in the board of directors. Christer Gardell, who represented Custos objectives, also seemed very conscious about the importance of information advantage and made great efforts to acquire information. The power of the threat of an exit also increased since the new strategy required Custos to be able to exert power, otherwise the holding would be sold.

5.2.3 Institutional owners

5.2.3.1 Interests/objectives

The institutional owners' objectives were unchanged during the two focus eras. That objective can be expressed as being one of maximising the relative or absolute shareholder value.

5.2.3.2 Voice/exit

The institutional investors were all passive owners. Since the institutional investors' holdings, in most cases were not long-term, they had a need to be able to trade the holdings without large limits. Some of the effects of being an active owner, by for example being represented on the board, would be that the trading of the holdings could be restricted due to legal barriers (i.e. laws on insider trading). Furthermore, their portfolios were well diversified resulting in a portfolio consisting of a large amount of different holdings. Exercising power through voice is a costly procedure and tends to use large amounts of resources. As a result utilising voice as an effective mechanism for control the holdings have to be large and few. There were some signs though, that the institutional owners did use the voice mechanism. For example there were some informal contacts between institutional owners and with management, they were represented at the board meetings and furthermore there was contact with the other owners. However, as discussed above, there was limited contribution of the power exerted by these

mechanisms. The strongest mechanism for institutional investors to exert power was therefore the exit mechanism. This mechanism is used frequently in most of their holdings and the threat of exit should therefore be powerful. The fact that their position in Perstorp had been more or less unchanged does however indicate that their required rate of return was in parity with the expected rate of return and therefore they did not have to use the exit mechanism.

5.2.4 The dominant objective of Perstorp

5.2.4.1 The dominant interest/objective

The dominating owner in Perstorp up until around 1995/1996 was without a doubt the Wendt family. Their dominance had several explanations: the fact that they had more than 50% of the voting power, they were the most active owners and the shareholder value was not the only objective for the family. The first two reasons speak for themselves but the third reason deserves an explanation. The primary mechanism available to the other owners was exit. An exit puts pressure on the value of the stock on the exchanges. For an owner where maximising wealth is the only dimension of the objective, the pressure on the value of the stock created by an exit, would be perceived negatively. Consequently the threat of an exit should be more powerful when maximising wealth is the only objective. Due to the family's position as the dominating owner, Perstorp's strategy had been coloured by the family's objectives.

5.2.4.2 Changes in the dominant objectives

The dominant owner up until 1996 was, as mentioned earlier, the Wendt family. However, in 1996 the Wendt family was challenged as the dominant owner when Custos changed its strategy and became the most active owner. The purpose of the new active behaviour was to get control of the firm and become the dominant owner. To become the dominant owner the majority of the formal voice power that the Wendt family had was an obstacle for Custos. The majority of the voice power that the family enjoyed was based on the fact that there was a difference in voice power between A and B series shares and consequently Custos did not approve of the differences. In that situation it was psychologically hard for the family to use their formal voice power to force decisions through that was in conflict with the decisions desired by Custos. The real difference between the voice power of the series A and series B shares can therefore be argued to have decreased.

The change in Custos' strategy and the fact that they did extensive work on strategic analysis of Perstorp's enterprises gave them an informational advantage. Utilising that advantage, Custos commenced dialogues with other owners leading to alliances being built between institutional investors and the "modernist" group with the Wendt family.

Custos also made a cash offer for the A shares well above the market price, that visualised for the owners in the family what shareholder value could be worth for them. This was meant to change the focus of the family's objectives and align the interests of the family with that of Custos. Custos also issued options on their stocks that were given to the management to align their interests with shareholder value maximisation.

Custos, in its newly found position, demanded two seats on the board but were only successful at negotiating one seat. The board consisted, (after Christer Gardell was elected to the board) of board members that represented two different kinds of objectives. Custos, together with the "modernists" now represented a shareholder value oriented objective and Gösta Wiking together with the "traditionalist"s represented the family's traditional objective. Before the board meetings the alliance of "modernists" met to reach a consensus so that they were able to control the board. Gösta Wiking and the "traditionalists" resigned from the board in 1999 after an unsuccessful attempt to take complete control of the board. Subsequently, the destiny of Perstorp lay in the hands of a board that only consisted of members representing the shareholder-oriented objective.

The control of the firm was no longer in the hands of the family because the family as a homogeneous group no longer existed. Instead the major part of the voting rights were divided between the "modernists" with about 25% of the votes, the "traditionalists" with 25% of the votes and Custos with about 12% of the votes. The dominating objective was now only concerned with creating maximum shareholder value in the traditional sense.

5.2.5 The owners' influence on the strategy of Perstorp

5.2.5.1 The effects of the dominant objective

The fact that one objective was to keep the control of the firm within the family restricted the family's ability to diversify its wealth. Given a limited wealth with a large part of the wealth tied in Perstorp, diversification was limited. The result of the objective of control therefore gave rise to another aspect of the family's objectives of ownership, namely diversification. Since the owners themselves could not diversify, the strategy of Perstorp had to fill that function for the family. Since the family was in control of the firm the diversification strategy that Perstorp followed, up until its major transformation started, therefore appears to have been strongly influenced by the control and diversification objectives of the family.

Another dimension that could be a part of the explanation of Perstorp's corporate structure in the middle of the 1990s was the family's desire for Perstorp to be an important part of the community. One way to fulfil that desire could be by making Perstorp constitute a large part of the society's economic activities and a large part of the society's labour market. A

conglomerate consists of several business units and is therefore, *ceteris paribus*, larger than a focused firm. Subsequently a strategy to create a conglomerate would be appropriate in fulfilling the family's objective to become an important part of the community. Hence, the family's control over Perstorp and the family's desire for Perstorp to be an important part of the community seem to have been one of the main reasons for the diversification strategy of Perstorp.

In achieving the other dimensions of the objective, which was the survival of the firm and diversification of the wealth of the owners, it would be helpful if Perstorp were a conglomerate. If Perstorp were only involved in one business, it would not benefit from the lesser than 100% correlation that exists between different businesses. If one business had problems with performance utilising revenues from other businesses could rescue the firm. By diversifying, the risk of default would be lower and at the same time volatility of cash flow back to the owners would also be lower. One of the reasons for the multiple niches/diversification strategy seemed to have been the influence that the family exerted over Perstorp together with the family's objective to diversify.

5.2.5.2 The effect of a new dominating objective

With changes in the objectives, the earlier logical structure of the firm was not logical anymore. The niche strategy that had once fitted well with the earlier objectives was no longer a matching one. The conglomerate structure that was the result of that strategy could no longer be motivated because the dominating objective did not include social objectives, objectives of the survival of the firm and diversification of the family's holdings through the firm. Instead the structure needed to be changed in order to be in line with the new objective, which was maximising the shareholder value. In a shareholder value perspective it is not efficient to have a conglomerate structure. The management in conglomerates can often not manage the disparate businesses and therefore the performance of the firm suffers. Perstorp also seemed to exhibit this symptom, with problematic businesses that lead to the negligence of other businesses. The different aspects that makes a conglomerate structure contradictory to the new objective about maximising shareholder value was further developed in the section about capital markets. The change in strategy and corporate structure does therefore seem to have been affected by the fact that the dominant objective had changed.

An example that illustrates the change in objective is when PerBio was spun-off with only one series of shares. Had the traditional objective been dominating, the aspect of keeping the family in control of the firm would probably have led to a division of shares into A and B shares. That was also what the traditionalist side of the family advocated.

Another example was the change in perception from a stakeholder perspective, which had dominated Perstorp traditionally, to a shareholder perspective. The stakeholder perspective is an appropriate perspective if there is a social dimension to the objective. The shareholder perspective is an appropriate perspective if the objective is to maximise shareholder value. Had the traditional objective prevailed, the stakeholder perspective would have likely remained.

The best example of the change in the dominating objective was when Industri Kapital made an offer for Perstorp. Had the old objective about continuing the legacy of granddad been dominating, the board would not have recommended an acceptance of the offer and the shareholders would not have accepted the offer. The traditionalists that held on to their objectives did however accept the offer. The acceptance was probably not due to a change in objective; rather it was an expression of having few alternatives. They did not seem to think that it was possible to once again have the firm follow the old strategy.

It is also worthwhile to be aware of that it was the first time when the family did not have someone acting as a diplomat (mediating the split within the family) causing the rift to remain. Maybe the factions would not have remained had their lawyer been there to mediate. In that case Custos could have been left without an ally in the family and the traditional objectives could have survived as the dominating objective. In such a scenario the events in Perstorp could have been totally different.

5.2.5.3 The effect of voice/exit behaviour

In the contemporary history of Perstorp there seem to be a lack in the voice power of the owners. The owners suffered from an informational gap, which gave management the upper hand. Literature written on informational asymmetry states that management, with enough leegroom, will act in their own best interest. According to Gedajlovic and Shapiro (1998) management discretion can result in increased costs manifested as increased compensation for management or as unrelated diversification that contributes to the power, prestige and status of the managers. Some of our interviews also indicate that these results were present, for example the management had access to limousines at their discretion. Furthermore the conglomerate structure can be a sign of management using their informational advantage. The fact that the conglomerate structure matches the objectives of the dominant owner does, however, mean that the interests of management and the owners were not in conflict. The problem of informational asymmetries had thus limited effect on strategy.

5.2.5.4 Changes in voice/exit behaviour and the effect on Perstorp

The asymmetries in information described earlier could have affected the strategy if there had been a conflict of interest between the owners' dominant objective and the interest of the managers. A change in the dominant objective and the effect that can have on strategy, as discussed earlier, could also be identified when Custos entered the scene. The information asymmetries would then become a factor affecting strategy since these asymmetries would make it possible for the managers to carry out a strategy that would not be in line with the objectives of Custos. However, when Custos started to implement their new ownership strategy and became an active owner in Perstorp the role of the board changed. The meetings were held 30-35 times a year and the board carried out more of the strategic analysis. Custos also contributed with a lot of strategic analysis. This indicates that the size of the information asymmetries became drastically lower. The management's objectives were also changed due to the fact that Custos issued options to the management. The interests were therefore more or less in alignment with the shareholder perspective of the new dominant objective and the new voice/exit behaviour did not seem to have influenced the corporate strategy.

5.2.6 Summary

An illustration and an interpretation of the effect that the owners and their characteristics had on the development of Perstorp can be seen in figure 5.2. At first the family's objective and their dominance as an owner led to a dominating owner objective with several dimensions; control within the family, importance in the community and diversification. At this point the management's interests were aligned with the dominant objective and the effects of any potential informational asymmetries resulting from the owners' behaviour were small. The dominant objective was therefore the major factor that led to diversification being the corporate strategy.

The altered behaviour of some of the owners changed that picture. The behaviour of Custos changed and that, together with the fact that some of the family members changed the focus of their objective, resulted in a change in the dominant owner objective. The change in the dominant objective also meant that the interests of management, if unchanged, would no longer be in alignment with the dominant owner objective. Custos' changed behaviour in the form of issuing options to management did however change the interests of management leading to a mitigation of the conflict of interest. The informational problem was therefore not a major problem even after the change in the dominant owner objective. Consequently the governing factor concerning the corporate strategy was still the dominant owner objective. This time the dominant owner objective was mostly related to shareholder value maximisation and led to a focused strategy since that was the corporate structure that was seen to have the highest value on the stock market.

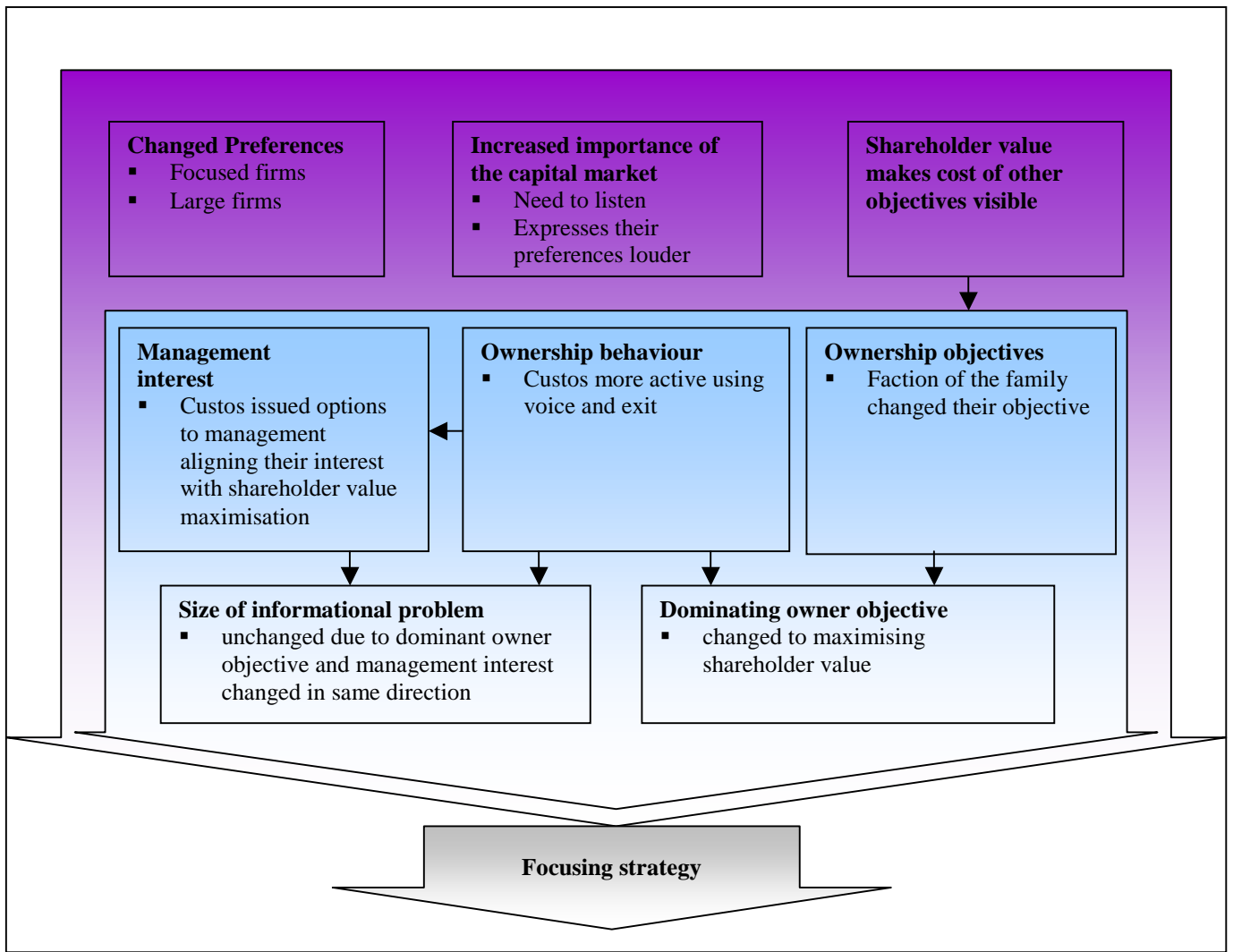


Figure 5.2: “How the capital market and the owners influenced strategy”

5.3 Perception of industry as an influence

The last two sections have indicated that the owners and the capital market had a great influence on the strategy of Perstorp. The combined effect seemed to have changed the strategy from a multiple niche to a more focused strategy. The degree of diversification and its relation to the capital market in general and more specifically the owners of Perstorp have thus been examined. The next task is to examine the degree to which the perception of the industries has affected the choice of industry given the choice of diversification. The analysis of the influence of the perception of industry will be made for each major event.

5.3.1 Components

The first major change was when Components was sold. The industry that the business was in had experienced major changes making the industry less attractive. The customers, who were large automotive firms, had grown considerably and an industry that depends mainly on sizeable volume buyers tends to build a structure where suppliers are not in a position to exert power. The customers also experienced problems with profitability that made them put pressure on their suppliers in order to lower the costs. These changes thus decreased the attractiveness of the industry.

Furthermore, customers had changed purchasing strategies and therefore preferred fewer suppliers that could offer a more complete range of products. In order to do that Perstorp would have to offer products that could not be classified as niche products and staying in the industry would therefore not be in compliance with a niche strategy.

Selling of Components was therefore to a great extent the effect of changes in the industry. The industry attractiveness had changed as well as the possibility of being a niche participator.

5.3.2 Analytical

The industry that Analytical was in, had also changed. The industry had entered a more mature stage where size had become more important. The importance of size was primarily found in the importance of cost advantages as a mean to create competitive advantages as well as the importance of market power that a leading market position offers. In order to reach a size that could create this cost advantage and market power advantage, acquisitions had to be made. One of the potential candidates, Foss, was however not interested in selling and the consequence was therefore that Foss acquired Analytical.

Once again changes in the industry seem to have been, together with problems finding means to grow, a part of the reason for divesting one of their business areas.

5.3.3 Plastic Systems

Plastic Systems was a Perstorp subsidiary that showed poor profitability. Furthermore over the years there were signs of growing competition, which was subsequently diminishing the subsidiaries profits within the industry. One factor that could have been the cause of Perstorp's diminishing profits was the fundamental change in the structure of the industry. The 1990s brought about a re-structuring process to the industry, at which Plastic Systems found themselves in a new and less profitable position. For example the European market was at a convergence stage caused by societies changed perception on the global environment. That led to an increase in the demand for improved logistical and sound environment friendly solutions. Capitalising on societies needs, firms entered the market with propositions of substitutes to existing solutions. As a consequence the sheer amount of new entrants saturated the market showing signs of having excess capacity leading to competition of market shares through for example stringent price wars.

If that industry were going to be attractive again a restructuring of the business would have to take place and the excess capacity had to disappear. Furthermore, to prevent excess capacity to be created once again, barriers to entry had to be built. Furthermore, Perstorp did not see any long-term growth potential and consequently, when an offer for the division was put forward, decided that its resources would be better used elsewhere. Behind the choice to sell there thus seemed to be industry aspects.

5.3.4 Life science/Perbio

The Life Science division experienced significant growth during the time that it was under the roof of Perstorp. The division was also very profitable and almost financed its growth internally. The division made several acquisitions to strengthen its operations and production base but also to strengthen its know-how. Furthermore, acquisitions were made to broaden their product base so that they could reach a broader product base and thus reap the benefits of economies of scope. The division was also projected to have a great future, a projection that has also proven to be correct.

The division was however eventually spun-off. The bright future, as well as its splendid past seems not to indicate any reasons, from an industry perspective, to be excluded from the

structure of Perstorp. Therefore the causes for its departure from the Perstorp corporate structure have to be related to other aspects.

5.3.5 Surface Materials

This division had been a success from the start when “Perstorp Plattan” was introduced. This division did however change into a division that did not perform very well. One reason for this poor performance was that the division suffered from competition from substitute products. The technology that Perstorp used was more expensive but yielded higher quality products. The poor performance however indicates that the higher quality could not be justified by the higher costs. The division could have adopted the new technique but would then have found themselves selling a bulk product not in line with the earlier pursued niche strategy.

5.3.6 Pergo

Pergo was a division within a market that was seen to have a bright future. The market was expected to grow and Pergo had a good position. A substitute technique to the one Pergo used did however change that situation. They were in much the same position as Surface Materials as the customers did not appreciate the better quality that Pergo offered. The change in technique did however take a while and the performance of Pergo started to deteriorate. In that sense it seemed like getting rid of Pergo would be a good choice. On the other hand the division operated in an industry and a market that was only in its infancy and had a great potential for growth.

5.3.7 Specialty chemicals

The specialty chemicals division is the one division that was meant to be kept. The division was in an industry that was already consolidated and it was also the division that was closest to the competence that had traditionally been seen as the core competence. The performance was also satisfactory and the firm had a strong position in its niche. From a resource and industry attractiveness perspective this seemed to be an appropriate industry to be in.

5.3.8 Summary

This section of the analysis has been dedicated to an investigation into the role that the industry characteristics had on the changes that Perstorp went through. Several characteristics concerning the industry have been identified that seem to have influenced the course of events for each business area. This influence arises through the boundaries that the industry sets in the eyes of the decision-makers. Furthermore the analysis indicates that the view on which competence that is the core competence has influenced the decision of which business area that the firm should focus on. A finding that requires an extension from the theoretical framework is also included, namely the fact that the business strategy required for the separate business areas might influence the decision of which industries to be in. This is symbolised in figure 5.3 where the box, that the business strategy level used to be written in, has been changed to an arrow pointing at the corporate strategy level arrow. The other findings of the analysis could also be found in figure 5.3.

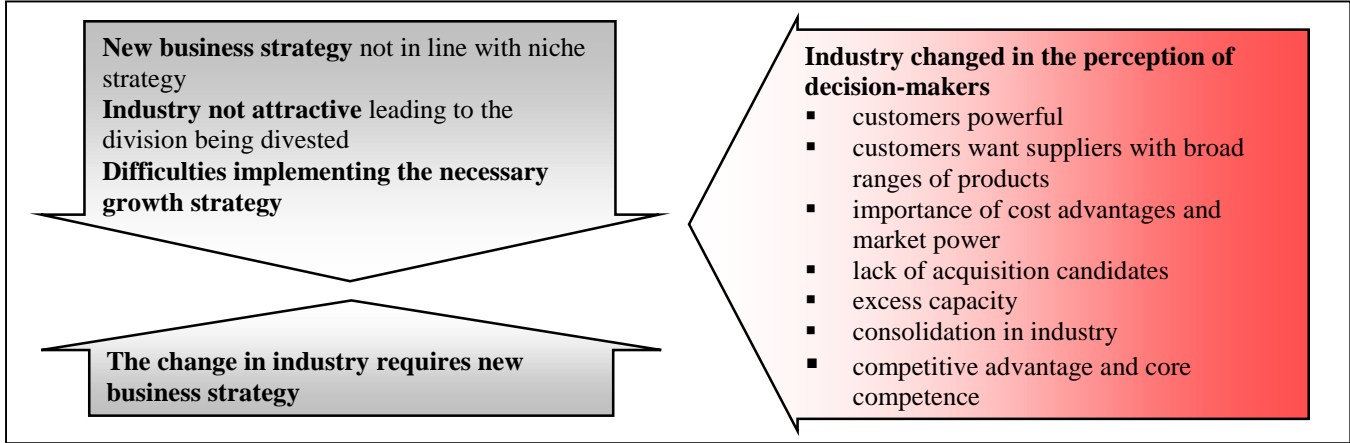


Figure 5.3: “How the industry influenced the events”

5.4 Full analysis: *Putting all aspects together*

The partial analysis is now completed and it is time for an analysis where all the aspects or explanatory variables are used at the same time. In this full analysis all the aspects will be used for each major event and some comments will be made about the importance of taking all the aspects into consideration when explaining the events in Perstorp.

5.4.1 New focused corporate strategy

The first aspect, the capital market, together with the second aspect, the ownership structure was an important part in explaining the changes in Perstorp. The capital market was also a part of the explanation for the changes in ownership structure of Perstorp regarding the objective of some of the owners. The changed exit and voice behaviour of Custos further resulted in Custos being the dominating owner which in turn changed the dominating objective of Perstorp.

The ownership structure and the capital market influenced the change in strategy from a diversified strategy to a focused strategy. The changed ownership structure, in regards to the changed objective, made the earlier diversified structure obsolete. In order to create shareholder value, that had become the dominating objective, complying with the preference of the capital market could be a possible solution and a focused strategy was therefore a more appropriate strategy. Since the information asymmetries between the managers and the owners did not give rise to any problems, due to the lack of conflicts of interest regarding strategy, the dominating owner objective was governing the strategy. Subsequently it resulted in a change to a focused strategy as illustrated in figure 5.4. This new strategy furthermore seemed to have been a major determinant for the sale of some of the subsidiaries, which is illustrated in the sections to come.

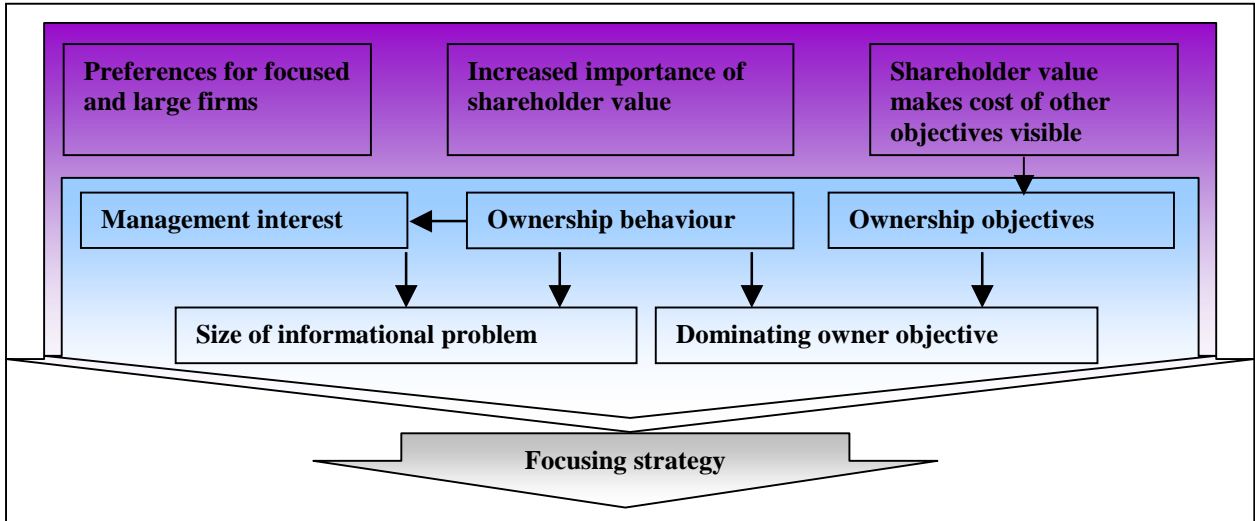


Figure 5.4: “The new corporate strategy”

5.4.2 Components was sold

The strategy did not change to a focused strategy until the dominating objective changed, which was sometime in 1998 or the beginning of 1999. The changes that took place before the change in objective can therefore not be a consequence of that change. Instead we could find the answer within the industry. Components had experienced major changes in its industry and the industry had become less attractive. The decision to retract from that industry therefore seemed to be an effect of the corporate headquarter wanting to change the allocation of resources between industries. Graphically this could be illustrated below in figure 5.5.

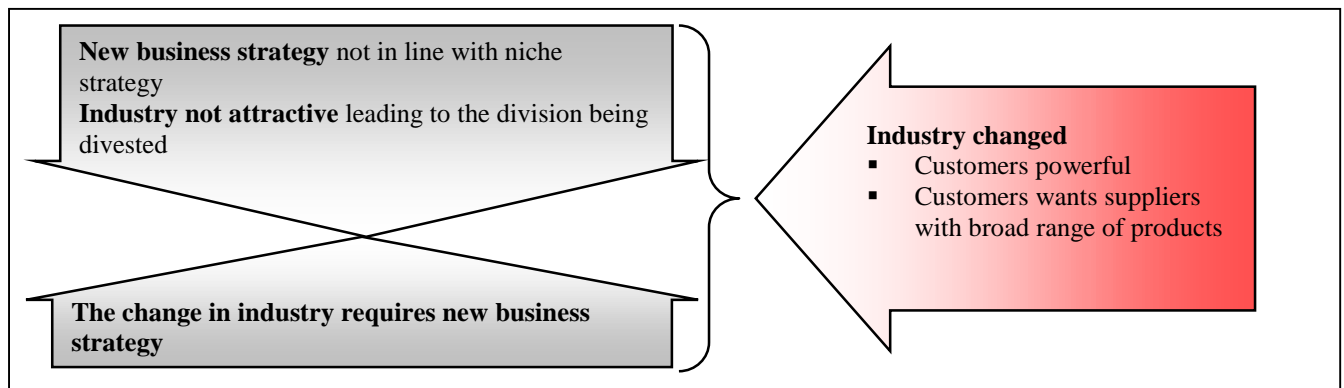


Figure 5.5: "The sale of Components"

5.4.3 Analytical is divested

When Analytical was sold the new strategy had not yet surfaced and therefore the new strategy could not explain the sale of this division. The explanation for the sale can instead be found in the fact that Analytical needed to grow to become more competitive but unfortunately, due to restrictions, there were no available candidates to acquire. The prospects for the division therefore warranted a reallocation of resources between industries. Graphically this could be illustrated below in figure 5.6.

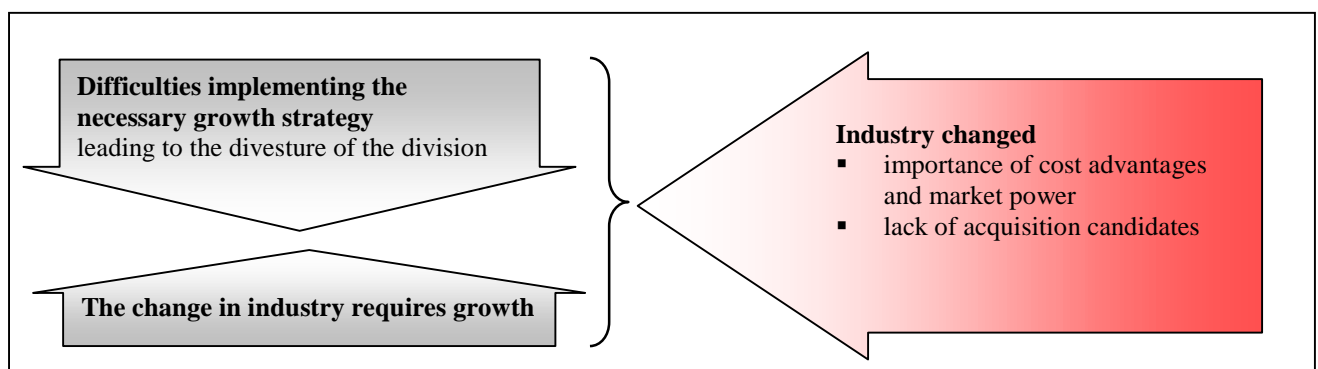


Figure 5.6: "The sale of Analytical"

5.4.4 Plastic system is acquired by Industri Kapital

Once again the explanation for the sale of the Plastic Division cannot be found in the change to a focusing strategy since the sale took place in the middle of 1998. Even if the dominating objective had changed at this point that would not be enough since the process of selling the firm started before the sale was formalised. Furthermore, the performance of the division was poor and the industry was in a need for restructuring due to excess capacity, low entry barriers and price wars. Graphically it could be illustrated as in figure 5.7 below:

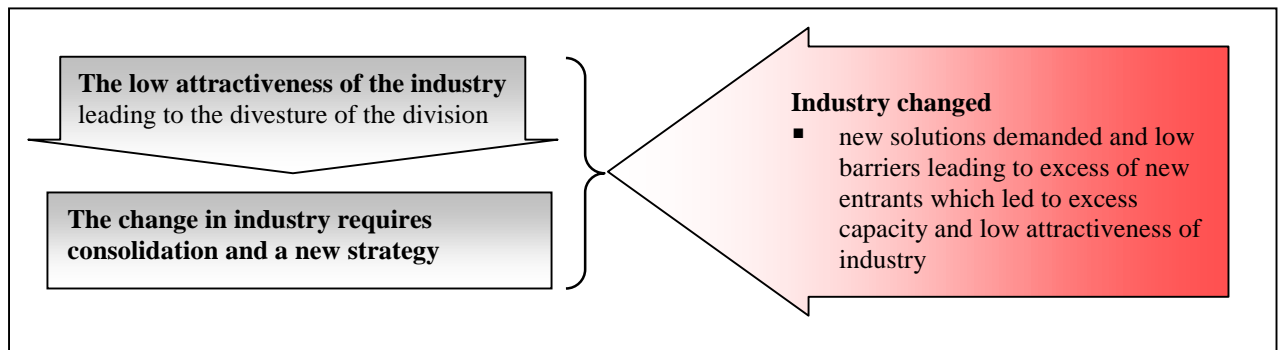


Figure 5.7: “The sale of Plastic System”

5.4.5 Surface Materials, Perbio and Pergo

Regarding the sale of Surface Materials it is difficult to reach a clear-cut conclusion about the causes. The dominating objective had changed at this point indicating that the sale of Surface Materials could be a result of the changed strategy. The industry had however changed and the division had not lived up to the performance requirements. What can be said is that the change in strategy did not slow down the process of selling the division. It is however not possible to say if the industry changes alone would have been enough to bring about the sale. Traditionally the division had been seen as closely integrated with Pergo and parts of Specialty Chemicals. That traditional view might have constituted an obstacle for change requiring more than poor performance as an argument for selling off the division. The new strategy might then have been the critical factor that triggered the sale.

Spinning-off Perbio is a more apparent indication of the new focused strategy. This subsidiary was in an attractive industry and had performed well in the past. At the time of the spin-off and at the time when the spin-off was decided upon, the dominating objective had changed. The lack of industrial aspects explaining the spin-off and the fact that it was spun off and not sold indicates that the reason lies in a change in strategy from a diversified strategy to a focused one.

The next change in corporate structure was the spin-off of Pergo. This division suffered from poor performance but a poor performance that had not yet surfaced when the spin-off was decided upon. The division was also pressured by a new substitute technology. Furthermore the strategy had changed at this point in time indicating that the sale could be due to the new strategy. The conclusion is that it is not possible to say whether this division had been sold without the change in strategy but the poor performance would probably have been overlooked for a while since the division was seen as closely integrated with Surface Materials and Specialty Chemicals. It is therefore likely that the new focused strategy was the critical factor that brought about the spin-off. The discussion above could be illustrated in figure 5.8.

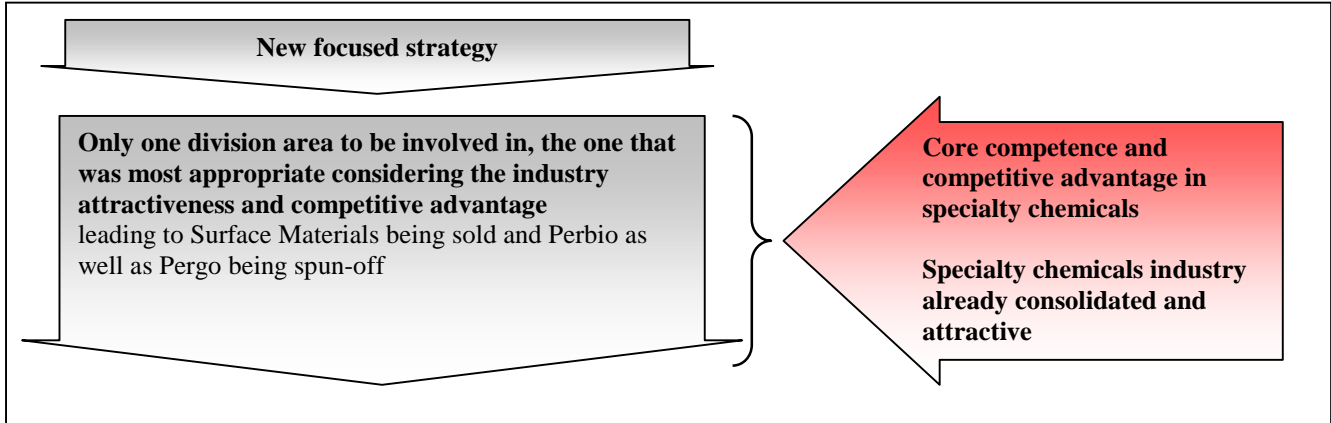


Figure 5.8: “The sale of Perbio, Pergo and Surface Materials”

5.4.6 The role of the three aspects

All of the aspect of the theoretical framework appears to have its role in explaining the events and developments of Perstorp. Had the framework only included the industry and resource aspects then the picture of what happened in Perstorp, portrayed in the empirical conclusions above, would have included fewer nuances. For example, the new dominant objective and its role in explaining the sale of the Surface Material division via the new strategy would not have been discovered. Neither would the role and importance of the changes in the capital market and the new preferences of the actors on that market have been detected. The authors would therefore like to suggest that the framework put forward do have a higher explanatory power regarding the developments in Perstorp than a model only incorporating the industry dimension. Furthermore it seems as if there is a need to understand how the capital market influences the specific owners of a firm. In the case of Perstorp, examining the ownership structure of Perstorp would have been helpful in explaining some of the reasons for a change in strategy. One of the reasons for that change was however that the objective of some of the owners had changed. If the capital market had not been included in the mindset when analysing the causes of the changes in Perstorp, the role that the capital market has played via

the changed objectives of some of the owners had not been identified. Furthermore, the analysis would have missed the role that the view of the actors on the capital market, that were not major owners or owners at all, play regarding the supply of capital (cost of capital) and the boundaries that it sets for the managers. The specifics of the existing owners and their behaviour contribute further to the understanding of the events. For example if only the capital market in general had been incorporated in the framework the changed behaviour of Custos and its new strategy would not have been noticed. Neither would the importance of the behaviour of the owners in determining the dominant objective of the firm have been discovered.

6. Conclusion: *The final theoretical framework and implications*

In this chapter the final model will be presented as well as a discussion about its generalisation value. There will also be a discussion about what kind of implications that follow from the findings concerning the capital market and ownership structure, and the chapter will be concluded by suggestions for further research.

6.1 The final model

In the introducing chapter of the thesis the authors argued that traditional models explaining the development of firms often do not incorporate capital market aspects and ownership structures. It was further argued that the capital market has become more important during the recent decade and that it therefore is warranted to include the capital market aspect in a model explaining the development of firms. In the traditional models the owners are furthermore treated as a homogenous group even though it is quite obvious that the objectives of different individuals differ. Both the ownership and capital market aspect were therefore accounted for in the construction of the original theoretical framework of this thesis.

The thesis objective was to create a theoretical framework describing how the capital market, the owners and the industry affect the development of firms. Since the framework only focuses on these dimensions there are quite naturally other aspects that could describe the development of firms that are omitted. The specific dimensions are also simplified and exclude potentially affecting aspects. The authors do however argue that the framework is an effective simplification of reality focusing on dimensions that are crucial for firms, and that the framework has high explanatory power. The authors also argues that the framework is user-friendly and the logical linkages easy to follow. In summation, it could be said that the framework shows high explanatory power in explaining the firm development in the case of Perstorp, and a discussion about the frameworks suitability in different settings will follow in section 6.2 “Generalisation Value”.

The findings in the empirical study indicated the validity of the theoretical framework but it also contributed new nuances to the framework. The original framework did not include anything about owners affecting the interests of managers the way Custos changed the interests of management by issuing options to them. This new aspect is shown in figure 6.1 “*The final model*” as the arrow between *Ownership behaviour* and *Management interest*.

Furthermore the empirical study has shown that the increased focus in the capital market in general can affect the objectives of owners in specific firms since the shareholder value focus makes the cost of other objectives visible, or put in other words, the alternative costs becomes more transparent. This new aspect are shown in figure 6.1 "*The final model*" as the new box to the upper right and the arrow connected to it that points at the box with *Owners' interests*.

After studying the developments of Perstorp the authors also found that the strategy that the decision-makers perceive to be appropriate to follow in an industry might influence whether the firm decides to operate in that industry. The reason for this influence is that the appropriate business area strategy might be in conflict with the overall corporate strategy. This finding is symbolised in figure 6.1 "*The final model*" where *Business area strategy* is now written inside an arrow pointing at the corporate strategy level arrow instead of written inside a box.

As it could be seen from figure 6.1 there is no direct linkage between the industry and the decision whether to focus or diversify. It could however be argued that the industry could affect this decision by for example customers demanding a wider array of products from a single supplier, just as in the case of Components. Although in that specific case it was the conflict between the niche strategy and the new demands from the customers that led to the division being sold, rather than a direct connection between the perception of the industry and the decision to focus. Since that linkage was not found in Perstorp it is not represented in the model.

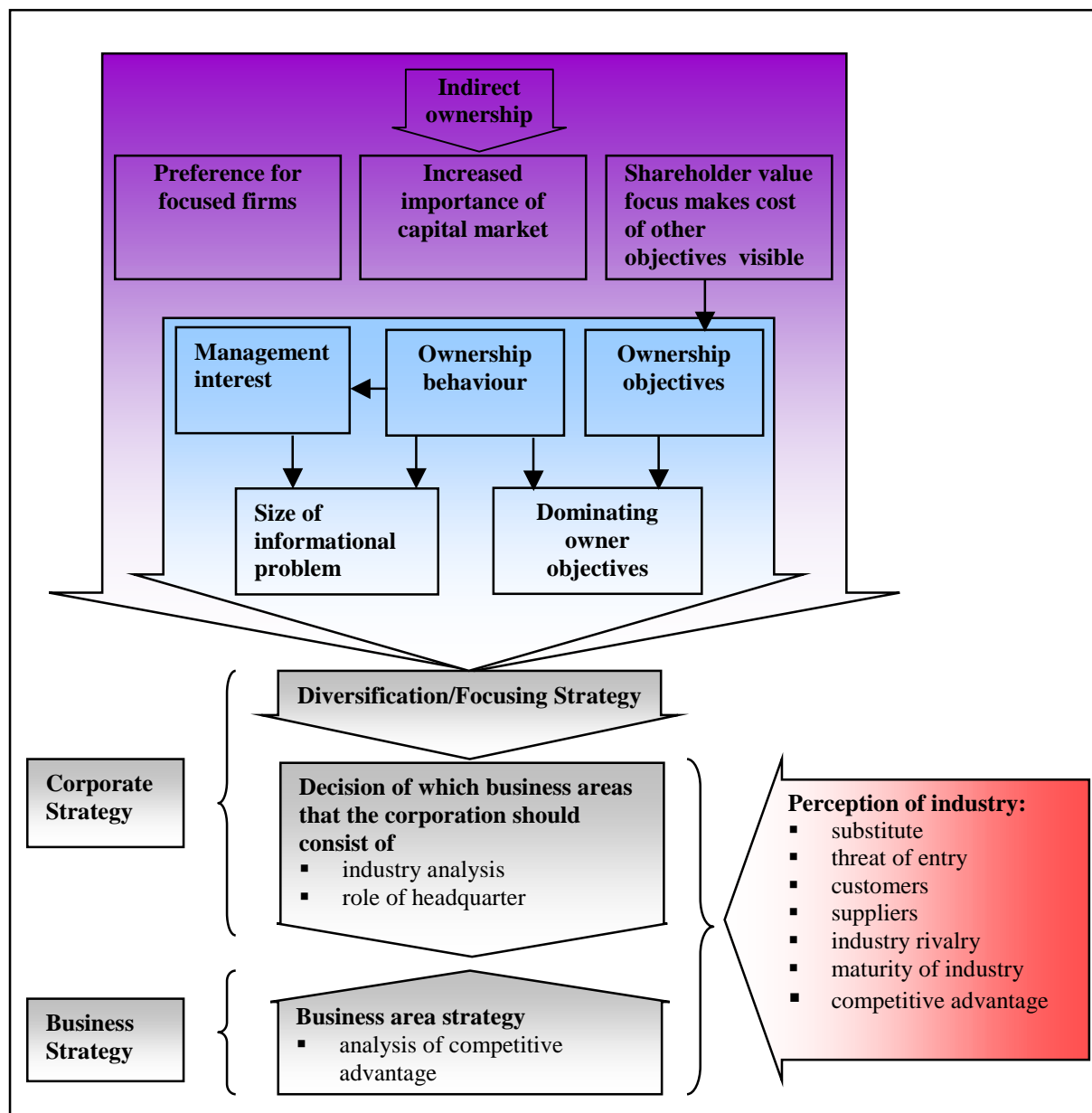


Figure 6.1: “The final model”

6.2 Generalisation value

As outlined in chapter two a case study could be argued to have a low, or non-existent, generalisation value since only a specific phenomenon is studied. The authors do however argue that the Perstorp case could be used to make naturalistic generalisations as well as serve as a foundation for reader specific generalisations. It could for example be argued that the framework could be used in explaining the developments in Trelleborg, a firm exerting many similarities with Perstorp. Presuming that the capital market influences a specific firm in a similar way as it did in Perstorp’s case and the ownership structure is similar to Perstorp, the framework could be generalised and argued to show high explanatory power. For example, the development of a conglomerate during the 1990s with a similar ownership structure as

Perstorp could be argued to be comparable to Perstorp's in terms of shifting ownership objectives.

The individual importance of the three different aspects of the framework might however differ from firm to firm. The development of some firms might be more related to the ownership structure and the capital market and the industry and resource aspect might better explain the development in other firms. Furthermore, if the model would be used when analysing changes in another firms and found without potential to explain the changes then the problem would have at least been narrowed down to include three explanations less. The value of the model would however increase substantially if it were tested on a larger population of cases that focuses on the same situation and aspects. The value of this thesis is thus much dependent on the findings in such a study. This thesis should therefore be seen to bring value in the sense that it can be the base for further studies, but also in the sense that it produces a holistic and realistic description of the developments in the case firm. Suggestions for further studies will be discussed more under the section 6.4 "Suggestions for further studies".

6.3 Implications of the role of the capital market and the ownership structure

The high explanatory power of the capital market that was found in this thesis indicates the importance of a well functioning capital market. If the capital market would be inefficient, in the sense that it systematically encourages owners to take actions that creates profits in the short term in exchange for a loss in the long-term profit creation ability, the capital market's strong influence on the development of firms would have devastating effects on the economy. If institutions, like private equity firms, take advantage of this inefficiency by acquiring firms and implementing measures that increases the value that the capital market ascribe to the acquired firm, but lowers the real economic value of the firm then the private equity firms are not adding value or redistributing value. Instead, they would be destroying value and could be argued to be a menace to society.

On the other hand, if the capital market were efficient, private equity firms would not be able to take advantage of any inefficiencies and the capital market would punish measures that destroys value. In such a situation private equity firms would play a vital role in monitoring firms and their managers and would create value in an indirect way as well as a direct way. The indirect way that they would create value is through the threat that they constitute for managers. This threat sets boundaries for managerial behaviour that is unwanted from society's point of view. The measures that they implement in the firms that they do acquire

create value in a direct sense. An example of such measures could be to divest businesses that do not perform well and only adds value to the managers.

This indicates the importance of investigating the efficiency of the capital market and the potential systematic errors in the analysts' valuation models. This study has given a weak indication of a capital market that exhibits inefficiencies. The analysis process followed by analysts seem to miss out on the long term consequences of investments due to the fact that the models assume a steady state after only one or two years. With such models investments with a long time horizon, with large negative cash flows the first years and with large positive cash flows further in the future, will be evaluated in a harsher way than investments with a shorter time horizon even if their net present value would match each other. Consequently the models used exhibit robustness problems. An example of an investment that would be treated unfairly by such models are research and development projects. Further investigation into the area of the analysis process of analysts is therefore warranted.

The above-mentioned problems concerning the valuation process, resulting in under-investments and a short-sighted focus on financial returns, as well as the characteristics of the market for corporate control give rise to another problem, namely responsibility. To ensure industrial development someone has to take a long-term responsibility concerning investments and accept that the pay-back time might be long, rather than focus on investments that give swift returns but do not improve the industrial development. Since the indirect owners seems to increase and loyal owners in the form of families diminish, the indirect owners have to take over the responsibility of creating long-term industrial development not only for the benefit of the firm, but also for society. It could however be argued that the indirect owners lack the industrial competence, as well as the long-term incentives, and is not suitable to take an active ownership role. This leaves the responsibility for industrial development to the management, but with the increased focus on shareholder value maximisation and corporate governance, it seems as if their freedom of action is constantly diminishing. If the average turnover time of a CEO as well as compensation plans favouring short-term financial returns, is taken into account, it seems difficult for the management to create any industrial development without risking their employment. Since the major part of the direct owners actually have long-term investment horizons through for example pension plans, it could be argued that there is a possibility for indirect owners to position themselves as loyal long-term owners and let the management take the industrial responsibility.

The ownership structure measured as the actual behaviour and interests of the owners was also found to have high explanatory power. This indicates further the importance of the efficiency of the capital market. The voice and exit behaviour of the owners was an important determinant for the strategy choices. This importance was found not only via the relationship between managers and owners but also via the relationship between the different owners. The

voice and exit behaviour was very much the determinant of the power that each actor had in the relationship. Since the power determines which party's objective that firm will follow it becomes essential for the society that the power is in the hands of the parties that have interests that are aligned with society's interest. Consequently the voice and exit behaviour of the different parties becomes important for society. With an inefficient capital market it would thus be important for society that the investors with a long-term view use voice and exit in such a manner that they control the firms. If the control of firms would be in the hands of owners behaving like private equity firms the society would instead suffer since the firms would under-invest. The matter of which hands the control of the firm is in becomes less important however if the market is efficient. All owners with an interest in shareholder value would then have interests in line with the interests of society.

6.4 Suggestions for further research

As previously mentioned the theoretical framework would benefit from being tested on a larger population of relevant firms. By making a case study on Trelleborg focusing on the dimensions of the capital market, the owners and the industry, and apply the framework on this case the generalisation value would increase. There also seems to be a need for research concerning the valuation principles utilised by analysts and how these principles affect under-investments.

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Appendix A: Glossary

amino plastic = a thermoset plastic based on a melamine and/or urea formaldehyde resin, normally with a cellulose filler

biotechnology = utilization of biological and biochemical processes

catalyst = an active substance in a chemical process that is not actually consumed

cell cultivation = the reproduction of new cells, for such uses as the production of pharmaceuticals

cell cultivation media = nutrients for cell growth

CFC = a popular designation for a group of carbon-fluorine-chlorine products that precipitate the erosion of the ozone in the atmosphere

composite = material or product comprising several different components, such as fiber-reinforced plastic, designed to provide specific product properties

decorative laminate = materials consisting of several layers of impregnated paper pressed together under high pressure to form a board with desired mechanical, color and surface properties

dendritic polymer = hyperbranched polymer that has unique physical and mechanical properties

foils = thin sheets of decorative/ impregnated paper used, for example, for surface covering of furniture

formalin = aqueous solution of formaldehyde, which is used as a basic component in the chemical industry primarily in production of plastics and glues

laminate = see decorative laminate

life sciences = field of operations in biotechnology, medical technology and pharmaceutical products

melamine plastic = a thermoset plastic based on a melamine/formaldehyde resin, normally with a cellulose filler

molding compounds = thermosetting raw material which, after molding, provides products with good mechanical and electrical properties

phenolic plastic = heat-resistant thermoset plastic produced from phenol and formaldehyde resin. Used in heat and electrical insulation products and components in engineering industries

polymer = a (usually organic) chemical compound composed of many identical or similar basic molecules, used in plastics, paints, fibers, etc.

polyol (polyalcohol) = a polyfunctional alcohol

resins = the part of plastics and paints that binds fillers, pigments, etc., to give products such characteristic properties as gloss, strength and chemical resistance

thermoset = plastic that receives its final chemical structure at the molding stage, which includes tempering

Appendix B: Questions to interviewees

Mr. Åke Fredriksson

Would you like to describe your perceptions of the chain-off events in Perstorp during the 90s?

Ownership and the board of directors

What were your views of the owners' objectives concerning Perstorp, what were their goals?

Did the goals differ depending on the type of owner?

What were the different owners' future visions of Perstorp? – The same question applies to the management and the board of directors?

Was there a conflict in visions – in which way and between whom?

How did the family exert power, communicate with the firm and when exerting power with which mechanisms?

Were certain owners more active during the restructuring phase of Perstorp?

Were there factions between and within different owners, and if so would you describe it?

What was the real power of the family, composition of the family members?

What were the roles of management and board of directors – how did the relation between management and board of directors look like – responsibility, control?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a difference between the first and second bid?

Grouping the owners by means of goal, vision and intention – what were the clear changes in the groups during the course of time?

Strategy and Industry

According to you, what is Perstorp's optimal corporate structure?

In which industry should the firm be involved in?

How important was time concerning taking upon a new more focused strategy?

What are your views on the forces and success factors within the industry?

How would Perstorp be able to gain a strong market position?

Fanns ett behov av att växa? I så fall hur?

Was there growth need, and if so how?

Were did the newly found cash (spinning off subsidiaries) go?

Were there other potential firms for acquisition besides Neste and Dyno?

What were your views on the firm's capital structure?

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What are your perceptions on the strategic changes during the 90s?

In what way did Custos contribute to the change in Perstorp? – And the other owners?

Mr. Fredrik Arp

Would you describe your perception of the chain-off events in Perstorp during the 90s?

Ownership and the board of directors

What were the family's intention concerning their ownership of Perstorp – did it change through time?

What visions did the different owners, management and board members have, were there a difference in their view of the future?

How did the family exert power, communicate with the firm and when exerting power with which mechanisms?

Where there factions between and within different owners, and if so would you describe it?

What was the real power of the family, composition of the family members?

How active was the board of directors in the daily business of Perstorp?

What roll did the board of directors have?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a difference between the first and second bid?

Strategy and Industry

According to you, what is Perstorp's optimal corporate structure?

In which industry should the firm be involved in?

How important was time concerning taking upon a new more focused strategy?

What are your views on the forces and success factors within the industry?

How would Perstorp be able to gain a strong market position?

Was there growth need, and if so how?

Were did the newly found cash (spinning off subsidiaries) go?

Where there other potential firms for acquisition besides Neste and Dyno?

What were your views on the firm's capital structure?

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What are your perceptions on the strategic changes during the 90s?

In what way did the family contribute to the change in Perstorp? – And the other owners?

Mr. Christer Gardell

Would you like to describe your perception of the chain-off events in Perstorp during the 90s?

Ownership and the board of directors

What were the intentions of Custos of owning shares in Perstorp?

Were there any indications to what the other owners' perception was?

What were the goals of Custos – shares? Maximising return rates or where there other goals?

What were the goals of the other owners?

What were your visions, what were your views on the future of Perstorp?

What was your perception of the other owners' views on the future of Perstorp?

What was Custos praxis in exerting influence – with which mechanisms?

What was your perception on the family's and other owners' praxis in exerting influence?

With what resources did Custos contribute the firm?

Where there conflicts between different owners and if so what type of conflicts aroused?

Where there factions between and within different owners, and if so would you describe it?

How much influence did Custos exert compared to the other owners?

Furthermore how did that influence change over time?

How active was the board of directors in the daily business of Perstorp?

What roll did the board of directors have?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a difference between the first and second bid?

Strategy and Industry

According to you, what is Perstorp's optimal corporate structure?

In which industry should the firm be involved in?

How important was time concerning taking upon a new more focused strategy?

What are your views on the forces and success factors within the industry?

How would Perstorp be able to gain a strong market position?

Was there growth need, and if so how?

Were did the newly found cash (spinning off subsidiaries) go?

Where there other potential firms for acquisition besides Neste and Dyno?

What were your views on the firm's capital structure?

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What are your perceptions on the strategic changes during the 90s?

In what way did the family contribute to the change in Perstorp? – And the other owners?

Dr. Bo Ursing

Would you describe your perception of the chain-off events in Perstorp during the 90s?

Ownership and the board of directors

What were the family's intention concerning their ownership of Perstorp – did it change through time?

What were the goals of the family?

Vilka visioner hade de olika ägarna, ledningen och styrelsen, hur såg man på framtiden?

Fanns det konflikter i visioner – på vilket sätt och mellan vilka?

What visions did the different owners, management and board members have, were there a difference in their view of the future?

How did the family exert power, communicate with the firm and when exerting power with which mechanisms?

Where there factions between and within different owners, and if so would you describe it?

What was the real power of the family, composition of the family members?

How active was the board of directors in the daily business of Perstorp?

What roll did the board of directors have?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a difference between the first and second bid?

Strategy and Industry

According to you, what is Perstorp's optimal corporate structure?

In which industry should the firm be involved in?

How important was time concerning taking upon a new more focused strategy?

What are your views on the forces and success factors within the industry?

How would Perstorp be able to gain a strong market position?

Was there growth need, and if so how?

Were did the newly found cash (spinning off subsidiaries) go?

Where there other potential firms for acquisition besides Neste and Dyno?

What were your views on the firm's capital structure?

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What are your perceptions on the strategic changes during the 90s?

In what way did the family contribute to the change in Perstorp? – And the other owners?

Mr. Karl-Erik Sahlberg

Would you describe your perception of the chain-off events in Perstorp during the 90s?

Industry and Capital Market

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What role did the capital market have on Perstorp's corporate restructuring?

And if so, were you attentive enough to meet with the requirements of the capital market?

When did your perception on whether Perstorp should go from a diversified to a more focused strategy begin?

Your views on Perstorp's profitability?

Did management get any signals from the board of directors on to which course Perstorp should embark? And if so which signals and why?

What role did the board of directors have?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a shortage of capital?

Did you perceive any change in the family's dominating objective.

Mr. Gösta Wiking

Would you describe your perception of the chain-off events in Perstorp during the 90s?

Industry and Capital Market

Was it the industry and growth within the industry that contributed in Perstorp's change in strategy and corporate structure?

What role did the capital market have on Perstorp's corporate restructuring?

And if so, were you attentive enough to meet with the requirements of the capital market?

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Did management get any signals from the board of directors on to which course Perstorp should embark? And if so which signals and why?

What role did the board of directors have?

Were the board of directors united in accepting the bid from Industri Kapital?

Was there a shortage of capital?

Did you perceive any change in the family's dominating objective?

Appendix C: Ownership development 1996-2000

Ownership development 1996-2000

