Esmaeilzadeh Holding AB (publ)

EHAB

M&A WITH DECENTRALIZED MANAGEMENT IN PRACTICE

BY VIKTOR STRÖM & SAEID ESMAEILZADEH

2023-02-20

Operating a successful merger and acquisition (M&A) strategy is difficult because acquiring and maintaining multiple businesses is both complex and complicated. It is complex in the sense that it consists of multiple components, with varying degrees of interrelatedness. And it is complicated in the sense that some aspects are built on tacit knowledge, unexpected things inevitably occur at regular intervals, and there is a lot of competition. Hence, it is not very surprising research has found that more than half of all M&As fail, i.e., fall short of expectations[1].

A broad analysis of 2500 M&A deals shows that
more than 60% destroys shareholder value[2]

Therefore, knowing what can go wrong is so important. In our last whitepaper – Empowering Entrepreneurs through Decentralized Management – we examined two factors that are especially critical to get right in order to be successful post-acquisition: The need for the acquired firm's level of decentralization, and the need for strategic interdependence between the acquiring-acquired firms[3]. Thus, what is chiefly important is that the acquirer rightly matches the specific needs of the acquired firm (the level of decentralization) with the strategic purpose of the acquisition (the level of strategic interdependence).

At Esmaeilzadeh Holding, we intend to let *entrepreneurs be entrepreneurs* while supporting them along the way. Typically, we contribute to the future success of the acquired firms through board work, participating in investment committees, creating superior incentive schemes, and adding them to our growing ecosystem of successful and dedicated entrepreneurs. However, the ultimate success of an acquired firm should not be dependent on the strategic interdependence of the focal acquired firm and the rest of the portfolio companies, although collaborations (if suitable) between portfolio companies are encouraged.

One reason why we so strongly advocate this distinct strategy - which we refer to as the *Alliance* strategy - is that research suggests it augments entrepreneurship while simultaneously reducing the risks associated with acquisitions. It augments entrepreneurship as the acquired firm maintains its autonomy simultaneously as they receive additional access to human and financial capital through the acquiring firm. This can facilitate the recombination of resources, which is a key ingredient in innovation[4,5]. And it reduces the risks associated with the acquisition because the strategy entails minimal operational and/or structural changes, that is, it is 'business as usual'[6,7].

---

1 Christensen, C. M., Alton, R., Rising, C., & Waldeck, A. (2011). The new M&A playbook. Harvard business review (March 2011).
2 Lewis, A. & McKone, D. (2016). So many M&A deals fail because companies overlook this simple strategy. Harvard Business Review (May 2016).
3 Ström, V. & Esmaeilzadeh, S. (2023). Empowering Entrepreneurs through Decentralized Management. EHAB Whitepaper, available on https://ehab.group
4 Schumpeter, J. (1911/1934). The Theory of Economic Development. Cambridge, MA: Harvard Economic Studies.
5 Penrose, E. T. (1959). The theory of the growth of the firm. Oxford, England: Oxford University Press.
6 Angwin, D. N. & Meadows, M. (2009). The choice of insider or outsider top executives in acquired companies. Long Range Planning, 42(3), 359-389.
7 Siehl, C. & Smith, D. (1990). Avoiding the loss of a gain: Retaining top managers in an acquisition. Human Resource Management, 29(2), 167-185;

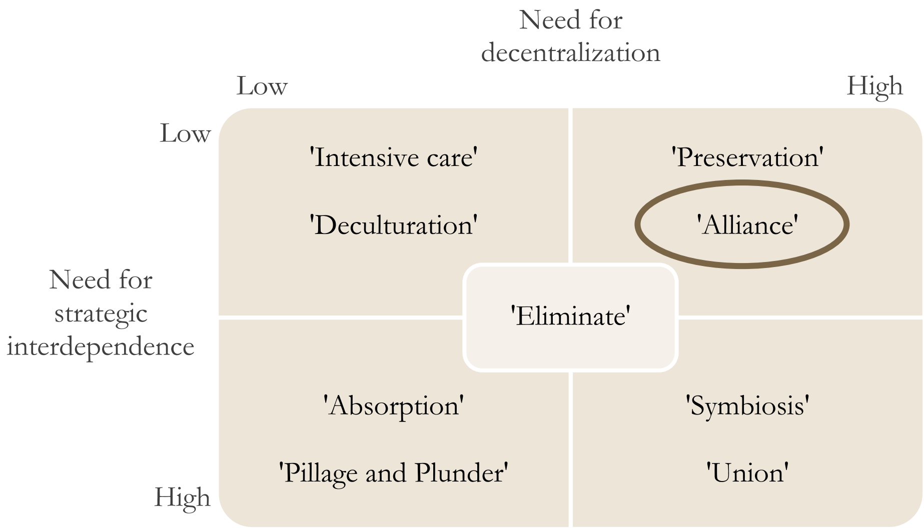

Figure 1: M&A strategies

A well-known and central concern for firms involved in M&A deals is the principal-agent problem. The principal-agent problem, also commonly referred to as the agency theory, is a well-studied phenomenon. The origins of this theory are often traced back to the work by Berle and Means in 1932[8] and/or Jensen and Meckling in 1976[9]. In essence, it refers to the problems arising from separating ownership and control. More formally, Jensen and Meckling defined it as:

> *"a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent"*

There are two types of principal-agent problems that can arise[10]. The first is a conflict in goals between the principal and the agent, and the second is a discrepancy in risk preferences between the principal and the agent. Whereas the former principal-agent problem arises as a result of the agent acting deliberately in self-interest, the latter principal-agent problem arises due to different appetites for risk, which can be argued to be either intentional or unintentional. The critical issue lies in the inquiry: If the principal cannot verify the agent's action, how can he or she be certain that the agent has acted appropriately?

The purpose of this paper is to show how our portfolio companies plan to address this problem. The purpose is also to have a better understanding of other critical components that are required for the decentralized M&A model's success. Four components emerged from the gathered data that merit additional investigation. In this essay, we outline the four components that futureproof the decentralized M&A strategy *Alliance:* buyer-seller fit, aligned incentives, long-term thinking, and perpetual alliance.

---

[8] Berle, A. A. & Means, G. C. (1932). The Modern Corporation and Private Property. New York: Harcourt, Brace & World, Inc.
[9] Jensen, M. C. & Meckling, W. H. (1976). Theory of the firm: managerial behavior, agency costs, and ownership structure. Journal of Financial Economics, 3, 305-60.
[10] Eisenhardt, K. M. (1989). Agency theory: an assessment and review. Academy of Management Review, 14, 57-74.

The primary data used for this endeavor are two interviews and a number of email exchanges with the CEOs of our - Esmaeilzadeh Holding's - two largest holdings, as well as interviews and email exchanges with the CEOs of some of their portfolio companies. More specifically, we will analyze both Novedo and two of its portfolio companies, Elforum and Ventilationskontroll, as well as Mirovia (now part of Lyvia Group) and two of its portfolio companies, Lemontree and Transformant. Secondary data include related reports, presentations, and financial data.

A brief overview of the case firms is required before discussing the components that emerged from the interviews.

Case companies

Novedo was founded in 2020 and is an industrial firm that acquires and develops profitable niche businesses in three critical areas: infrastructure, installation and services, and manufacturing and trade. Ventilationskontroll and Elforum are among the 20 firms that make up the group today.

Mirovia, today part of Lyvia Group, was created in 2020. Its primary business is to invest in and assist in developing entrepreneur-led enterprises that provide software solutions and niche IT services in mission-critical areas. The group now comprises 19 companies, including Lemontree and Transformant Group.

Ventilationskontroll has established itself as a leading expert in ventilation-related services in the Region Västra Götaland over a lengthy period of time (since 1980). Owing to their well-reputed brand within this region, they now have over 500 service agreements in place with various types of actors. The outcome of this is a strong network with a highly diversified customer base. They generated an EBIT of around 13 MSEK in 2021.

Elforum has quickly established itself as a specialist in electricity-related services, in the Region Västra Götaland. Even though their company is new (established in 2017), their team is comprised of experienced and skilled personnel, as seen by their notable EBIT growth rate of close to 100% from 2020 to 2021 (from approx. 5.7 MSEK to 11.1 MSEK).

Lemontree specializes in automating processes, i.e., making the complex simple and eliminating the time-consuming. They have won numerous distinctions since its founding in 1999, such as the DI Gasell Award in 2000, Snabbväxarna in 2013, and the Great Place to Work Award in 2018-2021. They generated an EBIT CAGR of 34.7% between 2018-2021, resulting in an EBIT of 13.7 MSEK in 2021.

Transformant Group has expertise in app-based IT services and consulting. In 2020, Transformant took a large hit when they failed to renew a procurement with their biggest customer, who accounted for 28.2% of their revenues in the preceding 12 months. In less than 10 months after this, they reached an all-time high in revenues, now with a much more diversified customer base. The new all-time-high is owing to a joint effort between Transformant and Mirovia in further developing Transformant's sales department, including developing new sales processes, recruiting new top sales talent, and completing an asset acquisition. In 2021, they generated an EBIT of around 11.3 MSEK.

Buyer-Seller Fit

There are numerous characteristics that come into play in relation to what Novedo and Mirovia (i.e., the buyers) regard as noteworthy in their targeted firms. This includes, but is not limited to:

- Revenue model, Financial stability/predictability, Barriers to entry
- Size, Growth, Operating margin, Cash flow conversion, Market outlook
- Customer base, Customer satisfaction, Customer churn rate/Recurring customers
- Ownership structure, Main entrepreneurs, Culture

This whole paper could be dedicated to discussing the different factors outlined above. That is, however, not the purpose of this paper. Instead, we will concentrate on the one element that the interviewees argued matters more for their decentralized M&A strategy, as compared to centralized M&A strategies. This element is the key entrepreneurs. They are especially important to the decentralized M&A strategy because that model entails letting the entrepreneurs continue to steer the ship the way they have in the past, in conjunction with support from the parent company.

> *"To attract and retain exceptional entrepreneurs such as Rickard [CEO Lemontree], you must give them freedom. Without offering this freedom, they can just as easily sell to an industrial player and get an employment number and an access badge. (...) Besides autonomy, operational leeway is especially important. Our portfolio companies can increase their expenditure up to 30% without needing our approval"* – Sebastian, CEO Mirovia

To echo the last whitepaper with an example, research scholars have argued that "it is the freedom granted to individuals and teams who can exercise their creativity and champion promising ideas that are needed for entrepreneurship to occur. (...) entrepreneurial managers are important to the growth of firms because they provide the vision and imagination necessary to engage in opportunistic expansion"[11]. Hence, in accordance with this and other literature discussed in the prior whitepaper[12], it is clear from the interviews that both Mirovia and Novedo's CEOs understand that granting the acquired firm high levels of autonomy is the right path for long-term value creation when dealing with entrepreneurial leaders.

From the other point of view, one misconception is that all acquired firms (i.e., the sellers) *only* care about the transaction price. Although some sellers arguably fall into this category, especially those who wish to depart from the firm post-transaction, not everyone does, particularly not the entrepreneurs who wish to continue leading the firm toward new heights.

It quickly became evident when interviewing the acquired firms' CEOs that they especially considered retaining their autonomy post-transaction as an utterly important aspect and that they would not see themselves embarking on this

[11] Lumpkin, G. T. & Dess, G. G. (1996). Clarifying the entrepreneurial orientation construct and linking it to performance. Academy of management Review, 21(1), 135-172.

[12] Ström, V. & Esmaeilzadeh, S. (2023). Empowering Entrepreneurs through Decentralized Management. EHAB Whitepaper, available on https://ehab.group

journey without this freedom. In addition to this, they also stressed the advantage of decentralized management with regard to their employees' safety and well-being. Put differently, they did not want any of their employees to feel that they do not want to continue working for their firm because of the ownership changes, and the decentralized approach enabled them to achieve that.

> *"For me, personally, it [decentralization] became a fundamental element as I wanted to continue running the business the way I have since 2016. (...) One goal I had was that no employee should feel that they wanted to leave due to the changes in ownership, and I believe Mirovia's decentralized approach helped us reach that goal"* – Rickard, CEO Lemontree

Aligned Incentives

Apart from giving the acquired firms a substantial degree of autonomy, the buyers also emphasized one other component that is crucial for retaining the key entrepreneurs. This component is aligned incentives. In essence, aligned incentives help to eliminate, or at least minimize, the problems arising from separating ownership and control (i.e., the two issues emerging from the principal-agent problem discussed earlier).

Both Novedo and Mirovia's CEOs maintained that decisions regarding how to incentivize the acquired firms' key entrepreneurs to perform at their very best can have a significant impact on the portfolio companies' long-term performance. Put differently, they argued that when they design and execute those incentives in such a way that aligns their firm's long-term objectives and key results (OKRs) with the key entrepreneurs' day-to-day behavior, superior performance will be achieved.

As commonly done within the M&A realm, both firms utilize the deal structure as a way to align everyone's incentives. Apart from having a direct up-front payment, a smaller part of the purchase price is normally based on the short- to medium-term performance of the acquired firm, usually over the subsequent three years after the acquisition date. We refer to this as an earn-out payment. Accordingly, the earn-out payment incentivizes the sellers (i.e., the key entrepreneurs) to perform at their very best in this period because the better they perform, the more they are paid, and vice versa. Because the interviewed entrepreneurs are a competitive group of people, this type of incentive truly motivates them to outperform.

> *"Like most entrepreneurs, I am competitive in nature, hence I am driven by beating the projected growth target communicated to Novedo"* – Aleksander, CEO Ventilationskontroll

In addition to the earn-out payment, a smaller share of the purchase price is also commonly offered as a reinvestment opportunity in the parent company. This is called the reinvestment sum. Whereas the earn-out payment incentivizes the portfolio company to outperform in the short to medium term, the reinvestment sum incentivizes the portfolio companies to outperform in the long run.

Note the subtle but important difference, the former is based on the individual company whereas the latter is based on the collective. This, too, motivate the interviewed entrepreneurs to outperform as they become part of something greater, where everyone is working together towards the same goal.

> *"I feel very optimistic about investing in Novedo together with like-minded entrepreneurs. Everyone has skin in the game and is working towards the same goal"* – Aleksander, CEO Ventilationskontroll

From the buyers' perspective, it was stressed in the interviews that aligned incentives, in coalescence with their decentralized management approach that gives the entrepreneurs ample autonomy and decision-making power, is essential for attracting new entrepreneurs, retaining them, and making them perform at their best.

> *"The fact that the owners of the acquired companies are also offered to invest in Novedo, together with our decentralized management, offers a strong incentive for entrepreneurial companies to become part of Novedo. (...) Incentives are particularly important for encouraging the entrepreneurs to stay on board"* – Per-Johan, CEO Novedo

Long-Term Mindset

Similar to Buyer-Seller Fit being conditional on many criteria, was a long-term mindset apparent in many ways. When interviewing the buyers, they discussed the importance of not focusing too much on the present, that is, the current quarter. It is instead more important to take the long view and make the necessary adjustments today that maximize the chances that the long-term OKRs will be reached. To use an analogy – it is more important to win the war rather than to sacrifice the war to win the next battle.

In line with the above, we will focus on one element of this component, specifically the element that the interviewees claimed matters more for the decentralized M&A strategy. It is moreover an element that often seems to lie far down the road, and hence, it arguably does not receive the attention it deserves. In other words, we are referring to the unavoidable succession.

Both firms emphasized the importance of always being prepared for this (i.e., the C-suite succession), regardless of when one might believe that will occur. One of the firms, Mirovia, has already supported one of their portfolio companies when hiring a new CEO, arguably one whom the portfolio company would not be able to attract without being part of the Mirovia group. And the other firm, Novedo, is currently rolling out its Leadership Academy, which objective is both to make their current portfolio companies' leadership first-class, but also to increase the internal pool of potential successors.

> *"The purpose [of our Leadership Academy] is to gather the portfolio companies' C-suites, especially the CEOs, and discuss and share knowledge in relation to how to act, how to manage, and how to motivate. The purpose is also to allow other key personnel to participate and learn, both to increase their output but also to have a larger pool of potential internal C-suite successors"* – Per-Johan, CEO Novedo

From the sellers' perspective, the underlying reason they sold (apart from the obvious paycheck) was to pave the way for accelerated growth, obtain a stronger competitive position in the market, and become part of something greater. One reason for this is, of course, to become more profitable, but another, the less explicitly articulated reason, is to become more enduringly profitable. Put differently, they expressed their interest in securing their firm's future existence by being more strategic now.

> *"I believe that the best way to secure my firm's future existence is to continue executing on our growth trajectory. If we stagnate now we will be in a much weaker position in the future. (...) Novedo will help us reach our long-term growth goals"* – Johan, CEO Elforum

Perpetual Alliance

As both Mirovia and Novedo's way of organizing is characterized by decentralization and giving their portfolio companies ample autonomy, they do not have any pre-decided, standardized post-acquisition strategy templates. What they do, and how they do it, is thus a function of the acquired firms' specific needs.

One activity both firms rely on to better understand these needs early on is to have a workshop or meeting with the newly acquired firm. This usually takes place two to four weeks after signing the share purpose agreement (SPA) to allow some breathing space. According to Sebastian, the CEO of Mirovia, this always tends to be a very positive meeting because everyone is eager to start working together towards attaining the next level. In addition to this structured but tailored initial gathering post-transaction, both firms expressed that it is mainly through board meetings they do most of the work, which should not be remarkable considering their management philosophy.

Besides these more formal, infrequent activities, there is also this element of relatively frequent informal conversations taking place here and there. How often these occur depends on the focal entrepreneur's preferences. The underlying need for these can be attributed to the fact that we live in the ever-changing knowledge economy, which is characterized by an accelerated pace of technical and scientific advances[13], which suggests that support might be called for in-between these parsed formal meetings.

---

[13] Powell, W. W. & Snellman, K. (2004). The knowledge economy. Annu. Rev. Sociol., 30, 199-220.

Even when there is no support needed, these chats are arguably valuable because informal conversations constitute an important part of knowledge transfer, and they also function as a 'getting to know each other' amplifier.

> *"Because opportunities can arise all the time, it is important that we are agile in our supporting role. (...) I typically talk with most of the leading entrepreneurs, those who prefer that, close to one time per week"* – Sebastian, CEO Mirovia

From the other point of view, the CEOs of the acquired firms expressed that everything was more or less exactly as how they expected it to be post-acquisition, that is, everything stayed the same. An interesting remark though was that some of the employees in Ventilationskontroll expected things to be worse, i.e., that everything would not stay the same; however, after some open discussions and as time went by, they quickly realized that everything actually did stay the same. There are two potential explanations for this. The first can be attributed to the press which tends to highlight when an acquisition fails and/or when an acquisition results in layoffs. And the second can relate to a lack of trust, originating from the fact that the buyer has not yet had the time to build up their trust with the employees, but only with the sellers. Yet, as alluded to above, when the skeptical employees started to trust the buyers and their management philosophy, these concerns disappeared.

In addition to the meetings between the parent firm and the portfolio company, the parent firm also utilizes other strategies to identify new opportunities, unlock value, and/or motivate their portfolio companies. One such activity is Novedo's Leadership Academy discussed above. Another example is Mirovia's Management Meets, which essentially is a whole day of presentations, workshops, and roundtable discussions taking place between the portfolio companies and invited experts. Further elaborated, the roundtable discussions center around finding solutions to issues the portfolio companies are facing, and the invited experts shed light on important business aspects (e.g., Christer Wallberg from Tacton Systems lectured about growth, Mattias Loxi from Cinode spoke about skills management, and Judith Wolst discussed sustainable technology).

> *"The objectives of our management meets are many, including sharing knowledge and experiences, creating new connections between the portfolio companies, and discussing which projects the group, as a whole, should concentrate on in the near future. The most positive outcome of these meets is a surplus of new ideas and new friendships"* – Sebastian, CEO Mirovia

Conforming with the decentralized management philosophy, activities like these are, of course, voluntary. The parent firms' CEOs described their role in these activities as an enabler and a facilitator, that is, the individual who makes the process easier for all other involved parties, whereas it is up to the portfolio companies to make all the decisions.

"We have no forced synergies. Any synergies that emerge will be commercially driven and voluntary for our portfolio companies. We make it easier for our firms to collaborate and share best practices. (...) The most significant synergy is the possibility to exchange ideas with a large number of smart and talented entrepreneurs" – Per-Johan, CEO Novedo

To conclude this paper with a synthesis

We have examined, from both the buyer's and the seller's perspectives, what components are essential for the success of the decentralized M&A strategy *Alliance*. Four central components emerged from the data, namely buyer-seller fit, aligned incentives, long-term thinking, and perpetual alliance. Appropriately designed, these building blocks will reinforce each other and strengthen the involved firms.

In short, it is apparent that there is a real buyer-seller fit in relation to how they believe the acquired firm should be managed post-transaction. The parent firms' CEOs advocate that the best way forward is to give the founding entrepreneurs ample autonomy and decision-making power, which seems to be exactly what driven entrepreneurs desire. Similarly, the parent firms' CEOs promote skin in the game to minimize the drawbacks of the principal-agent problem, and this too appears to be what motivates ambitious entrepreneurs. Furthermore, both sides have a long-term attitude in that they emphasize making decisions today that will position them for future success.

Lastly, we can note that *Alliance* is more accurate than just a catchphrase. In one sense, all interviewees suggest that the two different entities (the parent firm and the portfolio company) are independent albeit working together towards the same goal. There is a larger part of informal conversations taking place (e.g., phone calls, emails), combined with more infrequent meetups (e.g., meetings, workshops, board meetings) as well as the occasional introductions to the rest of the alliance members (e.g., Leadership Academy, Management Meets). But what is truly intriguing here, and also arguably one of the reasons why this has worked so well up until today, is that the relationship stagnates in terms of the corporate structure while maintaining the dynamism that allows for serendipitous value creation. In other words, there is no aim of taking things further (i.e., to reach the *Union* strategy) where all operations, products, and services are linked together. As argued in the earlier whitepaper, the drawback of the *Union* approach is that it is more uncertain because of the requisite major changes and significant resources involved justified to reach the desired outcome[14].

[14] Ström, V & Esmaeilzadeh, S. (2023). Empowering Entrepreneurs through Decentralized Management. EHAB Whitepaper, available on https://ehab.group

Authors

Viktor Ström

Research manager,
Ph.D. student

Saeid Esmaeilzadeh

Co-Founder, CEO,
board member, Ph.D.