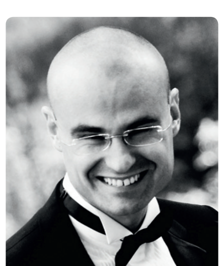
## How Changes in Managers' Sensemaking Influence a Strategic Change


The study builds on the belief that change has become a normal state of affairs in business life, and that one highly contemporary actor – the private equity firm – has evolved to become specialized in change through repetitively changing its portfolio firms in its quest to generate value. The quest of reshaping a portfolio firm in order to optimize its strategic position, profitability, and financial structure in order to generate value has consequently been this study's starting point.

This dissertation presents how sensemaking, which is about the interplay of action and interpretation, changes over time and how it affects the strategic change of a portfolio firm. By studying and directly observing the communication and interaction between the portfolio firms's CEO, board, and management team in real-time during a prolonged period when change occurs at a revolutionary pace, this dissertation seeks to examine the development and influence of this sensemaking.

The study demonstrates how certain traits of private equity firms influence the timeline, risk profile, and governance of strategic change, how the presence of an idiosyncratic language influences the strategic change by transcending one mindset into a diametrically opposed ditto, and how the materialization of a mental iron cage affects the boundaries of the potential changes as well as adaptations and worldviews.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## Strategizing in a Private Equity Context


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David A. A. von Laskowski

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*To my mother and father, as well as my wife and daughter.*

# Foreword

This volume is the result of a research project carried out at the Department of Management and Organizationat the Stockholm School of Economics (SSE).

This volume is submitted as a doctor's thesis at SSE. In keeping with the policies of SSE, the author has been entirely free to conduct and present his research in the manner of his choosing as an expression of his own ideas.

SSE is grateful for the financial support provided by the Lars Erik Lundberg Foundation for Research and Education and the Ann-Margret and Bengt Fabian Svartz foundation which has made it possible to fulfill the project.

*Göran Lindqvist*

Director of Research
Stockholm School of Economics

*Pär Åhlström*

Professor and Head of the
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Although this thesis is the product of my ambitions, demons, and aspirations of self-fulfillment, it is with a substantial amount of debt that my PhD journey has come to an end.

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Fifth and lastly, I want to thank the ones around whom my world spins. My mother and my deceased father that have been the safe haven and inspiration of my life since the day I was born. They always made me believe that I can achieve anything I want – and so far I have! Furthermore, my never-ending gratitude goes to my amazing wife Sofi and our incredible daughter Nicole who both mean the world to me. I am so indebted for your love and understanding that it will take a lifetime to even the standing. My seven years in pursuit of this PhD (with a full-time career in business on the side) have been a constant iteration between the academic and the business community, meaning no vacation and no workweeks that amounted to less than 80 hours. I can hardly understand how you have ever endured!

*Stockholm, October, 2012*

*David A. A. von Laskowski*

# Contents

# Chapter 1

# Change Forces and Private Equity

In the contemporary world characterized by fluctuating consumer preferences, new technologies, transforming economies, shifting demographics, reforming governments, dynamic competition, financial ingenuity and financial turmoil, the question is not whether a firm should change, but when, how, and in what direction they 'must' change (Eisenhardt & Martin, 2000).[1]

Hedberg et al. (1976) take the argument so far as to characterize change as one of the world's dominant properties, thus, change is not an exception; rather, it is the rule that affects most of the currently active firms and organizations. Change is, therefore, an acknowledged force that affects business in general. Hence, change is a normal state of affairs.

One could infer from Kirzner (1997) that one reason for change initiatives within the business world is because the 'market process' consists of continual entrepreneurial discoveries[2]. This means that less efficient

[1]In the mid-sixties Ansoff (1965) had already identified three primary groups of forces within the business world that drive change: product dynamics, market dynamics, and the firm–society relationship. While *product dynamics* refer to changes governed by technological development, constantly refined customer demand, and innovative improvement, *market dynamics* refer to the transformation of the competitive landscape through internationalizations, consolidations, and other structural changes. The last force refers to the so-often complex relationship between societies and firms.

[2]It must be advocated here that utilization of Kirzner's (1979) definition of entrepreneurship is, within this study, only applied to the buyout firms' discovery processes (e.g. generating a deal flow) and not

and less imaginative courses of productive action have a tendency to be replaced by newly discovered ways of serving customers. The rationale lies in the possibility of leveraging on hitherto unknown, yet available, sources of resource supply and/or producing better products and services. The entrepreneur who discovers a profit opportunity is discovering the existence of a gain that had not been seen by himself[3] or by anyone else or has the willingness or ability to pursue it existed (Moran & Ghoshal, 1999). This discovery (or perhaps invention) leads either to change-force adaptation or to driving the same forces (cf. Ansoff's (1965) change-forces).

Even though researchers in wide set of academic fields as well as business professionals recognize change as a dominant property in the contemporary business world, many business organizations seem rather reluctant to implement extensive changes. The reason for this reluctance might be captured in the pending answer to Rumelt's (1995 p. 3) simple but yet complex question, "why is change so difficult?"

Paradoxically, one highly contemporary actor who could be assumed to actively work with entrepreneurial discovery and, thus, profit from comprehensive (strategic) change[4] emerged on the global scene a few decades ago. This actor is known as a *buyout firm* or a private equity firm

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upon other interactions with, for example, their portfolio firms. For instance, I adhere to the idea that buyout firms' primary activity, that is to say when identifying potential acquisitions, is exploration and exploitation of opportunities à la Kirzner (1997) while their activities within their acquisitions might concern the carrying out of new combinations à la Schumpeter (1934). Schumpeter (1934) perceives the entrepreneur as an innovator who implements change within markets through the carrying out of new combinations. This combination can take several forms: the introduction of a new good or quality thereof, the introduction of a new method of production, the opening of a new market, the conquest of a new source of supply of new materials or parts, and the carrying out of the new organization of an industry. Schumpeter's (1934) perception is that entrepreneurs move the market away from equilibrium. On the other hand, Kirzner's (1979) perception is that entrepreneurs recognize and act upon market opportunities— thus, he is an arbitrageur. Consequently, in contrast to Schumpeter's position, the entrepreneur moves the market toward equilibrium. In short, while Schumpeter's idea is that innovations create imbalance, Kirzner's (1979) idea is that they rectify the imbalance.

[3] I will, henceforth, use him and her interchangeably.

[4] In fact, I argue that buyout firms focus both on discovery à la Kirzner (1979) and change as well as leverage à la Schumpeter (1934).

focusing on so-called buyouts[5]. Buyout is one subset within the private equity investment area together with venture and seed capital. While venture capital firms and business angels invest in the early stages of a firm's lifecycle, buyout firms invest in more mature and established firms with strong cash flows, leading market positions, and competent as well as engaged management teams (see Appendix A for a description of the different buyout definitions) (Meyer & Mathonet, 2006; SVCA, 2007; Lerner at al., 2009).

Although the research interest in buyout has increased remarkably, the primary focus has been directed toward the monetary value created by buyout firms in contrast to the performance of the portfolio firms[6]. Thus, I will discuss value generation in general terms; however, I shall use Berg and Gottschalg's (2005) dichotomy to delineate my scope. Hence, I separate value capturing from value creation. *Value capturing* only affects the owner's (i.e. buyout firm's) outcome. These include (i) changes in market valuation or multiple riding[7] (Berg et al., 2005), (ii) private or insider information (DeAngelo et al., 1984; Lowenstein, 1985; Jensen, 1989a; Lehn & Poulsen, 1989; Singh, 1990), (iii) market information or proprietary deal flow[8] (Anders, 1992; Butler, 2001), and (iv) reduction of conglomerate discount[9] (Magowan, 1989). *Value creation,* however, affects the performance of the portfolio firm. That is to say, while the former component—value capturing—does not affect the portfolio firm performance, the latter component—value creation—affects performance through altering revenues, margins, and capital require-

[5] I will use the terms private equity and buyout interchangeably for buyout even though buyout is a subset of private equity.

[6]The firm or entity into which a buyout firm invests is usually referred to as a *portfolio firm.*

[7]The form of financial arbitrage, often referred to among practitioners as multiple riding, concerns the exogenous effect of changes in the public market valuation multiples for comparable firms (i.e. peers).

[8]Due to the buyout firm partners' extensive industrial and financial experience, the network of buyout firms is often very comprehensive. This makes it possible for buyout firms to build an extensive industry expertise pool and uphold a continuous (and hopefully proprietary) deal flow, that is to say, new potential acquisitions (Anders, 1992).

[9]Reduction of conglomerate discount is an asset-stripping approach where the rationale is that the target multi-unit firm is worth less than the sum of its parts. Magowan (1989) argues that a skilful buyout firm can acquire a (portfolio) firm, and sell its natural or constructed undervalued sub-units and maximize their individual values.

ments of the portfolio firm. While the mechanisms affecting the bottom-line indirectly include various agency costs and parenting effects, the direct value creating mechanisms include financial engineering, operational effectiveness, and strategic positioning.[10]

The focus of this research will, therefore, take place in the context of portfolio firms working with the three value-creating mechanisms: *strategic positioning*, *operational effectiveness*, and *financial engineering*.

Given the aforementioned, I argue that buyout firms can be visualized as Kirzner's (1997) entrepreneurial actors with one core objective: to change the set-up of the firms they acquire (i.e. through strategic, operational, and financial mechanisms) in order to create and capture value. This is achieved through the modification of the resource bundles[11]; more importantly, the resources will be continually shifted from some uses to others. Hence, by moving resources from one line of production to another value can be (captured and) created.

Industry data indicate that buyout firms are, in some sense, more successful than others at managing change (The Global Economic Impact of Private Equity, 2009) (i.e. within their portfolio firms) in the context of Ansoff's (1965) change-forces—product dynamics, market dynamics, and firm-society relationship—thus either by excelling in their adaptation to these forces or by driving the direction and impact of them. Another view could be that buyout firms are highly successful at identifying and acquiring firms that (already) have an inherent, yet unrealized ability to manage and/or adapt to change.

In fact, the private equity industry in general, which consists of approximately 160 actors in Sweden, has grown dramatically the last years. Buyout, which amounts to approximately 47 firms in Sweden: has seen a

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[10] This could be compared to the large and growing discussion within the private equity community on value from *alpha* versus from *beta*.

[11] Following Wernerfelt (1984) I refer to a resource as anything, which could be thought of as a strength or weakness of a given firm. In more formal terms, a firm's resources at a given time could be defined as those (tangible and intangible) assets which are tied semi-permanently to the firm (see Caves, 1980). Examples of resources include in-house knowledge of technology, brand names, trade contacts, employment of skilled personnel, machinery, capital, efficient procedures etc.

particular increase at least up until the global financial turmoil that started in 2007 and came into full power 2008/2009. They have since continued with its first major Swedish default on March 5th 2009[12]. The buyout firms in Sweden currently manage approximately 383 billion SEK and own an estimated 123 portfolio firms. These figures position Sweden as the largest market by country of the portfolio firm origin in Europe, measured as investment in % of GDP 2007; Sweden is also the second largest market by country of the private equity firm origin in Europe measured as investment in % of GDP (SVCA, 2007). Moreover, buyout owned firms in Sweden have historically grown considerably faster, both in terms of revenue and headcount compared to other firms: more than three times faster than firms traded at the formerly known A-list and ten times faster than the average firm in Sweden (SVCA, 2007). In fact, the World Economic Forum's 2009 report on Global Economic Impact of Private Equity recognizes that buyout firms' portfolio firms have a few percent higher productivity growth than firms with other owners. This report is based on the comparison of 4,000 firms in twelve countries; it argues that this is due to the fact that their superior leadership more efficiently exploits the firm's resources. However, the years 2008-2012 tell another story where the high gearing in the portfolio firms have lead several of them into financial difficulties, sometimes even into financial distress.

We must state here at the outset that the act of grasping an opportunity — thus, discovering and identifying an opportunity in an array of infinite alternatives — is not the focal point of this research per sé; rather, it is the arena where the process of shifting resources within the opportunity takes place: the process of changing[13] the opportunity's (i.e.

[12] One of the largest Nordic private equity firms, Nordic Capital, filed its portfolio firm Plastal AB with approximately 6,000 employees for bankruptcy on March 5th 2009. Plastal was a leading supplier of engineered plastics to the automotive industry.

[13] In contemporary (strategy and change) research different theories on change have lead different researchers to focus upon distinctive facets of change (Pettigrew, 1990). Miller and Friesen Miller (1982a) have described quantum and piecemeal changes, Pettigrew (1985) revolutionary and evolutionary changes or eras, and Tushman and Romanelli (1985) periods of convergence and reorientation, just to mention a few.

portfolio firm's) set-up along strategic, operational, and financial dimensions. Consequently, it is on this arena where this work has its focus and will, consequently, make its primary contributions.

## Transcending an Infinite Research Array into Something Manageable

As the title indicates, pursuing research concerning a wide, if not infinite, area such as change processes in general, must be delineated in order to clarify and fulfill one's personal interest. Thus far, the focus has been delimitated to the private equity industry or, more precisely, to the arena where the strategic agenda and change processes emerge within a firm recently acquired by a buyout firm. Furthermore, my interest has been drawn to the processes of altering the portfolio firm's strategic position and operational efficiency. This is primarily due to the industry data's indications of buyout firms' historical success with requiring, initiating, controlling, and/or realizing change.

My ambition is to further delimit the scope by focusing on a smaller, yet nonetheless important subset of change process, that is to say, the social and cognitive sphere of the strategic changes. Hence, I am interested in how sensemaking (i.e. strategic thinking) not only affects the process of strategic change, yet how it also changes over time.

In other words, I am interested in how strategic thinking changes over time and how it affects the process of strategizing and strategic change. Studying and directly observing the communication and interaction between individuals and groups in real-time within the context of a portfolio firm and its owner, during a period of revolutionary strategic change, will attain this. Thus, I will study a set of key decision makers, which have been chosen based upon their abilities or possibilities to affect the strategic agenda and thus the strategic change. I will then focus on their interpretations and actions, thus sensemaking. I should declare that I, by no means, have the ability to see into people's minds; rather, I use sensemaking as a proxy for strategic thinking (more on that later). The owner, board, and management team of the portfolio firm are identified as the key decision markers due to their respective active roles in the strategic change process, as well as their ability to affect and formulate the strategic agenda.

By studying how the sensemaking of these key decision makers develops and affect the strategic change, the issue of *temporal dynamics* (Corner et al., 1994; Fiol, 1994) becomes a central concept: how the interplay between individual and group level cognitive processes develops through time. In parallel to this, I deem it fruitful to call attention to the enactment of a belief system over time and how the strengths of specific beliefs change as interest groups (or individual decision makers) compete for *interpretive dominance*.

Interpretive dominance is seen as a conceptualization of a belief system as an active arena where power groups such as the three aforementioned or parts thereof compete for dominance to impose their preferred order and interpretations of the firm and its environment onto others (cf. the concept of sensegiving). The idea of this arena also introduces the requirement of an effective *process of conversation*, through which strategic cognitions can be compared, challenged, and negotiated (van der Heijden & Eden, 1998). In order to be effective, this process of conversation requires a language in which strategy concepts can be expressed. Weick et al. (2005, p. 409) describes sensemaking as"[…] importantly, an issue of language, talk, and communication. Situations, organizations, and environments are talked into existence […] Sensemaking is about the interplay of action and interpretation…"

While this (strategic) language is influenced by many sources, such as strategic management textbooks and educational as well as social backgrounds and experiences, most organizations develop an idiosyncratic (strategic) language. Hence, there is a large interest in how it becomes affected by the new actors (i.e. new owner and board) and, consequently, its implications on the strategic change process.

Furthermore, this language is primarily based upon the strategic experience that the firm has experienced in the past (van der Heijden & Eden, 1998). The existence and development of jargon, labels, and concepts are manifestations of language building and can consequently only represent strategic problems of the past since they were generated to categorize particular occurred events (e.g. invest or die). However, it should not be neglected that individuals with emotions, hopes, and values also carry individual or shared language repertoires based on past experiences or endowments.

One can assume that the new actors with somewhat different backgrounds and experiences (such as the new owner and board of a newly acquired portfolio firm) will (partially) introduce a new (strategic) language that might affect the old one. This might subsequently affect how the portfolio firm perceives itself and its environment. Consequently, using an existing language as a means for categorizing new situations will, almost by definition, fail to completely describe a new reality. So how will the new actors affect this language and how will that affect the strategic change?

Hence, the focus of this study is this processual outlook how chains of (inter) action and interpretation influence the strategic change process. More directly, how the interplay between interpretations and actions within, and between, the acquired firm's management team, board, and owners influence, and is influenced by, the strategizing and strategic change within the firm.

This will be a narrative of moving beyond the mere rhetoric of strategy-in-the-making: listening to stories and watching decision-making in real-time, and observing how interaction between the strategy affecting actors develops and affects interpretations and actions during a strategic change in the making. The story will illuminate how strategic thinking (i.e. sensemaking) develops within, and between, the different actors (micro) – owner, board, and management team – thus, affecting the development of an acquired portfolio firm (meso). From this point on, however, the board will represent a proxy for both the board and the owner since the latter acts through their position on the board. I will focus on two primary actors: the board and the management team. This study's uniqueness lies in observing organizational and strategic decisions and actions in real-time within a context of the still covert buyout or private equity arena during a time of several large and revolutionary strategic changes within a portfolio firm. Hence, my exclusive access to the buyout arena (in general) and to this specific case (in particular) has provided me with the opportunity to be an overt participant in a buyout process. I have been able to observe from the inside and in real-time the actions, interpretations, reflections, and discussions among the stakeholders who directly affect this process. Hence, this research addresses the issues raised in the strategy-as-practice field, which has grown in part from an increasing dissatisfaction with conventional strategy research (Jarzabkowski & Spee, 2009). People strategize. In contrast to the multivariate analysis of firm or on the industry level that populates most strategy research, there is an interesting absence of human actors and their actions in most strategy research.

The process of interacting as well as negotiating new meanings and establishing shared ones during this strategic change is the loci of this study or, in paraphrasing, a forthcoming chapter – how can changes in the sensemaking of managers affect the strategizing and the development of the strategic change.

## Purpose and Research Question

The purpose of this study is to explore, interpret, and elaborate on the sensemaking processes surrounding the strategizing and strategic change that take place in a firm after being acquired by a buyout firm. Hence, it is to understand the way in which organizational and strategic change may be attained by changes in the sensemaking of managers.

The following research questions are, thus, derived:

(i) *How* does sensemaking develop over time within, and between, decision-making groups?

(ii) *How* does the board's and management team's sensemaking affect the strategic change process (and vice-versa)?

I believe that it is necessary to depict a holistic view of these interpretations and actions (i.e. sensemaking), their context, and their consequences in order to understand how they affect different individuals, groups, and organizational processes. This will be done in lieu of measuring any distinct parts. In other words, I aim to observe and interpret broadly conceived sensemaking patterns and assess how they become intertwined with the social circumstances of the organizational activities. Hence, it is my role to depict a holistic view[14]: an integrated overview of the context under study in order to understand how sensemaking affects individuals, groups, and organizations, as well as the strategic change process.

# Disposition

The study's disposition attempts to consider the needs and demands of both scholars and practitioners wanting to read the study in *extensio* or in parts.

The study begins in the first chapter where I describe my inherent interest in change processes, how change has become a normal state of affairs in business life, and how one highly contemporary actor – the buyout firm – has evolved to become specialized in change through repetitively changing its portfolio firms in its quest to generate value. This first and current chapter also describes how the focus on strategizing and change processes within this specific buyout context will be delimitated. The chapter continues by posing the overall purpose and its associated research questions.

[14] It is in fact the real-time direct observation of the communication and interaction among these strategizing (power) actors over a long time period that allows me to depict a holistic view of this process.

The second chapter presents the acquired and acquiring firm and may be considered premature according to conventional approaches. However, it is my firm belief that the reader should attain a first familiarity early on of the two main actors – the acquiring firm (i.e. the buyout firm represented by the board) and the acquired firm (i.e. the portfolio firm represented by the management team) – since this will augment the understanding and contextuality of the following three chapters. While this chapter is empirical in nature, it should only be perceived as a complement to the main empirical chapter (chapter 6).

The point of departure for buyout firms in general, and in this study in particular, is value generation. The third chapter typographically puts forth the different mechanism that buyout firms use in order to capture and create value in their portfolio firms. The value of having this chapter separated from the main theoretical chapter is that it presents the ambition of buyout firms, the language and terminology they use, and the arsenal (read: concepts, tools, approaches, etc.) that they deploy. Chapter 5, the second and main theoretical chapter, will develop the main lenses used to interpret the actions and thoughts of the portfolio firm's management team and board in the empirical chapter. In parallel to the former empirical chapter, this third chapter should be perceived as a complement to the main theoretical chapter that is later developed. Furthermore, its early position in this thesis is believed to augment the understanding and contextuality of the following two chapters.

The fourth chapter develops the methodology if use in this study. The reason that it appears prior to the main theoretical chapter is the notion that it is neatly intertwined with my theoretical and empirical ambitions. The methodology receives a prominent role and could be perceived, to a certain extent, as an integral part of the theoretical chapter since one important objective with this scientific undertaking is to elucidate theories-in-use rather than espoused theories (Argyris and Schön, 1974; 1978). My scientific outlook in both an epistemological and ontological sense governs the methodology, which aims to describe the way in which this research has been conducted. Since academics and practitioners have different desires on this description it has been my ambition to fulfill both sets of requirements with some inflatedness as a consequence.

The fifth chapter is develops the main theoretical framework. This chapter might a prima be interpreted as vista or perceived as being somewhat eclectic or perhaps even a bricolage of sorts; however, it is firmly rooted in the liminal area of strategy-as-practice, strategic management, and managerial and organizational cognition. Building on the ideas from the former chapter on value generation and methodology, the main concepts and theoretical lenses are developed, such as interpretive dominance and temporal dynamics, which are deployed to understand the empirical data.

The theoretical chapter is primarily used to understand the empirical data. The sixth chapter constitutes the main empirical chapter, which is divided into several explicit sections. The first part elucidates the viability of the investment opportunity; the subsequent section scrutinizes the common ground and outlook of the two dominant (strategy influencing) actors. The following parts elaborate on the strategic arenas or conversation processes that take place within and around the acquired firm. The empirical richness and extensive scope has influenced me to amalgamate the analysis and the empirical presentation, rather than arrange the analysis of this empirical data in a separate chapter. Hence, the theoretical framework and methodological approach has lead the structure and presentation of the empirical data. The primary theoretical lens has already been applied within this chapter.

The seventh and final chapter presents the primary conclusions and a discussion on these conclusions.

# Chapter 2

# The Acquiring and Acquired Firm

As I briefly mentioned in the introduction, this study will include two actors: the acquiring or buyout firm *Bay Lake* and the acquired or portfolio firm *Arrow*. The buyout firm has twelve employees (excluding the administrative staff), of whom three are represented on Arrow's board. Arrow has approximately 1,080 employees. There is also a third actor - that is to say, the portfolio firm's board - that consists of three owner representatives (i.e. Bay Lake partners), three industrial experts (hired by Bay Lake partners and members of their industrial network), the CEO of Arrow, and two union representatives. Hence, this study includes three actors: the management and board of the acquired firm and the owner or acquiring firm. As aforementioned, the owner and the board will be perceived as *one actor* since the owner (i.e. Bay Lake) is represented on the board; it acts through the board function, and decides how the board should be compiled. I should also mention that the quantitative data of Arrow, as well as that of Bay Lake, has been somewhat distorted to ensure the anonymity of the actors. This, however, does not affect the despcription of the two companies.

This chapter will continue to describe the origin of Bay Lake and Arrow.

# The Buyout Firm—Bay Lake

## Investment Profile

The buyout firm of this study, hereafter referred to as *Bay Lake*, is a private investment firm that primarily focuses on making control-oriented buyout and later-stage expansion capital investments within the Nordic region. Bay Lake's investment strategy is to purchase controlling equity interests of 100–1,000 million SEK in firms with a total enterprise value[15] of 200–5,000 million SEK and where Bay Lake believes to have a clear potential for value generation (see next section for an elaboration on value generation). With its relatively long history, Bay Lake has been responsible for numerous investments that have generated a realized gross IRR[16] of >70 % thus far and attained a realized multiple of invested capital amounting to approximately five. The company's average and median investment or ownership horizon is 4 and 3.4 years, respectively; this parallels the comparables for the Swedish and Nordic private equity sector. Bay Lake indicated early on that the investment horizon for Arrow would probably be prolonged compared to normal practice due to its business cycle sensitivity, the current consolidations in the industry, and the fact the firm's considerable size and fragmented market is open to a multitude of improvement opportunities. In fact, the CEO of Bay Lake mentioned that this would probably be the toughest investment they have ever made – a statement that will be substantiated.

Bay Lake believes that the Nordic region offers a substantial opportunity for buyout investments due to its large corporate sector and high degree of internationalizations. Factors such as a large number of possi-

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[15]Enterprise value = the firm's market capitalization – cash and cash equivalents + preferred stock + debt.

[16]The *internal rate of return* (IRR) is the discount rate that results in a net present value of zero for a series of future cash flows. This is a discounted cash flow (DCF) approach to valuation and investing just as net present value (NPV). Both IRR and NPV are widely used to decide which investments should or should not be undertaken.

ble investment opportunities, the relatively limited competition from financial purchasers, the potential to create significant operational improvements and growth within this size of firms, and the favorable trade sales potential in the region has given Bay Lake good preconditions for delivering attractive investment returns to its investors (usually referred to as Limited Partners or LPs).

Bay Lake resembles many Nordic and international private equity firms that focus on buyout and later-stage expansion capital investments in that they are not specialized in any specific industry. Instead, the potential investment return guides their investments, which makes them somewhat generalistic and opportunistic.

## Management Team and Professional Network

Bay Lake is comprised of a handful of investment professionals, and has long standing industrial and financial experience; it is one of the more seasoned firms on the Nordic private equity scene. The team members have various backgrounds in areas such as firm operations, financial control, strategic consulting, project management, accounting, investment banking, and law. This blend of industrial and financial experience is something that Bay Lake believes is a competitive advantage in delivering returns to both its investors and portfolio firm management partners. Bay Lake's management team refers to the company as "findustrialists".

Bay Lake's operating expertise is complemented by the experience of their professional network. This network, which consists of some 50 seasoned industrial advisors, board candidates and exit facilitators, is an important source of experience, expertise, and support for continuing to deliver the aforementioned investment returns. While the industrial advisors source and evaluate transactions for Bay Lake, exit facilitators assist in identifying and creating exit opportunities as well as facilitating multi-track exit routes. The board candidates, who act as non-executive board members in the portfolio firms, usually have vast experience from large international firms that represent an important component in the value generation process since the firms in which Bay Lake invests often lack the ability to attract experienced managers due to their size, financial resource, profitability outlook, and/or network.

## Investment Strategy and Value Generation

While Bay Lake's key objective is to create and capture as much value as possible, it tries to accomplish that in one or several stages of the investment process. The three phases constitute the value chain and consist of the pre-acquisition period, the post-acquisition period, and process of exiting the investment through paths such as an initial public offer (IPO), trade sale or a secondary buyout (SBO). This means that another buyout firm acquires the portfolio firm for further development. These phases will be, henceforth, called entry, enhance, and exit (see chapter on value generation for an extensive elaboration). Bay Lake has an explicit business model, which pinpoints the activities that are to be focused upon during each and every one of the three phases (see Appendix B for an illustration on Bay Lake's business model).

Bay Lake seeks to invest at attractive valuations in the first phase — pre-acquisitions or *entry* — through a number of way: by identifying (investment) opportunities with limited competition, securing the support of the portfolio firm management early on in the process, becoming a preferred purchaser of vendors, identifying unique deal premises, identifying value shifts in the market, and analyzing the timing of individual transactions (e.g. in business cycle terms). The second or middle phase is known as post-acquisition or enhancement; it is fully devoted to enhancing the equity value through active ownership by focusing on a number of key areas: (i) operational performance improvements through revenue growth and margin expansion, (ii) improving the strategic position of the underlying business, and (iii) enhancing the financial efficiency. The third and last phase is called the divestment or exit; this is a continuous phase, which is already initiated during the pre-acquisition stage, where possible exit hypothesis are elaborated. Bay Lake continuously monitors, guides, and develops its investment toward an exit. They seek to obtain a full valuation for their operational and strategic improvements via a prepared and controlled exit process.

## Acquisition Background

Arrow has been part of a larger group for over a half a century. For this reason, now that it has been acquired by Bay Lake, which has initiated its journey of becoming an autonomous, thus independent, firm means a substantial change for the traditional company.

While the sales price of the equity was 700 million SEK, the book value of Arrow was almost 400 million SEK higher. Thus, the seller recorded a capital loss of almost 400 million SEK, while a badwill (i.e. negative goodwill) of the same amount emerged within Arrow Holding, which now owns Arrow.

Given that Arrow produces approximately 250,000 ton Widgets annually, the sales prices correspond to SEK 2,800 per ton. I should also note that the divestment of Arrow had no material effect on the seller's operating profit.

Given these figures, one can only speculate why the seller sold Arrow for approximately 65 % of its book value. Although this issue is not significant for this study per sé, Arrow's management and board, as well as industrial experts, have posed several arguments during the empirical inquiry of this study. This could be compared to Kirzner's (1997) idea of *over-pessimism*[17] from the seller's side. The seller is a large group (hereafter called Goliath) that is compounded of numerous businesses, divisions, and business units, thus, producing a wide set of different Widgets; it is publicly traded on several stock exchanges around the world and has had a disappointing development in its share price during the last few years. This has increased the pressure on Goliath to show its power to act. Another explanation is that Goliath consolidates its product portfolio and is,

[17] E.g. a seller may underestimate the eagerness of a buyer to buy; a buyer may underestimate the eagerness of a seller to sell.

thus, divesting Widget variants that are positioned within niches such as Arrow's.

# The Portfolio Firm—Arrow[18]

## Historical Exposé

Arrow has been a member of the Goliath group for over half a century and is an old firm that manually produced Widgets for decades before the production assumed a more automated shape with the introduction of Widget producing machines (hereafter referred to as Widget machines). Since the demand for the product grew steadily, more and more Widget machines emerged on the global market scene. This emergence of production capacity increased the importance of another restriction: the lack of raw material Alpha. Thus, a supply shortage of the primary input factor of the production process emerged. This shortage lead to a period of exploration before another input factor was identified: Beta, which could be exploited as a substitute for Alpha.

This substitution reshaped many facets of the industry with the primary effect being on the Widget price. In just a few years, the Widget prices saw a 60 % decrease and, after a few decades, Widgets were sold at 15-20 % of the price before the substituting raw material Beta was introduced.

Arrow's product portfolio became increasingly broader during the following years, incorporating a large set of Widget variants for different applications; the plant doubled its capacity to two Widget machines during this period. Moreover, Arrow decided to become more independent,

[18] I am very grateful for the well compounded and nuanced reports and depictions that have been written about this industry and its major players although, due to anonymity issues, no references will be used in this chapter. One author in particular has especially contributed to this description of Arrow and its industry.

and integrated back through the establishment of its own semi-production of its primary input factor Beta. Arrow had now become renowned as a high quality producer in the market place.

Throughout its long history, Arrow had developed a language based upon its experiences. While this will be extensively elaborated upon in the empirical chapter, it can be noted here that several preconceived assumptions had a strong foothold within the organization: such as the idea that production is the predominant activity in any successful Widget firm and that quality is a goal rather than a means. Another idea with a strong foothold at Arrow is that a Widget firm cannot survive without annual volume investments.

## Losing the Autonomy: Moving Away From Diversification and Into Commoditization

A consolidation trend among Widget firms emerged, and it did not take long before the large industry leader Goliath acquired Arrow. By this time, Arrow's product portfolio was much diversified compared to a competing Widget producer of similar size. The acquirer Goliath deployed a product consolidation process within Arrow where the different Widget variants and application areas were converged: an idea similar to Prahalad and Hamel's (1990) idea of core competence, thus, the idea of *focus* as competitive strategy.

The world consumption of Widgets swelled dramatically during the early 70s, with the subsequent effect that both the national and global supply of Widgets increased at a faster pace than the demand, although with some dislocation. The cost-competitiveness movement that affected many industries during this period also affected the Widget industry, which led to a commoditization among Widget variants. This increased the international competition and focus on costs, which was most notable through the large economies of scale focus, leading to a steep downward shift in supply curves (i.e. in production costs).

As paradoxical as it might seem, the backward integration became increasingly questioned during this period; this refers to the former owner (i.e. before Goliath), which was established by quasi-producing one of its most important input factors. Due to reasons such as control of the production chain and the increased economies of scale, the advantage of vertical integration had been recognized for years in the industry; however, it had gradually become more manifested in the market place that non-integrated Widget producers were performing at least as good, and sometimes even better, than their integrated peers. A central decision on a group level – that is to say, above Arrow's management - lead to the termination of the input factor production. This decision was probably based upon several assumptions, including less cost difference between integrated and non-integrated Widget producers and greater flexibility in choosing a Beta supplier based upon aspects as quality, price, and type.

The Widget industry is known for its frequent use of benchmarking, both intra and inter-group as well as between freestanding Widget producers. Arrow in general and one of its now three Widget machines in particular had a world leading position in these measurements, where the utilization of both time and material is compared (in terms of efficiency, productivity, and quality). Arrow is still believed to posses that position.

## Industry Characteristics and Arrow's Position

Arrow is consequently positioned within a specific (narrow, yet not necessarily niched) segment of the Widget industry that produces a Widget with a specific set of characteristics suitable for high-end products. There are approximately eleven competing brands within this segment produced by nine Widget producers. While the total market supply within this segment is approximately 1.2-1.4 million tons, Arrow is assumed to have a market share in the high teens. However, it is heavily debated on the current board and management team whether the market segment is as clearly delimited as to include only these market players or whether more substitute products than the eleven aforementioned actually exist.

This assumption would drastically decrease Arrow's market share to a low single digit percentage. The majority of discussions taking place within Arrow indicate that the internal and external perception parallel this idea of a small segment; it should be recognized that a high market share - ceteris paribus - is very important for the firm's value according to Bay Lake's rationale. A primary trait that distinguishes Arrow from its competitors within the segment is that, in contrast to almost all other players, Arrow is autonomous (now after Bay Lake's acquisition. Thus, it is not a part of a larger group.

During the last decades, this segment within which Arrow is positioned has had a compounded annual growth rate (CAGR) of over 6 % and was expected to have a CAGR of 3-4 % for the next decade. However, it should be emphasized that this forecast is being increasingly questioned. Some well-known consultancy firms within the Widget industry are publishing reports indicating a growth for the upcoming years of approximately 1-2 %, thus, below the long-term global GDP[19]. This figure should be compared with the efficiency enhancements of current plants that are approximated to be 2 % annually; thus, a decrease in the global production capacity is a requirement in balancing the global supply and demand.

## A New Lower 'Natural' Price Level

As in many other industries, the Widget industry is facing structural changes with increasing costs and constraints as well as a shift in both production and consumption when moving to emerging markets such as Latin America, China, and other parts of Asia. Western Europe in general and the Nordic region in particular are net exporters; the other regions are net importers.

Due to the fact that this segment of the Widget industry has been hit especially hard with weak demand and low prices for more than a dec-

[19] These levels have now been adjusted downward to approximately +-0 or slightly negative due to the global recession.

ade now, evidence has started to emerge that a more disciplined industry approach to capacity expansion is being assumed. In fact, several major firms (i.e. competitors) have announced extensive programs to restore profitability by cost reduction, efficiency improvements, and closures of the least competitive Widget capacity, and to focus instead on those units that possess the best potential for being profitable in the long-term. Hence, although structural changes and capacity expansions have positively shifted expectations of future price development, one can only speculate whether a potential price recovery will initiate a new wave of expansions, thus, deteriorating profits and resulting in diminished possibilities for improved shareholder value.

Many industrial experts in the area speculate whether there is a strong indication that Widget prices have reached a new lower long-term price level now that it is an increased market entry in the Widget industry. As in many other industries, globalization has had a vast effect on labor-intense (and low-margin) industries. Perhaps this possible long-term shift in 'natural' cost levels could be equated with the price shift that took place when the industry substituted the primary input factor Alpha for Beta. With a profit and loss statement to that of Arrow and many of its competitors, a 1 % change in the average price has substantial effects on the EBITDA due to the low margins in the industry. Moreover, the quality and efficiency of the Widget machines in Asia and Latin America become equated with those in Western European plants; in fact, they already have the biggest, fastest, and most efficient Widget machines. Therefore, the 'natural' price level for Widget will probably remain at this lower level or even continue its journey downward.

## The Challenge for Arrow and Bay Lake

Given the former passages that describe new structural landscapes, challenges and lower price level, it is not hard to understand that the Widget industry, in general terms, has failed to deliver expected returns to its shareholders. In many cases, the return on the industry's capital has been below its cost (CoC)[20] without any great hope of increased future profits.

The question whether satisfying the return requirements of its shareholders is the most important objective for any firm and, as a result, it usually initiates lengthy discussions. Therefore, this is definitely the primary objective for a buyout firm such as Bay Lake. This is also where this study began, with the quest of reshaping Arrow in order to increase profitability as well as strengthen its strategic position in order to generate value for the new owner. Numerous ways to create and capture value exist, thus, providing a high return based on limited risk exposure, such as using innovations and discipline when minimizing capital expenditures and to only invest when no other solution is available. This will be elaborated upon in the next chapter.

Arrow is no exception when it comes to profitability problems. The primary factors affecting Arrow's downward trend in profitability have been similar to those of its peers: lower Widget prices, steady price increases of the input factor Beta, and the price increase of other important input factors as well as energy costs. The global financial turmoil has recently leveraged the problems to a whole new level. The return on capital employed (RoCE) has decreased from approximately 20 % in 2001 to about 2 % in 2009. Since the cost of capital is roughly 10 %, it is evident that a ROCE in the range of 2-4 % in the long term is too low.[21]

## Why Invest in Arrow: The Bay Lake Rationale

The sales price of 700 million SEK compared to the book value of approximately 1,100 million SEK will obviously improve capital turnover

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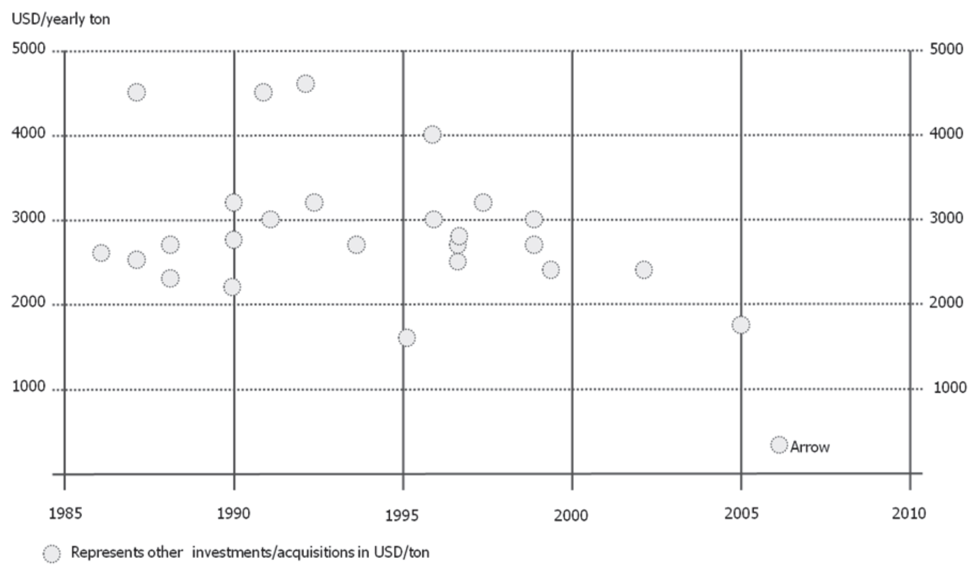
[20] Cost of capital (CoC) is the overall percentage cost of the various funds used to finance a firm's assets. Hence, it is a composite cost of the different individual sources of funds including common stock, debt, preferred stock, and retained earnings. The overall cost of capital depends upon the cost of each source and the proportion that source represents of all capital used by the firm.

[21] Since the minimum cost of survival in any business is the cost of capital, a business such as Arrow that does not earn these costs is bound to fade and disappear. Thus, the goal of any firm is to limit investment to assets that provide a return that is higher than the cost of the capital that was used to finance those assets.

and RoCE. The low profitability during the past couple of years is reflected in the sales price of 700 million SEK for Arrow. As a point of reference, the total machine investments in Arrow amount to 1.6 billion SEK during 1995-2004. Investment costs for new Widget machines can also be used as a guideline, even if design and prerequisites might differ substantially in the various alternatives. The average investment cost per annual ton is approximately 21,000 SEK at the start-up for new Widget machines. Arrow, as a going concern, was sold for less than ⅛ of that. Thus, it was - and still is - much cheaper to buy capacity than to build it, which is illustrated in the following figure.

Figure 2.1: Investment Cost for a New Widget Machine per Produced Ton




Another important component of Bay Lake's acquisition of Arrow was a price ceiling or subsidy of the most important input factor: Beta. Thus, the former owner of Arrow—that is also a large Beta producer—agreed to subsidize Arrow's Beta consumption for a nine-month period. This price ceiling, which was largest in the beginning of the period, decreased in three quarterly steps. The board and Arrow's management team labeled this as the *window of opportunity* in their daily discussions. Hence, this nine-month period was the primary period that was going to be used to change Arrow's strategic, operational, and financial set-up.

In addition to the two aforementioned reasons - the low acquisition price and the price ceiling on the Beta - there was tentatively a fairly good fit with Bay Lake's generic investment heuristics. Arrow was a Nordic firm, although 93 % of its sales were in export, and it was thought to have a leading market position: a market share in the high teens; it had a fairly strong positive cash flow, and was believed to have a proven and capable management team. Bay Lake was the lead investor; in fact, it was the only investor except for the management team and board, and the investment was a leveraged buyout. However, at first sight, two or more major conflicts between the investment and Bay Lake's investment heuristics existed. First, Arrow had a heavy balance sheet; second, it was highly dependent upon the business cycle. Both of these divergences were in direct contrast to Bay Lake's investment philosophy.

The extensive industry experience that Bay Lake's network had from this industry, the fact that it had partnered with a leading industry expert, and that the management team and board were ready to acquire approximately 10 % of Arrow's equity (also known as "sweet equity"[22]) were three other arguments used when promoting the investment to Bay Lake's investment committee.

While all the former arguments could be perceived more or less as hygiene factors, the following five made the investment a reality.

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[22] Sweet equity is an incentive form for the management of the acquired firm. The idea is that they may invest in the firm at a lower valuation than the acquirer (i.e. buyout firm) in order to make ownership possible and to establish a personal financial incentive for them to work diligently towards the success of the investment.

Table 2.1 Investment Motives

| Motive: | Motive Descriptor: |
|---|---|
| Sales Price | The sales price was vastly below book value, which created downward protection toward the banks since the consequential badwill would cover Arrow from potential future covenant breaches. In other words, the case was "financially unsinkable". |
| Shift in the Industry Specific Business Cycle | There was a foreseeable shift in the industry specific business cycle where large capacity reduction had been communicated to the market, thus, moving the supply and demand more into balance. |
| Strategic Reposition | There was an opportunity to *strategically re-position* Arrow toward its customers, increase the cooperation with a larger set of sales intermediaries, as well as position its products toward more profitable market segments, geographies, and application areas. In fact, the primary motive was converting Arrow from a cost-driven production unit (cf. cost-center) into a market-oriented and customer-driven autonomous firm (cf. profit-center). When Bay Lake acquired Arrow, only six out of 1,080 individuals within Arrow interacted with the customers. |
| Operational Efficiency | To improve the *operational efficiency* by introducing a more objective oriented modus operandi within Arrow's functional areas and to decrease the head count. |
| Financial Engineering | Attractively finance the acquisition with beneficial vendor notes from the seller Goliath and deploy a set of *financial engineering* activities such as leveraging the firm, vastly decreasing the working capital through warehouse activities, and adjusting payment terms toward customers, suppliers and so on, as well as planning the deployment for a future re-financing solution with the purpose of minimizing Bay Lake's equity exposures. |

Bay Lake defines their business model around the purchase of controlling equity interests in firms within a specific size span and where they believe themselves to have a clear potential for value generation. However, according to their investment heuristics, there is a fundamental importance in understanding what is meant by value generation. Furthermore, there is a fundamental need for an overview since Bay Lake's arsenal (read: concepts, tools, approaches, and so on), language and terminology is heavily built upon ideas of value generation.

# Chapter 3

# On Value Generation

Bay Lake's rationale for acquiring portfolio firms is based upon an assumption of value generation. Hence, it argues there are numerous ways of generating value through different activities. As aforementioned, this study begins with the arena of reshaping Arrow in order to increase the profitability and strengthen the strategic position, and hence, to generate value in general for the new owner.

This chapter will consequently introduce the idea of value generation, its two inherent mechanisms, and the instruments as well as components that are vital to this study. Another purpose of this chapter is to elaborate upon the tools that buyout firms such as Bay Lake deploy in order to fulfill its goal of value generation. While these concepts and mechanisms not only affect the terminology of one of the two actors in this study (that is to say, the board) they also affect the *conversational processes* at Arrow. This becomes especially interesting when considering that Arrow's management team has been so production-oriented that financial issues have not historically been on the top of its management team's agenda. In fact, Arrow's CFO was not even part of the management team before Bay Lake took over the helm.

# The Quest of Value Generation

When discussing value, attention can be directed toward the monetary value generated for the buyout firm or in the portfolio firm. The latter indirectly generates value for the buyout firm as well. According to Brealey and Myers (2002), amongst others, the objective of an investment decision is to find tangible and intangible assets that are worth more than they cost; secondly, they are to maximize the current market value of the firm's equity (cf. the former discussion on Kirzner's ideas). This consequently means that value equates the firm's equity value over a certain period of time. Hence, the evaluation of buyout firms' value generation is usually measured based on the internal rate of return (IRR) calculations. Bay Lake has had an average IRR of >70 % throughout its history, while the cumulative pooled average IRR in Europe over a 10-year period ending in 2006 is 14.1 % (Dantas Machado & Raade, 2008). The formula to evaluate equity is as follows (Penman, 2001):

(i) Value of Equity = Enterprise Value[23] – Value of Debt

or

(ii) Value of Equity = Valuation Multiple * Revenue * Profit Margin – Net Debt

The latter equation builds on Berg and Gottschalg's (2005) notion that the most important type of value generation is based upon change within the valuation of equity. This evaluation is determined by four factors: valuation multiple, revenue, profit margin, and net debt - all of which will be directly or, through various mechanisms and components, indi-

[23] Enterprise value = the firm's market capitalization – cash and cash equivalents + preferred stock + debt; consequently, value of equity = the firm's market capitalization – cash and cash equivalents + preferred stock

rectly elaborated upon later. The upcoming empirical chapter will also illustrate how Bay Lake uses a simplified version of the latter formula in their interaction with Arrow. I will assume Berg and Gottschalg's (2005) dichotomy when trying to fulfill this chapter's objective of ensuring the explicity of the value generation mechanisms and, hence, the buyout firms. Thus, I will divide value generation into a capturing and a creation mechanism.

These two value-generating mechanisms and their related components will consequently be elaborated upon throughout the rest of this chapter with an emphasis on the latter.

## Value Capturing

Berg and Gottschalg (2005) refer to value increases, which can occur without any changes in the underlying asset's underlying performance as value capturing mechanisms; an example of this is Bay Lake's portfolio firm. Value capturing mechanisms are primarily at work in the first and the last phases if one perceives the buyout firms' activity or investment in three phases: *entry* (acquisition), enhance (see section on value creation), and exit (divesture). They are consequently linked to the *valuation multiple* (see former equations). Thus, ceteris paribus, a positive development of the valuation multiple[24] leads to an increase in the portfolio firms' equity evaluation through what is sometimes referred to as *financial arbitrage*[25]. Consequently, when regarding this mechanism in isolation, the primary objective of the buyout firm is to buy low and sell high. This means capturing value without improving the portfolio firm's (financial) performance (even if these capturing mechanisms are primarily at work ex post and ex ante of the period under scrutiny. They must be understood in this research in order to comprehend the value creating mechanisms that

[24] However, it should be added here that the strategic position (i.e. a *value creating* issues) can also affect the valuation multiple. This is due to the portfolio firm having a strong fit for a potential industrial acquirer. Hence, there is both a market (*beta*) and a firm (*alpha*) component in the valuation multiple.
[25] If the notion of risk is disregarded, which (as per definition) is absent in arbitrage.

are at work. They also represent the linguistic arsenal that Bay Lake uses throughout its interaction with Arrow's management team.

The following section will provide a brief account for the different components of the value capturing mechanism: multiple riding, insider information, industry expertise and networks, proprietary deal flow, and the reduction of conglomerate discount. I must stress that these components are neither all encompassing nor mutually exclusive. Moreover, the rationale for this chapter is to introduce the reader to the value generating activities upon which buyout firms focus as well as their language practice (cf. idiosyncratic language).

### (i) Changes in Market Valuation: Multiple Riding

The form of financial arbitrage that practitioners often refer to as *multiple riding* concerns the exogenous effect of changes in the public market valuation multiples for comparable firms: peers. Buyout firms may suffer or benefit from this exogenous effect (Berg et al., 2005) to the extent that the portfolio firm valuation is correlated with changes in public market valuation multiples. Buyout investors might *ride on multiples* if they are successful in arbitrage in private markets or between private and public markets or, more accurately, can predict the changes in public market valuation multiples. A relevant example of this is that, directly after Bay Lake acquired Arrow in 2006, several large actors in the Widget industry announced that the industry was experiencing substantial over capacity and were initiating production capacity reduction in order to diminish the downward pressure on prices. The business media has interpreted this as the development of profitability improvement for the industry. On the other hand, the global financial turmoil that began in 2007/2008 has drastically decreased the markets' valuation multiples. This is something that Bay Lake predicted and had emphasized as an expected valuation multiple contraction in Arrow's Investment Memorandum.

### (ii) Private or Insider Information

Numerous researchers (DeAngelo et al., 1984; Jensen, 1989a; Lehn et al., 1989; Lowenstein, 1985) argue that insider information is an important component for capturing value in private equity transactions. Insider information could be an important component, particularly in management buyouts (MBOs), since there is often an information asymmetry between insiders (e.g. the management team of Arrow) and outsiders (e.g. capital market or potential acquirers of Arrow). One may argue that this insider advantage could lead to managerial opportunism in the form of various manipulations (Singh, 1990). For example, Arrow's management team admitted a few months after the acquisition that they had augmented their niche position too much. Investments based on under pricing are feasible only if a MBO takes place. According to Lowenstein (1985) and DeAngelo (1986), incorrect or increasingly negative forecasts (cf. Kirzner's (1997) concept of over pessimism) on earnings and revenues could affect the acquisition price (in favor of the buyout firm and current management).[26] In the case of Arrow, one might say that Bay Lake utilized quasi-insider information since an industry expert was employed to evaluate Arrow. This expert, who was a good friend of one of Bay Lake's senior partners, and the subsequent Chair of Arrow's board, had done business with Arrow on several occasions before and possessed good insight into Arrow's workings. Subsequently, this industry expert became the acting Sales Director of Arrow in no less than three months after Bay Lake had acquired Arrow; this was a position he held throughout the larger part of the investment period.

### (iii) Market Information and Proprietary Deal Flow

Since buyout firms are comprised of individuals with extensive industrial and financial experience, their network is often very comprehensive (Lerner et al., 2008). This makes it possible for them to build an extensive

[26] Although the usage of manipulative insider information is probably an important motivational factor for management teams proposing MBOs, the use of independent evaluations committees - commercial, financial as well as legal due diligences, and auctions - will most probably work as inhibiting factors for this behavior (Kohlberg *et al*, 1989).

industry expertise pool and uphold a continuous (and hopefully proprietary) deal flow, which occasionally delivers an opportunity for capturing value (Anders, 1992). However, this network supplies the buyout firm with a vast amount of information from a variety of constituencies such as management teams, investments shops/boutiques, banks, entrepreneurs, and various private equity actors. Deal making, negotiation, and analysis skills are also required in order to be successful. Thus, there are many factors that may greatly impact the acquisition price and, subsequently, the value of the financial arbitrage: the process of creating superior analyses of acquisition targets, the making of superior due diligences, the experience of different and efficient exits (e.g. finding industrial buyers through their network, making efficient initial public offerings, or identifying opportunities for secondary buyouts), and the ability to limit competition (e.g. through avoiding auctions[27]). Moreover, buyout firms are known for being tough and excellent negotiators, as well as being very flexible in their deal making methods (Butler, 2001).

### (iv) Reduction of Conglomerate Discount

An *asset-stripping approach* is this last and perhaps historically most frequently discussed value-capturing component: where the rationale is that the targeted multi-unit firm is worth less than the sum of its parts. Magowan (1989) argues that a skillful buyout firm can acquire a firm (i.e. portfolio firm) and sell its natural or constructed undervalued sub-units in order to maximize their individual enterprise values. This was one of few non-utilized mechanisms in the Arrow case; hence, no sub-units were divested (although parts of the production capacity were not completely utilized).

[27] One reason for Bay Lake to position them within the mid-cap market segment is the larger auction intensity in the large-cap segment.

## Value Creation

As aforementioned, I have used Berg and Gottschalg's (2005) dichotomy between *value capturing* and *value creation*. While the former section focused on capturing, this section will focus on *creation*, which is at work within the middle phase of the investment: the enhancement phase (cf. entry, enhance, and exit). The primary distinction between these two components is their effect upon the (financial) performance of the portfolio firm: in this case, Arrow per sé. Value capturing or financial arbitrage do not affect the performance in the portfolio firm; however, this component directly and indirectly alters performance by affecting revenues, margins, and capital requirements. While the mechanisms that indirectly affect the bottom line include various agency cost issues and parenting effects, the direct value creating mechanisms include financial engineering, operational effectiveness, and strategic positioning. As with the value capturing components, these value-creating components are neither all encompassing nor mutually exclusive; however, the arena upon which they are at work corresponds to the one where the strategizing and strategic change develops. Hence, this is at the center of this study.

### (i) Financial Engineering

The raison d'être of financial engineering or financial reengineering in buyout investments is leveraging and capitalizing the buyout firms' information, experience, and knowledge about the capital market in order to optimize the portfolio firm's capital structure, while reducing its tax obligation through various optimization efforts (Anders, 1992; Berg et al., 2005).

Buyout firms are repeated players within the debt market[28], in combination with a reputation as good customers (i.e. good borrowers[29]), extensive knowledge of the capital market and vast networks; therefore,

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[28] The rationale is that as the buyout firms lending increases, in volume and number, the more favourable customer they become and the better terms they will receive.

[29] This is an issue that has been heavily questioned in the aftermath of the global credit crunch and financial turmoil.

they often negotiate better financing terms than the target (i.e. portfolio firm) could ever do as a standalone firm (Magowan, 1989; Cotter & Peck, 2001)[30]. For example, Bay Lake has financed more than 55 acquisitions since its inception.

Interactions with various financial institutions and other debt providers is a rule rather than an exception; therefore, a good reputation and cultivating long-term relationships is a key success factor. Reductions in marginal agency costs for debt financing are consequently an effect of the former. DeAngelo et al. (1984) and DeAngelo (1986) emphasize how this long-term relationship and reputation dependency vastly diminishes the buyout firms' incentives to transfer wealth from its lenders. This awareness positively affects the lending terms offered to buyout firms. The raison d'être of all these activities is prolonging the identification and applying the right balance between various financing forms (equity, debt, and others mixes such as mezzanine: that is to say, a sort of hybrid capital)[31]. While the solidity of Arrow did not change, the holding firm that acquired Arrow has a large financing debt. The buyout firm as well as the management team and Arrow's board also owns Arrow through the holding firm, Arrow Holding. The recent financial turmoil has dramatically affected the banks' interest and ability to finance LBOs that, in combination with other factors, has dramatically decreased the national and global LBO activity in late 2008 and well into 2012 (with a short unfreeze in late 2010).

The reduction of corporate tax is an additional consequence of financial optimization. Lowenstein (1985) and Kaplan (1989a), as well as others, have argued extensively that tax savings are, or at least have been, one of the most important mechanisms for value creation in buyout investments. The rationale is that an increased level of debt increases

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[30]Negotiations typically include supporting the management team to settle various types of bank loans, bond underwritings, mezzanines, IPO at the end of the investment phase, and subsequent stock sales.

[31]It is important to emphasize that the right balance for the portfolio firm when owned by a buyout firm may be in diametric contrast to its preferable balance between equity and debt as a private or public stand-alone firm (Anders, 1992).

the interest payments, which are generally tax-deductible and are, thus, a tax shield for taxable incomes (Kaplan, 1989a).

### (ii) Operational Efficiency

The study of how buyout firms affect the operational efficiency of their portfolio firms have resulted in a fairly vast body of literature since the beginning of the 1990s (Bull, 1989; Kaplan, 1989b; Singh, 1990; Phan & Hill, 1995; Weir & Laing, 1998; Cressy et al., 2007; Acharya et al., 2008).

The improvement of operational effectiveness often has a direct effect on operating margins, cash flow, and other important operational measurements (and, consequently, on the value of the firm). An important distinction must be made: while these value generating components aim to create value, thus, leaving the firms strategic position as is and only altering the usage of the firm's resources base (cf. the former discussion on Kirzner's (1997) ideas), the component in the following section — that of strategic positioning — aims to alter the firm's position within the market per sé (cf. doing things right versus doing the right things or perhaps exploitation versus exploration). Consequently, operational efficiency improvements aim toward activities such as cutting costs and improving margins, reducing capital requirements, and removing managerial inefficiencies.

Buyout firms have strongly emphasized that cost reductions rather than revenue boosts more likely contribute to increasing portfolio firm profitability (Muscarella & Vetsuypens, 1990). The goal of these activities is to expand margins through actions such as increased control of corporate spending (Kaplan, 1989b; Magowan, 1989; Anders, 1992) and reductions of overhead costs through the decrease in management team size as well as size and structure of finance, administration, marketing, HR, and other staf' functions (Easterwood et al., 1989; Butler, 2001). Other cost-reducing activities that are usually put in place include policies for increased control of productions costs and plant productivity (Muscarella et al., 1990). This strategy was obvious in the Arrow case where cost-saving programs were continuously launched under the titles *cost leadership* and *the firm's overriding goal is survival.*

Another sub-component of value creation through operational effectiveness is the increase in capital productivity in the business through the reduction of capital requirements. While this could be achieved in numerous ways, Bull (1989) argues that the most frequent way is to use existing assets in more efficient ways through various rationalization and reorganization activities. Some explicit activities for achieving this include tightening inventory control and accounts receivable (Magowan, 1989; Singh, 1990), which subsequently diminish inventory levels and the amount of receivables (Easterwood et al., 1989). The introduction of more rigorous and stringent investment and other capital expenditure directives is also a rule rather than an exception; this often leads to divestment of underutilized assets (Magowan, 1989; Phan et al., 1995). Finally, Baker and Wruck (1989) acknowledge that the management of working capital is an activity frequently emphasized by buyout firms; in fact, Holtausen and Larcker (1996) put forth that post-buyout firms average significantly lower working capital levels than their industry peers. We will see later in the empirical chapter how the owner initiates a program called P200 after only a few months (that is to say, 200 million SEK in profit or increasing the EBITDA with 200 million SEK); this greatly emphasized cost cutting, margin improvements, and capital efficiency.

The last sub-component of the operations is a reduction in managerial inefficiencies. The rationale behind this sub-component is that changes in the management team's composition will strengthen performance (Anders, 1992). The most extreme and explicit example is management buy-ins (MBI) in which the entire management team, as per definition, is replaced with an external one (Jensen & Meckling, 1976). We will later see how the Arrow management team was reduced from fourteen to seven individuals within weeks after the acquisition (although other reasons than just the size per sé was emphasized). The CEO and

Sales Director were exchanged shortly after due to an argued absence of commercialism.

All of these operational effectiveness sub-components usually take place during the enhancement phase of the buyout investment: entry, enhance, and exit. Muscarella and Vetsuypens (1990) argue that the increase in profitability usually depends greatly upon these operational changes. The average EBITDA growth of Bay Lake's portfolio firms has been in excess of 160 %.

### (iii) Strategic Position

While several activities such as internationalizations, market consolidations, and product expansions are included in this component, I will categorize them as strategic repositioning and buy-and-build strategies.

Researchers such as Wright *et al* (2001) argue that buyouts, which primarily focus on downsizing, are a relic of the past. Several researchers (Muscarella et al., 1990; Anders, 1992; Seth & Easterwood, 1993) argue in favor of the core competency strategy put forward by Prahalad and Hamel (1990), thus, divesting and selling (or outsourcing) the parts of the firm that are not fully aligned with its core business[32]. Consequently, the reduction of complexity (Phan et al., 1995) is an important activity in buyout investments. This is also perhaps the most utilized modus operandi in the Arrow investment: where product, application, and geographical consolidations and focus were the backbone of the new strategy. As aforementioned, buyout firms exit their investment either by selling to an industrial acquirer (also referred to as a trade sale), an IPO, a secondary buyout (also referred to as a sponsor-to-sponsor deal), or through a less fortunate approach — such as default. Strong historical and forecasted growth is often a prerequisite for successful IPOs or trade sales (cf. building a *success story* in the empirical chapter) (Butler, 2001), which is why buyout firms often pursue both organic and non-organic (i.e. buy-and-build) growth strategies (Markides, 1997; Wright et al., 2001). The former are often aligned with the core competencies or dis-

[32] Although multifaceted, the reasons for this include strategy and competence concentrations as well as balance sheet diminishments.

tinctive competencies (cf. Kogut & Zander, 1992) and resources (cf. Barney, 1991) that the buyout firm has identified as being significant, if not essential, in order to excel in the defined industry and the portfolio firm's market.

The latter sub-component - strategic add-on acquisition or buy-and-build strategy - is a non-organic growth strategy; its rationale is to acquire other firms in order to establish various synergy effects, consolidate within a fragmented market (Baker et al., 1989; Seth et al., 1993; Wright, Robbie et al., 1994), leverage on existing core competencies and economies of scope/scale (Rumelt, 1982; Teece, 1982; Ramanujam & Varadarajan, 1989), or simply build volume that is assumed to drive value (e.g. market share). The purpose of this strategy is often to establish a dominant market position. When Bay Lake owned Arrow, several add-on acquisitions were evaluated, yet not realized (cf. Bay Lake's ambition to buy similar Widget firms to establish a niched Widget group). All strategic positioning sub-components are realized during the pre-enhancement and enhancement phases. However, they are often somewhat predetermined during the entry stage, thus, before the acquisition is finalized or even agreed upon (cf. the content of the Investment Memorandum).

## Indirect Value Creation

In addition to the aforementioned value creating mechanisms, which directly affect the financial performance of the portfolio firm (i.e. Arrow), a number of indirect ones exist as well. These indirect components affect performance through the aforementioned primary components: financial engineering, operational efficiency, and strategic position. These indirect components are either related to agency cost or parenting effect (Berg et al., 2005).

## Reduction of Agency Costs

While the reduction of various agency costs is the most scrutinized (Wright et al., 2001), the reduction is not the source of value creation per sé; instead, the indirect sub-components lead to this reduction.

Many have identified several factors that increase the agency costs of the portfolio firm, namely Jensen and Meckling (1976) as well as Jensen (1989b). These determinants include misalignment in incentives between owners and managers, the level of autonomy and discretion in managerial decision-making, as well as the owner's ability to monitor and control. Several strategic and operational components during the enhancement phase are at work and executed: for example, changes in the organizational structure. These changes facilitate the buyout firm's possibility to reduce agency cost tendencies (Kaplan, 1989b; Lehn et al., 1989).

The management team within MBOs and MBIs, as per definition, owns a share of the equity (Muscarella et al., 1990), as the 10 % in Arrow's case; therefore, they vastly decrease or even inhibit management incentives for managerial opportunism (Wright et al., 1994). I should stress that the decrease in managerial opportunism is heavily conditioned upon the situation of the managerial investors. Since Arrow's management team's investment in the company was relatively extensive given its personal financial situation, Bay Lake, through its principal banking partner, supported the team with very favorable loans. Hence, management was arguably dependent upon the success of Bay Lake's investment in Arrow.

Consequently, management's share of the equity is believed to increase management interest in value-creating activities and smarter investment decisions; thus, the incentives between owners and management are more aligned (Jensen et al., 1976)[33]. Incentives are further aligned through the use of, what is sometimes called, the stick-and-

[33]However, this managerial equity lock-in might increase managerial risk-aversion, thus, leading to too little opportunism and to decreased financial performance of the firm in the future (Fama and Jensen, 1985).

carrot strategy. This means combining positive incentives (that is to say, vastly increasing payoffs through sweet-equity at exit if the equity value develops positively) with negative restraints (Jensen, 1986, 1989b).

Due to a loss in reputation and control, default and bankruptcy can be very costly for managers; therefore, financing is an efficient and arguably unambiguous tool for controlling and reducing agency costs (Berg et al., 2005). The management team is assumed to work more effectively, efficiently, and diligently in order to handle interest payments since the lion's share of all buyout investments includes a high debt ratio (often much higher than pre-acquisition). One can assume (Jensen, 1986, 1989a, 1989b) that this debt burden encourages management to govern the firm more effectively and efficiently in an attempt to avoid defaulting on these payments, thus, governing or inhibiting the autonomy and decision discretion of management (Lowenstein, 1985; Jensen, 1986). In the case of Arrow, the vastly increased debt burden was perceived through its two-fold consequences: first, many investments were postponed (although not indefinitely) since interest and debt repayment were principal; second, the debt discussions were almost non-existent at management meetings before they were acquired and, hence, leveraged (i.e. increased their debt financing). In fact, the CFO was not a member of the management team. Bay Lake strongly advocated and sponsored investments affecting Arrow's strategic position (for example, new and greener energy sourcing); however, this was argued to have a substantial effect on Arrow's value in terms of strategic position. In fact, effects beyond Bay Lake's investment horizon positively affect its value generation. For example, a heuristic frequently used by Bay Lake was that all investments should be compared to the tentative EBITDA exit multiple. Hence, if Arrow's management team proposed an investment of 150 million SEK and the expected EBITDA exit multiple was five (4.5x), the investment had to lead to a profit expansion of >33.3 million SEK in order to be viable. Thus, it would generate or, in fact, create value for the owner.

There is naturally a flip side to the agency cost inhibiting effects of increased debt. Singh (1990), amongst others, recognizes the added risks that increased debt conveys in the form of increased exposure to interest rate raises, decreases in market demand, market jolts, and other unexpected shocks (such as the global credit crunch that started in 2007 and still remains in 2012). Furthermore, a larger emphasis on debt is probably also shifting managers' long-term focus on growth (due to an increased risk aversion) towards a short-term focus on interest payments.

Increased focus on monitoring and controlling is the last of the three sub-components of the indirect agency cost component. Changes in firm governance following a buyout increase the potential for augmented efficiency through increased monitoring and controlling (Singh, 1990). These changes can include: the establishment of a new board and a new organizational structure, and so on. The relationship between management and board is usually vastly strengthened after the acquisition; thus, the board adopts a very active role in governing the portfolio firm (even though they call themselves non-executive board members); this is usually achieved through the CEO and CFO. The board continuously evaluates the post-buyout management team (Anders, 1992) in order to tighten all processes.

As aforementioned in this section's introduction, these three agency costs' sub-components indirectly affect the financial performance, through the three value-creating components (Berg et al., 2005) that were used in Arrow's case: (i) alignment in incentives between owners and managers; (ii) level of autonomy; and (iii) discretion in managerial decision-making, as well as owner's ability to monitor and control.

## Parenting Effects

Buyout firms strive to establish an environment within their portfolio firms, which is characterized as entrepreneurial and creative. Frequently, when the acquisition targets of buyout firms is a part of a larger corporation or group, as in the Arrow case, the pre-acquisition focus of the firm or group as been somewhat scattered. A likely consequence is that the former owner or corporate headquarters has had a vast focus on costs rather than growth, which often inhibits the management team's entrepreneurial spirit and subsequent motivation. Arrow's management team, in fact, views itself as cost-cutters. In other words, division or business unit managers that are not fully aligned with the corporation, or who are not central to the headquarters, will often be governed as cost-center rather than profit-center (as a figure of speech) (Weir et al., 1998; Wright et al., 2001). This is a state that also characterized Arrow. Buyout firms try to infuse these pre-buyout (i.e. portfolio) firms with an entrepreneurial spirit in order to leverage on their ideas to subsequently increase the equity value (Jensen, 1989a; Singh, 1990).

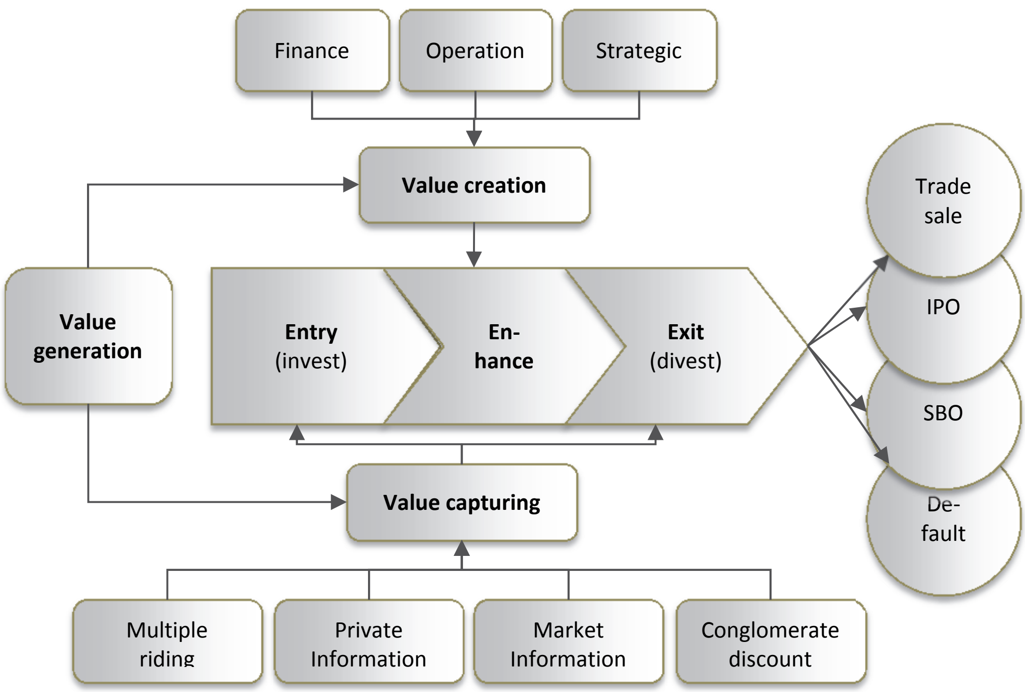
In contrast to many other forms of ownership, buyout firms are very active in their governing and advising role towards the portfolio firm's management team. Anders (1992) emphasizes the continuous and informal communication (the contact is more or less daily in contrast to earlier) between the board and the management team, which intends to encourage, support, and advise. This communication consequently empowers management in primarily strategic and financial, as well as operational issues. However, this should not be misinterpreted as an increased slack for management compared to the pre-buyout context. Buyout firms are known for being very demanding owners. Baker and Wruck (1989), as well as Magowan (1989), discuss how the level of demand on management vastly increases post-buyout.

As in the former set of indirect sub-components, infusing entrepreneurial spirit and empowerment also indirectly affects performance: primarily through the strategic positioning and operational effectiveness component.

## Summary of Value Generating Mechanisms

Buyout investments are a multifaceted phenomenon that includes a wide variety of mechanisms, components, and sub-components. While they either directly or indirectly affect the financial performance of the portfolio firm (or, in some cases, have no effect at all), they always affect the value for the owner. This chapter has depicted value generation in buyout investments as compounded by two sets of mechanisms: value capturing and value creating. Each of the two mechanisms is further compounded by a set of value (capturing or creating) components with inherent sub-components. While it is important to understand which component and sub-component belong to each mechanism, it is of even greater importance to understand where each mechanism is at work, thus, within which investment phase.

Figure 3.1: Value Generation Components and Mechanisms Overview.




As aforementioned, the investment process could be divided into three different phases: the initial or *entry* phase reaches up until the actual investment takes place, thus, the period from identifying a target (portfolio) firm to signing the share sales and purchase agreement (SPA). Several activities take place within this phase, such as scanning the market for target firms, short-listing several prospects, conducting legal, financial, commercial, and sometimes environmental due diligences on target firms, as well as developing tentative exit hypotheses and acquiring the firm itself. This is all encapsulated in the Investment Memorandum. Evaluation of the outlook concerning the four value capturing components is also conducted here. The second or the *enhancement* phase encompasses the time span when the actual acquisition is finalized to the initialization of the divesture. The third and final or *exit* phase is all about the divesture of the investment. More or less four different approaches for divesture exists: trade sale, thus, a sale to an industrial buyer; initial public offering; secondary buyout, thus, a sale to another buyout firm (sometimes referred to as an sponsor-to-sponsor deal); and, the less favorable exit, to default. This figure illustrates the process and where the different components are at work. Consequently, it illustrates that the value capturing and value creating mechanism are at work at different phases within the investment process: the former affects value in the first and last investment phase; the latter affects the enhancement phase.

The primary focus of this study is also directed here; this includes the strategizing and sensemaking processes that co-exist and surround the activities, which the buyout firm performs during the enhancement phase of the investment process. The emphasis is not directed towards the value creation per sé; it points instead toward the strategizing and sensemaking that take place in the portfolio firm where value creation is the focus.

Given the ambitions of this study, there is currently a gap between what I would like to accomplish and actually accomplishing it. The two following chapters strive to bridge this gap. Hence, proper methodological tools and adequate theoretical lenses are required in order to actually fulfill the ambitions of this study. The following two chapters will develop this.

The first centers on the methodological approach, and will explain my fundamental perception on research, my view on data, my approach to the empirical inquiry, and the implication of my choices. The latter chapter is in the form of the theoretical framework; this will implicitly continue to develop and explicate my methodological approach, as well as elucidate the theoretical lenses I will use to explore and interpret my empirical data.

# Chapter 4

# Methodological Approach

Since any scientific undertaking is always governed by the methodology in use, it is of fundamental importance to follow these methodologies that correspond to the purpose and research question(s) at hand. However, one should ascertain that the exploited methodology is in harmony with the scientific standpoint in both epistemological and ontological terms.

The raison d'être of this chapter is to describe how the research has been conducted; therefore, I will provide an explanation of precisely why I have used this particular approach in order to fulfill the purpose of this study and the implications thereof.

## The Overall Research Approach

This section is comprised of two parts; these respective rationales will explain which research strategy will be utilized in the empirical inquiry and what kind of data I will use, as well as the way in which I will use it.

## Research Strategy

Given the research questions, a corresponding research technique to infer empirical data is required. The following figure illustrates one process of arriving at an adequate research strategy. The figure should be perceived as a delineator that moves vertically from left to right; research strategies are excluded and more requirements and conditions are introduced.

The first condition covers the type of questions that are posed. While research questions in themselves have a significant impact upon the research approach (Strauss & Corbin, 1990), different questions sometimes demand drastically different research strategies. Yin (2003) states that posed research questions can be categorized in terms of 'how', 'why', 'who', 'what', 'where', 'how many', or 'how much'. Since 'how' questions are being posed within this study, research strategies such as surveys and archival analysis are insufficient and are, therefore, excluded from this research other than for complementary purposes. Instead, research strategies with more explanatory ambitions such as case studies, histories, and experiments are preferred. These questions "deal with operational links needing to be traced over time, rather than mere frequencies or incidence" (Yin, 2003, p. 6).

The second condition concerns the issue of my control over and access to actual behavioral events. Based upon this condition, the three remaining research strategies could be further distinct. The investigator can directly, precisely, and systematically manipulate the behavior (Yin, 2003) when experiments are conducted. This is diametrically opposed to this study where individuals involved in the strategizing and strategic change were observed, yet not exposed to any (intentional) behavioral manipulation.

The third and final condition regards the *contemporariness* of the studied occurrence or phenomenon. The special contribution of the historical method deals with the 'dead' past; that is to say, no relevant persons are alive to report, even retrospectively, what occurred and when. Therefore, an investigator must rely upon primary and secondary documents, as well as cultural and physical artifacts, as the main source of evidence[34]. This consequently means that the *case study* is the last research strategy exploitable of the initial five.

Figure 4.1: Relevant Situations for Different Research Strategies (Yin, 2003).

| | Type of research question | Requires control of behavioral events | Focuses on contemporary events |
|---|---|---|---|
| Survey | who, what, where, how many, how much? | No | Yes |
| Archival analysis | who, what, where, how many, how much? | No | Yes/No |
| Experiment | how, why? | Yes | Yes |
| History | how, why? | No | No |
| Case study | how, why? | No | Yes |

Consequently, when a researcher such as I, has "little control over events and the focus is on a contemporary phenomenon within some real-life context" (Yin, 2003, p. 1), posing 'how' and/or 'why' questions means the case study is the preferred research strategy.[35] Yin (1989, p. 23)

[34] Histories can, obviously, be done about contemporary events; in this situation the strategy begins to overlap with that of the case study (Yin, 2003).

[35] "Considerable support for the use of case study research can be found in many international strategic management studies (Bettis, 1991; Daft &Lewin, 1990; Mintzberg and McHugh, 1985; Mintzberg et al., 1976; Whipp et al., 1989) as well as specifically Swedish management studies (Eneroth, 1997; Melander, 1997; Regnér, 1999; Stein, 1993; Åkesson, 1997).

defines this research strategy as "an empirical inquiry that: investigates a contemporary phenomenon within its real-life context; when the boundaries between phenomenon and context are not clearly evident; and multiple sources of evidence are used"[36]. In reference to the discussion held at the beginning of this section, I must note that the case study strategy should not be confused 'with qualitative research' per sé (e.g. Denzin & Lincoln, 1994). Instead, case studies can be based upon any mix of qualitative and quantitative evidence.

Using case studies as a research strategy is constantly increasing; Stake (2000, p. 435) takes it so far as to say that case studies have become "one of the most common ways to do qualitative inquiry". The confidence in the strategy has grown to a great extent and is perceived as a rigorous research strategy in its own right (Hartley, 1994; 2004).

In parallel to both the primary features of qualitative studies, the case study approach allows me to retain a holistic perspective. "The distinctive need for case studies stems from the desire to understand complex social phenomena…[since]…the case study approach allows investigators to retain the holistic and meaningful characteristics of real-life events", such as managerial and organizational processes (Yin, 2003, p. 2).

We can infer several key characteristics of case studies from the previous discussion that is presented in the following figure. I will briefly elaborate upon these traits and set into relation to the study at hand before moving onto a discussion of qualitative and quantitative data as well as unfolding the research journey.[37]

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[36]Hartley (2004 p. 323) gives a similar, yet less detailed definition when he states that case study research "consists of a detailed investigation, often with data (that is) collected over a period of time, of phenomena, within their context" with the primary objective being "to provide a analysis of the context and process, which illuminate the theoretical issues being studied".

[37]It is important not to confuse the case study method with a specific data collection method such as participant observation (Jorgensen, 1989), which will be elaborated upon later within this methodology section.

Figure 4.2: Key Characteristics of Case Studies

1. The phenomena or occurrence is studied in its natural or real-life setting
2. Multiple sources of evidence are used
3. Focus is directed toward specific entities
4. The desire is to understand a complex social phenomena
5. No direct, precise, nor systematic behavior manipulation is involved nor experimentation
6. The focus is on a contemporary phenomena
7. The boundary between the phenomena and context is not clearly evident
8. 'How' and 'why' questions are being posed since these deal with operational links needing to be traced over time, rather than mere frequencies or incidence

(1) The primary means of inquiry took the form of interviews and direct observation in order to attain a rich picture of the observed phenomenon and the different perspectives (see sub-section on interviews and participant observation, respectively). This was regarded as not only ideal; it was required in order to understand the different processes that took place and, hence, the development and implication of the interpretations and actions, thus, the sensemaking. This is also something that differentiates me from the cast body of research on strategic change. (2) The sources of inquiry were not only multiple, such as interviews, direct observation, and documentation; they were also (3) directed towards specific actors: for example, the new board and the management team of Arrow. (4 & 6) Since the primary objective of this study is to answer the stipulated research questions, the intention is to understand the complex phenomena of sensemaking strategic thinking in the context of the strategic change; thus, it is to understand a complex and contemporary social phenomenon. (5) Since the processes taking place are not (intentionally) tampered with in any way, thus only observed, neither manipulation nor experimentation has had a role in this study. (7) The

boundaries between the studied phenomenon and the context are ambiguous, which is in parallel to the key characteristics of case studies; therefore, they seem to reshape themselves every time they are elucidated. (8) Finally, the posed questions within the study at hand correspond to those argued for by Yin (2003).

The following section will explore and explicate my perception on the usage and value of qualitative and quantitative empirical data.

## On Qualitative Research

While the dichotomy between qualitative and quantitative can be made long, complex, and ambiguous, the objective here is to clarify my position and its implication to this study. As mentioned in the former section, the chosen research strategy — that of the case study — can be based upon any mixture of qualitative and quantitative data. A combination of both data categories has also been required in this study in order to answer the research questions posed from the start. However, since I study strategic change processes from a sensemaking perspective, I have drawn more heavily on qualitative data.

Although a vast flora of different perceptions of qualitative research characteristics exist[38], I have chosen have to put forth eight recurring features of qualitative studies that will be paralleled and contrasted to my position (Miles & Huberman, 1994, p. 6-7):

(i) When studying why strategic thinking (with sensemaking as a proxy) develops over time within and between decision-making groups and how this gradually affects the process of strategic change and strate-

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[38]Merriam and Nilsson (1994) argue that data or information communicated through words is called qualitative. Straus and Corbin (1990) widen the definition by "anti-defining" it as research that is not conducted with statistical procedures and that other means of quantification is qualitative. Patel and Tebelius (1987) advocate that quantitative approaches determine pre-established qualities whereas qualitative aims to identify and distinguish a studied phenomenon. Neuman (1997) argues that qualitative means collecting data in the form of word and pictures while quantitative means collecting data in the form of numbers. The aforementioned definitions may be perceived as somewhat over-simplified or even superficial.

gy formation, I have focused upon communication and interaction between individuals and groups. An "intense and/or prolonged contact with this 'field' or life situation" (Miles et al., 1994, p. 6) is of utmost importance in order to capture these process-related attributes and understand the actors, their experiences and reflections of the occurrence, as well as any changes. The identification and understanding of the strategic thinking that affects the organization, its members, and the subsequent change processes require this intense and lengthy contact.

(ii) I have chosen not to measure some specific parts. Instead this research depicts a holistic view of interpreting and acting: the sensemaking processes, their context, and inevitable consequences in order to understand why they emerge and how they affect different individual, group, and organizational processes. In other words, I have observed and interpreted broadly conceived patterns and how they become intertwined with the social circumstances of the organizational activities. According to Holme and Solvang (1997), providing a holistic view is one of the primary strengths of a qualitative approach. In resemblance to Miles and Huberman (1994, p. 6), I believe that my role is to gain a holistic view, thus, a "systematic encompassing and integrated overview of the context under study: its logic, its arrangements, its explicit and implicit rules" (Miles et al., 1994, p. 6). This is done to understand a strategic change process: why strategic thoughts emerge and how they affect individuals, groups, and organizations.

(iii) I have attempted to "capture data on the perceptions of local actors 'from the inside', through a process of deep attentiveness and of emphatic understanding" (Miles et al., 1994, p. 6). While this "inside view" can be accomplished in numerous ways, two primary means have been used throughout the empirical inquiry: interviews and direct observations (see section on interviews and on participant observation).

(iv) In resemblance to Miles and Huberman's (1994) characterization of qualitative research certain themes, which can be reviewed by the informants, have been isolated and focused upon within the study in order to elucidate the sensemaking process. These have been maintained in their original form throughout the study, as per Miles and Huberman's (1994) recommendation.

(v) I must explain the ways in which the informants "come to understand, account for, take action, and otherwise manage their day-to-day situations" (Miles et al., 1994, p. 7) in order to comprehend why different strategic thinking and sensemaking processes emerge and how these affect different processes . In order to achieve this, a good approach is to observe the informants in their daily lives (Jorgensen, 1989).

(vi) This research material can be interpreted in numerous ways. However, some interpretations are more compelling than others (Miles et al., 1994) given the purpose of the study and its associated research questions, not to mention the theoretical reasons as well as the need for internal consistency.

(vii) The primary measurement device of the study is the researcher per sé and "relatively little standardized instrumentation is used at the outset" (Miles et al., 1994, p. 7).

(viii) The last feature of qualitative research, as identified by Miles and Huberman (1994), is the way in which most analysis is conducted: with words. This fully parallels the analysis made in my own research. The fact that "words can be assembled, sub-clustered, (and) broken into semiotic segments" (Miles et al., 1994, p. 7) is the primary reason for this. Another cause is that the empirical inquiry has focused upon sources that primarily communicate with words (I will elaborate more upon later in this section). This allows the researcher to "contrast, compare, and bestow patterns upon them" (Miles et al., 1994, p. 7).

# Unfolding the Journey and the Case Study Design

The research design is the logic that links the data to be collected (and conclusions to be drawn) to the initial questions of the study at hand (Yin, 2003). Consequently, the rationale of the following section is to explore the journey of empirical data collection and elaborate upon the research design that has guided me in "the procedure of collecting, analyzing, and interpreting observations" (Nachmias and Nachmias, 1992, p. 79). I will also account for how the data has been structured and analyzed.

## The Quasi-Longitudinal Case Study

A primary distinction in designing case studies is the division in single and multiple case designs. Whereas there are several rationales for choosing single-case designs (see Yin, 2003, p. 39-42 for a discussion), three have been guiding this study[39]. First and foremost, primarily due to practical reasons such as time, there is a tradeoff between the depth and breadth when conducting case studies. While emphasis on the latter gives the advantage of comparative insights, the former emphasizes the advantage of deeper more intricate understanding of the phenomena under investigation. To the best of my knowledge, the activities of buyout firms have not been scrutinized before from this outlook or from this inner perspective. Therefore, depth has been prioritized over breadth.

According to Yin, "the use of a single-case study on the grounds of its *revelatory* nature" (2003, p. 42) is justified when an opportunity uncovers some prevalent and highly contemporary phenomenon that was previ-

[39] Yin (2003) points out five primary rationales for choosing a single-case study. These include the following: a critical case for testing a well-formulated theory, when the case represents an extreme or unique case, when the case is representative or typical, when the case is revelatory (see above discussion), and when the case study is longitudinal.

ously inaccessible to researchers, such as the buyout firms' increasing activity and conditions. As elaborated upon earlier, buyout firms are still secretive actors within the contemporary business society, which is why the complete and unquestioned access that I have been granted should be perceived as exceptional and, therefore, revelatory.

Since there is an interest in specifying how certain conditions evolve over time in order to understand the development and consequence of the sensemaking, several managerial processes and arenas have been observed for an extended period. The temporal delimitation for this research amounts to approximately 14 intense months between 2006 and 2007, plus 22 less intense months between 2007 and 2009 where the interaction was bi-weekly. (I have since had ongoing insight into both Arrow and Bay Lake, and still do today). This prolonged inquiry is termed *longitudinal* case study: Yin's (2003) last rationale for single-case studies. In accordance to Miller and Friesen's (1982b) *type 1*[40] category, a single longitudinal case study, has been consequently chosen to fulfill the purpose of this work. This broadly focused and non-quantitative study of a single organization is perhaps the most common longitudinal study.

The distinction in single and multiple cases is not as clear-cut as the former discussion seems to suggest. Eisenhardt (1991) points out that a single setting should not necessarily be perceived as a single case in Yin's (2003) terminology. Several comparative analyses and replications are possible. Since this study is longitudinal, comparisons between different points in time have not only been possible; they have also been conducted. Moreover, I have continuously compared and contrasted the perspectives of the board, the management team, and the CEO; this also could be perceived as traits resembling those of multiple case studies.

[40] Miller and Friesen identify several strengths of *type 1* studies with the prime being "that they provide a basis for real insights into *how* organizations make decisions, adapt to their environments, enact new environments, and restructure themselves. There is a wealth of detail on sequences of decisions and events and this affords much knowledge on the time priority of change in variables of strategy, structure, environment, decision making, methods and executive personality" (1982b, p. 57). Miller and Friesen (1982b) identify several studies such as Pettigrew (1973) and Kimberly (1979), which are very analytical and very carefully preformed within this genre.

This could infer that the boundary between what is characterized to be single and multiple case studies is not as unambiguous as one was lead to believe in the former passage (Eisenhardt, 1991).

## Selection Procedure

Several criteria that would govern the case selection procedure were identified at the outset of the study. Thus, six selection criteria were used to identify one relevant upcoming strategic change process based upon theoretical sampling procedures (Eisenhardt, 1989; Glaser & Strauss, 1967). The following section will discuss the six different criteria that were identified to be important and explain how they were fulfilled. Several prerequisites need to be fulfilled since the purpose of this study is to explore, interpret, and elaborate upon the way in which organizational or perhaps strategic change can be attained (either intentionally or unintentionally) through *changes in the sensemaking of managers*.

Identifying a buyout firm that was in the process of making an acquisition was of foremost importance. Since acquisition processes are comprised of issues such as closed biddings, intense negotiations and non-disclosure agreements, buyout firms do not publicly announce any acquisition until the deal is closed (cf. aspect four).

Secondly, there was also an ambition that the investment would be of substantial size for the buyout firm in order to secure Bay Lake's full attention and interest. Consequently, a firm of substantial size was chosen based upon investment size, headcount, revenue stream, and organizational complexity.

Figure 4.3: Case Selection Criteria

1. The observed firm (later portfolio firm) was to be acquired by a private equity firm
2. The portfolio firm should be of substantial size (in terms of FTE's, revenue, investment size)
3. Explicitly identified strategic change after the acquisition, thus an considerable change form prior strategy
4. Knowledge of the acquisition prior to the actual acquisition
5. Stronger assistance form both the private equity- and the portfolio firm
6. Granted full access to all organizational levels both with the private equity- and the portfolio firm

Third, as the buyout firm had intended, the strategic change had to involve a considerable change from a prior strategy. This criterion was imperative since the study aims to understand the strategic thinking, thus, sensemaking processes with which the strategic change is associated. This means that the change per sé must be evident and all encompassing.

Fourth, since I aim to establish an understanding of the emergence, evolvement, and consequence of different sensemaking processes during strategic change, there is a great deal of value in starting the inquiry prior to the actual acquisition, hence, before the strategic change was initiated. Thus, there was a need to have access to the organization and its forthcoming owner prior to the actual acquisition.

Fifth and sixth, given the former criteria, there was a need for strong assistance from an inside supporter at both the buyout and portfolio firms. This ensured assurance as well as full access to various organizational levels and other sources (see section on the empirical inquiry).

In addition to the aforementioned criteria, Stake (1995) emphasizes the importance of learning maximization as a fundamental criterion.

This parallels Yin's (2003) idea. Convenience and accessibility (as in geographical location) are two criteria that should have played a central role in the choice of observed phenomenon since direct observation demands numerous visits to the site. However, the conveniences criterion was not fulfilled since the distance to the Arrow offices was approximately 400 kilometers.

## Empirical Enquiry

The collection of empirical data was initiated during March 2006, and was governed by several principles: one was Yin's (2003) idea of using multiple sources of "evidence" (formerly identified as a major strength of case studies). The use of multiple sources for the empirical inquiry allows the study to address a "broader range of historical, attitudinal, and behavioral issues" (Yin, 2003, p. 98). While several sources were utilized in this study, two represented the lion's share of empirical data. Firstly, interviews occurred with all but one of the member of the Arrow's management team, as well as all except for one member of Arrow's board including Bay Lake's CEO and two partners, who are also board members. Secondly, I attended over 110 meetings (e.g. board, management, strategy, and sales meetings); these ranged in length from 20 minutes to six hours, averaging approximately 75 minutes each. Some interviews and direct observation represented the two primary data sources; several others were also exploited. This sub-section will be devoted to briefly elaborating upon all utilized sources of empirical data.

Figure 4.4: Six Sources of Evidence (Yin, 2003:86)

| Sources of evidence | **Strengths** | **Weaknesses** |
|---|---|---|
| **Documentation** | *Stable* – can be viewed repeatedly<br>*Unobtrusive* – not created as a result of the case study<br>*Exact* – contains exact names, references, and details of an event<br>*Broad coverage* – long span of time, many events, and many settings | *Retrivability* – can be low<br>*Biased selectivity*, if collection is incomplete<br>*Reporting bias* – reflects (unknown) bias of author<br>*Access* – may be deliberately blocked |
| **Archival records** | *[same as above for documentation]*<br>Precise and quantitative | *[same as above for documentation]*<br>Accessibility due to privacy reasons |
| **Interviews** | *Targeted* – focuses directly on case study topic<br>*Insightful* – provides perceived causal inference | Bias due to poorly constructed questions<br>Response bias<br>Inaccuracies – due to poor recall<br>*Reflexivity* – interviewee gives what interviewer wants to hear |
| **Direct observation** | *Reality* – cover events in real time<br>*Contextual* – covers context of events | Time-consuming<br>*Selectivity* – unless broad coverage<br>*Reflexivity* – event may proceed differently because it is being observed |
| **Additional sources** | **Participant observation** – not used within the study at hand<br>**Physical artifacts** – not used within the study at hand | |

Yin (2003) identifies six primary sources of data. While all are illustrated in the adjacent figure, the first four were used when conducting this case study.

(i) Different sorts of documentation have been heavily used during the study: protocols, policies, business plans, internal memos, minutes, information and investment memorandums[41], as well as annual reports. Documents have been a valuable source for several reasons: verifying correct spelling of names, titles, or other organizations that have been mentioned during the data collection. The pace is fast and there is a high possibility of misunderstanding a title or name of a competing organiza-

[41] The Investment Memorandum is the internal investment proposal that the buyout firm compounds. This document of 109 pages includes information from commercial, financial, and legal due diligence, as well as financial forecasts, identified Key value drivers, proposed financing of the acquisition, and projected yield of the investment.

tion; this is especially true during the process of direct observation (for example, meeting participation). Moreover, documents are good sources to find both corroborate and contradictory information for further inquiry. Arrow relied heavily upon distributing agendas and so on to all participants, including me, before all meetings, as well as handing out detailed minutes after every meeting.

(ii) Organizational charts, budgets, financial forecasts, and curriculum vitaes on, for example, the management team members have been used. Some of these archival records, such as financial forecasts, have been very valuable in understanding the sometimes-complex financial discussions that have been intermittently in focus during board and management meetings. It is important to recognize is that most of these archival records were produced for specific purposes and with a specific audience in mind. This must be "fully appreciated when interpreting the usefulness and accuracy of these records" (Yin, 2003, p. 89).

(iii) Interviews, which will be the focal point of the next section, have represented the lion share of the empirical data collection, along with direct observation. The study includes fourteen interviews with Arrow's management team members and board - including Bay Lake's CEO and both involved partners.

(iv) Direct observations, which range from formal to casual data collection activities that will be the focal point of an upcoming sub-section, have as aforementioned been very central. Primary ways in which direct observation have been used is participation at all meetings central to the studied processes, sidewalk activities, and following the CEO or management team to other sites, e.g. to the bank when financial covenants are discussed, or to the yearly strategy and budget events.

Several other strengths and weaknesses exist when documents, archival records, interviews, and direct observation are used as sources of empirical evidence; this is also true when direct observation and physical artifacts are used. For more information on these, the reader should direct attention to e.g. Yin (2003, p. 85-97).

## On Interviews

When used correctly, interviews can facilitate a profound understanding of the interviewees' perceptions; as aforementioned, interviews were one of two most important means of collecting empirical data in this study. The interviews give the interviewer great support in understanding the interviewees' different subjective and inter-subjective interpretations of the phenomenon addressed in the posed research questions.

Oldsfield (1947) identifies four primary traits of interviews: (i) A meeting between individuals in person; (ii) There is a specific purpose and it is carried out with that purpose in mind; (iii) There is a conversation; and (iv) There is rarely a mutual relationship between the parties. The interviews in the current research where conducted with the spirit of Oldsfield in mind (1947). All meetings were in person and carried out with an aspiration to attain a deep comprehension of the respondent's view on various issues related to the posed research questions. The lack of any mutual relations between the parties means that the interviewer generally controls the development of the dialogue, and that it has, more or less, a previously established direction instead (Lantz, 1993).

As there is a wide variety of interviews, they are usually set apart according to two different dimensions: *degree of standardization* and the *degree of structure* (Patel & Tebelius, 1987). The former relates to the construction and order of interview questions, while the latter relates to how the interviewee is allowed to answer the questions[42]. Interviews with a high level of structure and standardization generally mean that the interviewer asks questions that have been previously formulated in a predetermined order with prior fixed answer alternatives. During an interview with a low degree of structure and standardization, the interviewer asks wide open questions that leave room for the respondent to freely develop thoughts around them. This approach enables the respondent to construct a context, which he or she feels is necessary in describing the phenomenon

[42]Combinations of different positions on these dimensions or scales resemble the different types of interviews that Rubin and Rubin (1995) identify.

(Lantz, 1993). The latter interview, with a lower level of standardization and structure, characterizes the interviews conducted in this study since the questions were not strictly formulated, but were formed primarily as an interview guide (see Appendix C). The primary traits of the interview — being flexible, iterative, and continuous—resemble those of the *qualitative interview* (Rubin et al., 1995). Furthermore, a great deal of freedom was given to the respondent to exemplify and describe the phenomenon in whatever context he or she found supportive; this provided the opportunity to express one's beliefs and judgments on one's own terms (Shaughnessy & Zechmeister, 1985). In short, the discussions were open, leaving room for thought sharing and discussion, yet they were decided upon in advance.

This type of longer, more elaborate, and open interview has also been complemented with numerous *focused interviews* (Merton et al., 1990). These interviews differ in the sense that they are shorter, more focused, and follow a certain set of pre-defined questions (even though they might be open-ended). This type of interview was used in direct connection with specific events, such as when Arrow's CEO was set aside (a focused interview was conducted with him and the new Acting CEO only two hours after the dismissal was communicated to both of them).

As aforementioned, fourteen interviews were conducted with members of Arrow's management team and board, as well as parts of Bay Lake's management team and its CEO. Moreover, all approached managers, board members, and partners agreed to be interviewed without exception; all interviews except for two took place at the interviewees' office. The total amount of interview time reached over 17 hours, and the average length of an interview was approximately 75 minutes. The following table provides an overview of the conducted interviews.

Table 4.1 Interviews With Arrow and Bay Lake

| *Position* | *Firm* | *Group* | *Interview Duration* | *Date* |
|---|---|---|---|---|
| Managing Director | Arrow | Arrow Mgmt team | 99 minutes | May 2006 |
| Pro. Temp. Managing Director | Arrow | Arrow Mgmt team | 23 minutes | August 2006 |
| New Managing Director | Arrow | Arrow Mgmt team | 84 minutes | November 2006 |
| Sales and Marketing Director | Arrow | Arrow Mgmt team | 122 minutes | May 2006 |
| Administrative Director | Arrow | Arrow Mgmt team | 99 minutes | June 2006 |
| Financial Manager | Arrow | Arrow Mgmt team | 101 minutes | June 2006 |
| Purchasing Manager | Arrow | Arrow Mgmt team | 95 minutes | May 2006 |
| Consultant (later, Acting Sales and Marketing Director) | Arrow | Arrow Mgmt team | 54+30 min | July 2006 |
| Production Manager | Arrow | Arrow Mgmt team | 107 minutes | May 2006 |
| Board Chair (and Partner at Bay Lake) | Arrow and Bay Lake | Arrow Board, Bay Lake Mgmt team | 59 minutes | August 2006 |
| Board Member | Bay Lake | Arrow Board | 86 minutes | May 2006 |
| Board Member | Bay Lake | Arrow Board | 81 minutes | August 2006 |
| CEO of Bay Lake (and Arrow Board Member) | Bay Lake and Arrow | Bay Lake Mgmt team, Arrow Board | 50 minutes | September 2006 |
| Partner (and Arrow Board Member) | Bay Lake and Arrow | Bay Lake Mgmt team, Arrow Board | 72 minutes | September 2006 |

The interviewees did not receive the interview guide prior to the meeting; however, they were instead expected to discuss the matter free from potential pre-conceptions formed by any previous reading. The CEO was interviewed additionally using open-ended interviews after each important meeting (e.g. board, management, or advisory meeting) in order to capture his reflections of the meeting in close connection to the meeting itself. These latter interviews amount to approximately 25 and are not included in 14 aforementioned interviews.

Audiotaping can be a sensitive issue - especially since the interviews sometimes contained a large portion of reflections on how other managers or board members performed and understood the situation. In spite of this and the fact that the studied phenomenon is of delicate nature, a mutual trust developed between the interviewees and me. One primary reason for this evolved trust was probably due to my constant presence at Arrow, conducting direct observation months before initiating the actual interviews. Consequently, all interviews were taped and extensive notes were taken during the interviews. The interviewees were always consulted regarding the usage of a tape recorder and were given the right to push the stop button at any time (this never happened). I also tried to be as receptive as possible to detect any reluctance to outspokenness.

## On Participant Observation

As aforementioned, participant observation and interviews constitute the backbone of the empirical inquiry in this research. The method is exceptional "for studying processes, relationships among people and events, the organization of people and events, continuities over time, and patterns" (Jorgensen, 1989, p. 12). Moreover, the method facilitates the possibility of describing "what goes on, who or what is involved, when and where things happen, how they occur, and why—at least from the standpoint of the participants—things happen as they do in practical situations" (Jorgensen, 1989, p. 12). In short, the methodology focuses on the meanings of human existence as perceived by the insiders (Spradley, 1980). Since little is known, in this specific context, about the phenomenon of interest participant observation stands out as method. The fact that the phenomenon is hidden from public view, as well as obscured from other outsiders, is an additional motive for using participant observation.

Jorgensen (1989) has defined participant observation in terms of seven basic features, which are illustrated in the adjacent figure and elaborated upon here:

(i) *The insiders' viewpoint*—People make sense of the world surrounding them; it gives them meaning, which underpins their interaction (Denzin, 1978). For instance, when people define a situation as real. During the studied strategic change, it is real in its consequences (Thomas and Thomas (1928) in Jorgensen, 1989) (cf. Fleetwood, 2005, idea of causal efficacy). Consequently, even 'erroneous' beliefs are real in their consequences (cf. Fleetwood, 2005). Thus, everyday life constitutes a reality for its members. The insider's viewpoint means trying to understand the insiders' conception of reality, therefore, understanding the members of the setting studied here.

(ii) *The world of everyday life*—In contrast to environments that researchers manipulated (cf. characteristics of case studies), this method studies the everyday life - the natural environment of a strategic change - imposed after a buyout acquisition (however, the level of normality can be discussed). Every possible research disruption or interference on what is studied must consequently be minimized (Jorgensen, 1989).

(iii) *Interpretative theory and theorizing*—While concepts and interpretations inspired through participant observation are valuable for making practical decisions, the method aims to provide "practical and theoretical truths about human existence" (Jorgensen, 1989, p. 16).

(iv) *An open-ended-logic and process of inquiry*—Participant observation seeks to build theories grounded in concrete human realities. While a theoretical interest in strategic thinking and sensemaking was present at the outset of the study, precisely what concepts were important and how they were interrelated was not recognized *a priore*; thus, I remained open to refinement based upon what was observed during the empirical inquiry. This openness to "redefinition and based on information collected in the field" (Jorgensen, 1989, p. 18) parallels to some extent the ideas of the hermeneutic approach (Alvesson & Sköldberg, 1994).

(v) *In-depth case studies*—Although the methodology of participant observation is frequently practiced as a case study (Jorgensen, 1989), the method here is perceived as a specific data collection approach in parallel with (Yin, 2003) and not as a methodology per sé. However, both case studies emphasizes the idea of holistic examination and the avoidance of "separating components from the larger context to which these matters may be related" (Jorgensen, 1989, p. 19), as is participant observation as a data collection approach.

Figure 4.5: Basic Features of Participant Observation (Jorgensen, 1989)

1. The insiders' view point—a special interest in human meaning and interaction as viewed from the perspective of people who are insiders or members of particular situations and settings
2. The world of everyday life—location in the here and now of everyday life situations and settings as the foundation of inquiry and method
3. Interpretative theory and theorizing—a form of theory and theorizing stressing interpretation and understanding of human existence
4. An open-ended-logic and process of inquiry—a logic and process of inquiry that is open-ended, flexible, opportunistic and requires constant redefinition of what is problematic, based on facts gathered in concrete settings of human existence
5. In-depth case studies—an in-depth, qualitative case study approach and design
6. The participant role—the performance of a participant role or roles that involves establishing and maintaining relationships with natives in the field
7. Methods of collecting information—the use of direct observation along with other methods of gathering information

(vi) *The participant role*—Direct involvement in peoples' daily lives is required in order to fulfill the "insider perception" that participant observation strives toward. Consequently, as Jorgensen emphasizes (1989), participant observation is a very special strategy for gaining access to the inside, thus, seemingly subjective aspects of human existence. My involvement was *overt* in this study, thus, known by the insiders. Access and organizational knowledge about this access, which was formerly emphasized as a primary selection criterion, must be sustained once it is has been granted. The importance of this revealed itself when the CEO (who was my strongest supporter inside Arrow) was dismissed and an Acting CEO was appointed to bridge the temporal managerial void. Thus, the constant maintenance of relationships with people within the field is crucial (Johnson, 1975).

(vii) *Methods of collecting information*—Jorgensen (1989) emphasizes that *direct observation* is the primary method of collecting empirical data when participant observation is used; however, other sources such as documents and interviews are also perceived to be extremely valuable. In parallel to Yin (2003), I differentiate between participant observation and *direct observation* according to the degree of passivity. Participant observation is a special mode of observation in which one is not merely a passive observer, but actually participates in the studied events. This is in contrast to direct observation where one is strictly an observer (although some influence is inevitably present). My stance has been the one of direct observation, that is say, as a pure empirical data collection approach, which is in contrast to Jorgensen's (2004) idea. However, I believe the seven aforementioned features characterize how I perceive the approach and with what it contributes to this study. Due to this the term, direct observation has been used throughout the study instead of participant observation. Consequently, the direct observation, with the seven aforementioned primary traits, has been used as a method of empirical data collection. The following table gives a *partial* overview of the meetings that I attended during this study (AR = Arrow and BL = Bay Lake). For example, the statement "CEO and I" means that I was a part of the discussion. The following table is a short snapshot; the full overview can be found in Appendix D.

Table 4.2 Observed Meetings

| Topic of Meeting | Location | Attendants | Meeting Duration | Arena | Date |
|---|---|---|---|---|---|
| First night at a hostel next to Arrow | AR proximity | n/a | | TBD | 2006-03-15 |
| First day at Arrow HQ | AR HQ | AR CEO & co-workers | 30 min | CEO | 2006-03-16 |
| Discussing headhunting & CEO friends | AR HQ | AR CEO & I | 10 min | CEO | 2006-03-16 |
| Meeting with Arrow's new bank | AR HQ | AR CEO, CFO & Bank | 35 min | (CEO) | 2006-03-16 |
| Recruiting a new sales force | AR HQ | AR CEO, Sales Dir. & a external headhunter | 120 min | CEO | 2006-03-16 |
| Lunch meeting discussing problems | AR HQ | AR CEO + 6 from finance & production mgmt | 30 min | CEO/mgmt. | 2006-03-16 |
| Advisory meeting with a consultant/CEO friend | AR HQ | AR CEO + consultant/friend | 180 min | CEO | 2006-03-16 |
| The Goliath separation to-do team | AR HQ | AR CEO + 5 from mgmt | 145 min | CEO/mgmt. | 2006-03-17 |
| Monthly mgmt meeting (finance team) | AR HQ | AR full mgmt team | 90 min | Mgmt | 2006-03-17 |
| Monthly mgmt meeting (prod team) | AR HQ | AR full (prod.) mgmt team | 210 min | Mgmt | 2006-03-17 |

Please see appendix D for an full overview of the 113 meetings that I attended to between March 15th 2006 and March 10th 2008

Lastly, in the spirit of Argyris and Schön's (1974, 1978) dichotomy between theories-in-use and espoused theories, direct observation has the (possible) advantage of reaching the participant's theory-in-use rather than their espoused theory of action (Argyris & Schön, 1974, 1978) by observing the actors genuine and spontaneous behavior. This is in contrast to other data collection methods.

Before moving forward to the theoretical chapter, a section on how the empirical data was structured as well as analyzed will be now developed.

## Moving From Shapeless Data Spaghetti Toward Some Kind of Understanding: On Data Structuring and Analysis

The fact that there is a constant call in the scholarly literature for more in-depth process research is a well-known reality (Langley, 1999). Hence, there is an urge for research that enables us to comprehend organizational phenomena on a less superficial level (in fact, the field of strategy-as-practice has emerged as a consequence of the absence of human actors and their actions in research). Although, process data are notoriously challenging and messy; making sense of them is a continuous challenge (Langley, 1999).

The former sections within this methodological chapter have depicted a rather straightforward and linear research process; the actual doing is more characterized by plunging yourself deeply into the process and collecting fine-grained and often messy qualitative data in real-time. In parallel to Langley (1999), I believe this to be a process of understanding how (and why) events develop over time (in parallel to my research questions). This is why we must examine them directly (Mintzberg, 1979).

Process data collected within real organizational contexts, such as in the Arrow and Bay Lake case, posses numerous characteristics that make them difficult to analyze. Process research is aimed at understanding how things, such as strategizing, evolve over time and why it evolves in that specific way (Van de Ven & Huber, 1990). The analysis of process data requires a means to conceptualizing and detecting a pattern among the events since understanding patterns in events becomes a key aspect. As

Van de Ven and Poole (1995) argue, these patterns may assume a wide array of forms; the most commonly pattern that can be found in literature is the linear sequence of phases that occur over time (Langley, 1999). More complex phenomena, such as the ones scrutinized here, pose a fluid character that spreads out over both time and space (Pettigrew, 1992). This fluidity and its contextual dependency is one of the reasons why a qualitative process approach is often deployed and why I have chosen to apply it in this research project.

While the complexity of process data is certainly a reflection of the studied phenomena's intricacy, I argue that it is of importance that we try to transcend the data from being "[…] shapeless data spaghetti toward some kind of theoretical understanding that does not betray the richness, dynamism, and complexity of the data[…]" (Langley, 1999 p. 694). This also increases my possibilities of fulfilling the ambition of giving a holistic account of the process. There are numerous ways to analyze or make sense of process data, i.e. sensemaking strategies (Weick, 1979). There is also a dual perspective of sensemaking in this study, as both the studied actors' sensemaking processes and my sensemaking of their dittos. I have, therefore, chosen an approach equivalent to is what sometimes referred to as a narrative strategy (see Chandler, 1964; Bartunek, 1984; or Pettigrew, 1985 for examples)[43].

Le Guin (1989, p. 38) argues: "Narrative is language used to connect events in time. The connection whether conceived as a closed pattern, beginning-middle-end, or an open one, past-present-future, whether seen as lineal or spiral or recursive, involves a moment 'through' time for which spatial metaphor is adequate." Hence, this strategy involves construction of a detailed story from raw data. Descriptive narratives, as seen in this study are used as a traditional tool for ethnographers (Van Maanen, 1988). In fact, this approach is the most widely utilized approach in process research (Langley, 1999).

[43]Other sensemaking strategies include the following: (i) quantification strategies, (ii) alternate templates strategies, (iii) grounded theory strategies, (iv) visual mapping strategies, (v) temporal bracketing strategies, and (vi) synthetic strategies (see Langley (1999) for an elaboration on these).

The strategy has been used to chronologically structure the process (i.e. empirical) data, thus, preparing a timeline for the subsequent analysis. Hence, I have used chronology in concert with the idea of specific strategizing actors (or actors with the power to affect the strategic agenda) as a heuristic when the data has been structured and drafted. In other words, I have drafted a chronological process structured around three strategizing actors (more on that later) and their interaction through time with the intention of achieving an understanding of the phenomena by providing "vicarious experience" of a real life situation in all its richness and complexity (Lincoln &Guba, 1985, p. 359). This structuring allows the reader to follow the development of the temporal dynamics and the interpretive dominance within, and between, the strategizing actors through time. Langley (1999) argues that this kind of thick, thus, contextually detailed, description allows the reader to decide on its transferability of ideas to other situations. Hence, I try to avoid excessive data reduction in order to present the different stand and viewpoints of the strategizing actors as completely as possible. All (or at least most) of its subtlety and ambiguity is, hence, preserved; this is why, in Weick's (1979) terms, the accuracy is expected to be high. Golden-Biddle and Locke (1993) argue that appealing process research needs to transcend beyond authenticity and accuracy in order to make readers feel that something of greater value has been learned. This is my ambition as well.

Following the conversations, actions, interactions, and interpretations of these strategizing actors can elucidate central concepts and ideas important for the strategic change. More importantly, my dependence upon participants' perspectives and interpretation has been high since "sense-making is about the interplay of action and interpretation…" (Weick et al. 2005, p. 409). Thus, my ethnographic, real-time, and processual approach has been imperative in order for me to understand their sensemaking and strategic thoughts. According to Weick (1979), sensemaking is positioned and understood through the conversational process that takes place within the organization. Hence, I will be able to depict and elaborate upon how different ideas are interpreted and gain relevance over time by studying these processes; therefore, I will find patterns within, and between, the actors as well as their potential implications on the organization.

# Chapter 5

# Theoretical Framework

The last 35 years could be recognized as the period when the relationship between mind, management, and organization has been increasingly explored: a period called the *cognitive turn*. The groundwork for this turn has originated from a multitude of sources of which several could be emphasized. These include the early groundwork by the Carnegie School of organization theory, the success of contemporary cognitive science, and the diffusion of social constructionism within organizational studies. While this cognitive turn has affected research in a multitude of environments, what is of special interest to this study is the increased exploration of cognitive underpinnings in areas such as organizational and group belief systems, strategic and environmental sensemaking, as well as managerial decision making in the context of strategic change. Meindl and his colleagues (1994, p. 289) take it so far as asserting that few areas of contemporary organizational science "remain untouched by the cognitive agenda".

Lindell et al (1998, p. 76) also acknowledge the merits of the cognitive perspective by stating that it has "proved to be a powerful instrument for researching the management of change"; however, they also accentuate that in order to develop the understanding of the strategic impact of (managerial) cognition, we must increase our efforts in order to capture and interpret *empirical* data on managerial thinking processes. Moreover, *longitudinal* data needs to be attended to (Lindell et al., 1998) in order to increase the understanding of the role of cognition as a dynamic process.

The theoretical framework developed here to explore, interpret, and elaborate the sensemaking processes taking place within, and between, the actors might be perceived as somewhat eclectic; however, it will be firmly founded within the research veins of managerial and organizational cognition (MOC), finance, organization, and strategic management. By "managerial cognition", I mean the cognition (and, consequently, sensemaking) of top managers; this also includes board members who are, thus, the strategic decision-makers in this study (i.e. decision-maker affecting the strategic agenda).

I should also state here, at the outset of this theoretical framework, that my interpretation and treatment of the MOC field reflects a view that could be carelessly termed the multifaceted view. This is in contrast to the view that is equally carelessly termed the mono-faceted view found in such groundbreaking works as Huff's (1990) volume *Mapping Strategic Thought.* Consequently, I argue that action, interpretations, and change takes place in an organizational reality that is socially constructed in the sense that individuals with dissimilar mindsets and (subjective) worldviews interact. By assuming these individual differences, focus cannot exclusively be directed toward action or cognitions (à la the mono-faceted view); it must include the interplay of both managerial cognitions and action (à la the multifaceted view) since chains of thinking (i.e. interpreting) and acting shape and mould the strategic processes. I will elaborate upon this later.

This field grows out of the rejection of the presupposition that managerial decisions can be adequately analyzed by using hyper-rational[44] notions of correct and complete data, rigorously logical choice processes, and well-defined objective functions, that continue to have a strong foothold in the syllabi of many business schools. Thus, cognitive theory has

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[44] Simon (1958:XXIII), following Knight (1921) and others, reminds us - the individuals (cf. role occupants) - are at best 'intendedly rational'; hence, even complete and correct information may be misperceived. This introduced the problem of cognition into organizational analysis (Spender, 1998).

allowed organizational analysts to begin to operationalize Simon's (1957) concept of bounded rationality (Spender, 1998). In parallel to Eden and Spender (1998), I argue that managers form personal models of the focal situation in the sense that they differ extensively from the abstract models that are presupposed by formal choice theories. This field is consequently defined by its ambition to distinct itself from the abstract and hyper-rational models of the various manifestations of utility theory by introducing models of "real managers" (Eden & Spender, 1998). Hence, the manager is defined as a key actor who creates or invents a bounded field of decision possibilities within which the process of choice takes place. This study will cover both the boundary of this field as well as the terrain to be navigated.

Following Eden and Spender (1998), I presume that I am able to gain access to the personal models that I believe the actors of this study use when making decisions (by studying and observing their communication, interaction, and actions). I also place myself within the body of cognitive science rather than (purely) behavioral science since my ambition is to access the structure and boundaries of this model. However, in parallel to several others, I argue that behavior needs to be taken into account in order to increase our understanding of the following notions: Polanyi's sensemaking (1962) concept of objective and tacit knowledge, Nelson and Winter's (1982) ideas concerning organizational routines, Weick's (1979) perception concerning 'how do I know what I think until… I see how I act'; and Anderson's (1983) as well as Singley and Anderson's (1989) theory of 'declarative' and 'procedural' knowledge). There will be more in the subsequent passages on the separation between cognition and behavior (or action).

The actors studied here - that is to say, managers and decision-makers - are assumed to be "information workers" (McCall & Kaplan, 1985). They consequently spend their time absorbing, processing, and disseminating information about issues such as opportunities and problems. However, these processes constitute their primary challenge since their information worlds are enormously complex, ambiguous, and munificent (Mintzberg et al., 1976; Mason & Mitroff, 1981; Schwenk, 1984;

Starbuck & Milliken, 1988). Managers, as well as all individuals for that matter, meet this information challenge by employing what is known as *knowledge structures* in order to represent their information worlds and, hence, facilitate both information processing and decision-making (Walsh, 1995). The inherent and perhaps also intriguing problem in this information challenge is that these knowledge structures simultaneously transform complex information environments into tractable ones as they might blind decision and strategy makers (Walsh, 1995). Hence, they create the boundaries as well as navigate between them. This blinding might include the concealment of important changes in their business environment; thus, they compromise their capability of making sound strategic decisions or they might reveal new vast business opportunities that turn out to be premised on false information or on extreme projections.

Before continuing, or perhaps initiating the construction of the primary theoretical framework, I will now shed some light on three key questions[45] that Meindl and colleagues, (1994) as well as Huff (1990), raise concerning the development of the MOC field:

*(i) An Appropriate Construct System.* Meindl et al. (1994) acknowledge that while it is easy to emphasize the importance of how organizations and managers make sense of situations and events, it is quite challenging to actually depict or describe the 'sense' that results from the processes of learning and communication. They argue that this requires the development of a nomenclature for describing thought and meaning (Huff, 1990; Meindl et al., 1994). Most organizational research can agree that schemas, frames, interpretations, and assumptions are a part of the sensemaking process; however, their meaning and usage is still quite ambiguous.[46] In parallel to many others, I do not believe that the field will

[45]Meindl et al (1994) actually emphasize two additional questions: one concerning the relationship between cognitive structure and cognitive process, and one concerning the role of 'cognitive aids' in shaping managerial and organizational cognition. These questions are disregarded in this study.

[46] There is a vast amount of concepts in the field of managerial and organizational cognition. For example, maps relate "an uncertain event to existing concepts and they generate meaning for the event" (Weick & Bougon, 1986, p. 131); beliefs "translate a world that can be overwhelmingly complex and

converge into a few unambiguous global concepts in a neat construct system, nor escape the level-of-analysis; I believe instead that it will additionally thrive before a potential route to convergence could be attained.

Exploring the sensemaking processes will be accomplished by an interpretive method with less emphasis on a precise and unambiguous measurement system. Instead, more emphasis is directed toward broadly conceived patterns and how they become intertwined with the social circumstances of the organizational activities.

*(ii) Level of Analysis.* Issues concerning the level of analysis (i.e. individual, group, organization, industry, etc.) continue to be unresolved (if a resolution exists). Therefore, whether aggregated forms of cognitions (e.g. group, organization, etc.) are derived from cognitive processes on the individual level, or the opposite, individual cognitions are merely a reflection and articulation of collective-level processes. Consequently, the nature of cognition differs considerably given one's (ontological/epistemological) view and underlying assumptions. For example, behavioral psychologist F. H. Allport argued in line with the former standpoint: cognitions belong only to the individual, while notions of group or organizational cognition focus on role and influence of symbols in organizational life rather than address thinking. In the latter standpoint, it is argued that "an individual's consciousness and sense of self, which necessarily precedes and shapes all individual cognition, is grounded in interaction with the social; the social provides preconscious modes of cognizing" (Eden & Spender, 1998, p. 4).

In order to fulfill my purpose and answer my research questions, it becomes imperative to move beyond the individual manager in order to say something meaningful about the collective beliefs in the two aforementioned groups (i.e. Arrow's management team and its board). In order to accomplish this, I will (interpretatively) operationalize the

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ambiguous into comprehensible and familiar terms" (Donaldson &Lorsch, 1984, p. 79); schemas are "used to impose structure upon, and impart meaning to otherwise ambiguous social and situational information to facilitate understanding" (Gioia, 1986:56); the raison d'être of implicit theories "is that their holders seek to create an environment in which they will all have some elements of control" (Downey & Brief, 1986, p. 173). Frame of reference (Shrivastava & Mitroff, 1983), perceptual filters (Starbuck & Milliken, 1988), and paradigms (Johnson, 1987) are concepts with similar meaning.

collective beliefs within these groups as belief agreements among individual managers (i.e. decision-makers). This consensuality might be a sufficient condition for assuming the existence of collective cognition; however, it might also attract criticism toward my level of reductionism. The issue of group cognitions, group learning, and shared mental models in contrast to individual or organizational ditto (as a unitary actor) will be elaborated upon later.

Authors such as Corner et al. (1994) and Fiol (1994) illustrate in the 1994 special issue of *Organization Science* that the level-of-analysis issue can be reframed as an issue of *temporal dynamics*, involving the interplay of individual and group level cognitive processes over time. It will become apparent later within this study how disagreements and agreements concerning an issue evolve over time within, and between, the two decision-making groups. Hence, it is the temporal dynamic linking consensus with diversity that shapes the decision environment of the collective rather than being an issue of consensus versus diversity.

I concur with Garud and Rappa (1994): it could be fruitful to call attention to the enactment of a belief system over time where the strength of specific beliefs (continuously) change as interest groups (or individual managers) compete for *interpretative dominance*. I also am in line with Fiol (1994), Garud and Rappa (1994), and Meindl et al. (1994) in that the concepts of temporal dynamics and interpretive dominance are fruitful approaches since these introduce human agency into the nature of belief systems (cf. the strategy-as-practice field); thus, it acknowledges that beliefs are "actively developed, manipulated, and diffused by people" (Meindl et al., 1994, p. 291).

With regard to the former passages, I adhere to Meindl et al.'s (1994) perception on belief systems. Thus, "rather than viewing belief systems as having a hold over groups, organizations or industries, the notion of interpretive dominance conceptualizes a belief system as an active arena, where interest groups (of whatever level of aggregation) compete (cf. power struggles) to impose their preferred psychological order onto non-believers" (Meindl et al., 1994, p. 291, brackets added). By this, the level of aggregation (i.e. level-of-analysis) does not stand out as particularly important in contrast to *who* believes and *how much* believers can impose their assumptions onto others (cf. Gioia and Chittipeddi's (1991) "sensegiving" idea).

For practical reasons, researchers often attempt to focus on one aspect of a phenomenon (e.g. individual, group, organizational, industrial, societal, national, etc.) I want to put forth my belief that the interaction between context and individual literally implies a social construction of reality (Berger & Luckmann, 1966); thus, the aspects are inseparably intertwined.

*(iii) Managerial Cognition and Organizational Outcome*. Meindl et al (1994) and Huff (1990) amongst others accentuate the strong pressures within the organizational cognition literature to forge links between cognitive structures and processes to organizational outcomes such as adaptability to change, innovativeness, and profitability (a pressure also prevalent in the strategy-as-practice field). Whether one wants to bow to such pressures or not is beside the point; however, cognitive constructs prove unfortunately difficult to measure in the field (Meindl et al., 1994). The reason for this is their tight intertwining with other organizational variables, which make it difficult to disentangle their (casual) impact on behavior and outcome. There are numerous other factors, such as uncontrollable and unforeseeable environmental jolts, inertial forces of organizational structures, and a myriad of other non-cognitive factors that are all plausible alternative explanations for any supposed influence of cognition on organizational outcomes. I believe in a bi-directional (partial) causality between thoughts or interpretations and actions; hence, I assume there to be a coupling between thinking and acting. Therefore, I will try to refrain from becoming a part of the cognition-behavior-performance nexus.

The field is consequently characterized be heterogeneity in assumptions as well as in levels of analyses (Srivastva, 1983; Sims & Gioia, 1986; Huff, 1992); hence, contradictions rather than consensus seem to dominate this field.

Although few areas of contemporary organizational science remain untouched by the cognitive agenda, which has been asserted by now, managerial and organizational cognition will be applied/projected in this research based upon the context of strategic management. As a consequence, the ambition of this study is to explore, interpret, and understand the sensemaking processes surrounding the strategic change that takes place in a firm after having been acquired by a buyout firm. Hence, the purpose is to understand the way in which organizational and strategic change intentionally or unintentionally can be attained by changes in the sensemaking of managers. Thus, the raison d'être is how changes in the managers' sensemaking affect or is affected by the development of the strategic change in Arrow after Bay Lake's acquisition. The ideas developed in this theoretical framework will be firmly founded upon the aforementioned financial and organizational dittos as well as cognitive theories and strategic change theories (e.g. Pettigrew, 1985; Johnson, 1987; Hellgren & Melin, 1993; Houchin & MacLean, 2005; Fiss & Zajac, 2006; Balogun & Hailey, 2006; Helfat et al., 2007).

In other words, by using a theoretical framework derived from an integration of managerial and organizational cognition, strategic management, finance and organization theories, my objective is to understand the way in which strategic change can be attained by changes in the managers' sensemaking. Hence, I will pursue longitudinal empirical research that is deeply embedded in strategic thinking, thereby, fulfilling the demands that Lindell et al. (1998) amongst others propound. The following table is a brief remainder of the most important concepts:

Table 5.1: Brief Back-of-the-Envelope Reminder of the Concepts

| *Theoretical Concept, Idea, or Keyword* | *Brief Back-of-the-Envelope Reminder of the Concepts* |
|---|---|
| Manager | (i) A key actor (decision-maker) who creates or invents a bounded field of decision possibilities within which the process of choice takes place. Hence, this is a boundary as well as a terrain. |

| | |
|---|---|
| | (ii) An information worker who meets information challenges by employing so-called knowledge structures. |
| Construct System | The field will not converge into a few unambiguous global concepts in a neat construct system, nor escape the level-of-analysis; it will additionally thrive instead before a potential route to convergence could be attained. |
| Level of Analysis | (i) Issues concerning the level-of-analysis (i.e. individual, group, organization, industry, etc.) continue to be unresolved (if a resolution exists). Thus, aggregated forms of cognitions (e.g. group, organization, etc.) are derived from cognitive processes on the individual level, or the opposite. Thus, individual cognitions are merely a reflection and articulation of collective-level processes.<br>(ii) My ambition is to move beyond the individual manager in order to say something meaningful about the collective beliefs in the three aforementioned groups. In order to accomplish this, I will (interpretatively) operationalize the collective beliefs within these groups as belief-agreement among individual managers and introduce the concepts of temporal dynamics and interpretive dominance. |
| Collective Beliefs | Belief agreements among individual managers/decision-makers/strategy-makers |
| Temporal Dynamics | (i) Interplay of individual and group level cognitive processes over time.<br>(ii) Enactment of a belief system over time where the strength of specific beliefs (continuously) changes as interest groups (or individual managers) compete for interpretive dominance. |
| Interpretive Dominance | (i) The enactment of a belief system over time where the strength of specific beliefs (continuously) changes as interest groups (or individual managers) compete for interpretative dominance. Hence, the concepts of temporal dynamics and interpretive dominance are fruitful approaches since they introduce human agency into the nature of belief systems, as well as acknowledge that people actively develop, manipulate, and diffuse beliefs.<br>(ii) Thus, rather than viewing belief systems as having a hold over groups, organizations or industries, the notion of interpretive dominance conceptualizes a belief system as an active arena: interest groups (of whatever level of aggregation) compete to impose their preferred psychological order onto nonbelievers. By this, the level of aggregation (i.e. level-of-analysis) does not stand out as particularly important in contrast to *who* believes and *how much* believers can impose their assumptions onto others (cf. upcoming idea of sensegiving and sensemaking). |

## Cognitions and Knowledge as Embedded in Practice

Contemporary cognitive science informs us that even though we form mental representations of our situations, they remain profoundly problematic. Therefore, we know that, instead of these mental representations being the direct imprint of reality on the tabula rasa of our consciousness, they seem to be the product of complex selection, sorting, manipulation, and conversion processes, which are shaped by our existing knowledge, interests, and intentions (Spender, 1998). Consequently, our cognitive processes mediate considerably between what we assume or perceive to be facts and our behaviors (how we make sense through action and interpretation). Hence, in order for us to understand managerial decision-making, we must know about the cognitive frames in which these decision processes take place (Spender, 1998). In addition to the perceiving and deciding, the inherent components of decision-making, managers, groups, and organizations also experience as well as raise questions about the relationship between their perceptions and experiences. In line with Simon's (1957) well-known critique of economic rationality, it is easy to deal with the resulting confusion by assuming "that the manager's information is clear, complete and acted on without bias, that the employees understand the rules, that the competitive environment is certain, that the firm's resources are measured and controlled, and that the organization is a simple extension of the founder's or ruling group's mind and intentions" (Spender, 1998, p. 14). Interestingly enough, a large fraction of organizational and economic analysis still builds upon such heroic assumptions.

As mentioned at the outset of this chapter, I adhere to a more multifaceted view rather than a mono-faceted ditto concerning managerial and organizational cognition. Given this, I assume (issues such as) the following to be especially problematic and unclear: (i) the relationship between thinking or interpreting and acting, as well as the role of action and experience; (ii) the presupposition that there is but a single type of knowledge to be acquired and mapped.

One can turn to Polanyi's (1962) distinction between 'tacit' and 'objective knowledge' in an attempt to escape from the presupposition of a single kind of knowledge. Spender (1998) argues that a large number of organizational researchers have turned to Polanyi. Drawing upon Polanyi's ideas, Nelson and Winter (1982, p. 99) have argued that organizational routines, which are thought to embody the organization's memory, are action-learned; that is to say, they are learned-by-doing, thus, comprising objective knowledge that is explicit, symbolic, and attainable in language as well as tacit knowledge: that which is implicit and embedded in action. Cognitive mapping methods, which are heavily utilized in the mono-faceted approach, focus exclusively upon cognition rather than behavior; they are, by assumption, likely to ignore those tacit components of knowledge that cannot be readily retrieved and explicated by respondents (Spender, 1998). Hence, cognitions that focus upon symbols while ignoring action may be inadequate (cf. later discussions on theories-in-use and espoused theories). This is especially true in the research of groups (and organizations) as it is in the current study. Considering that "organizations are dynamic patterns of social activity, rather than scientifically designed tools for the achievement of well-understood objectives, the knowledge most evident in their day-to-day activity may well be more implicit rather than explicit." (Spender, 1998, p. 15) Assuming this to be true further strengthens and increases the adequateness of this study's research design (i.e. emphasis upon direct observation and interviews); it includes both the study of symbols and the observation of actions. This approach will also consider the communication processes among the group members (within and between the two groups), which is a prerequisite for understanding the collective knowledge (Weick & Roberts, 1993).

Consequently, knowledge can be separated into different types such as those suggested by James (1950, p. 1221): that is to say, "knowledge about" and "knowledge of acquaintance". While the former is abstract, the latter is the direct result of experience. Ryle (1949) similarly distinguishes "knowing what" from "knowing how" (Smith, 1988, p. 1). The former is yet again abstract, while the latter indicates knowing how to create "mindful" activity (see Weick & Roberts, 1993). An associated yet not identical distinction is that which exists between abstraction and practice: between what one knows consciously and what one might know in some other way that can only demonstrated through practice (Spender, 1998). The actors may not even be conscious of knowing this other type of knowledge. With the well-known words "people know more than they can tell" Polanyi (1967, p. 4) distinguishes between objective and tacit knowledge. The essence of this distinction "is less in activity than in the knowledge's communicability" (Spender, 1998, p. 23). This idea parallels that of the distinction between declarative and procedural types of knowledge (Anderson, 1983; Singley & Anderson, 1989).

An essential conclusion from the discussion on the different knowledge types is that collective mind is not only contextualized in a particular field of activity; it is also embedded in practice (cf. sensemaking is about the interplay of action and interpretation (Weick et al., 2005). The fact that knowledge cannot be separated from the activity since its quality is only evident in that given activity is in stark contrast to the ideas of positivist science where knowledge is abstract and decontextualized.

## Four Distinct Types of Cognition

For the sake of moving this study forward, it has become necessary to theorize about the two (or more) cognitive systems. We turn to Reber's (1993) theoretical and empirical work to distinguish between explicit (conscious) and implicit (automatic) types of knowledge in order to substantiate Polanyi's (1967) distinction, which is founded upon philosophy rather than cognitive psychology or cognitive neuroscience. Reber (1993, p. 5) has defined implicit learning as the acquisition of knowledge that takes place essentially independently of conscious attempts to learn as well as in the absence of explicit knowledge about what was learned.

Reber has noted that many perceptual processes involved operations that lay outside consciousness was already known a century ago (Reber, (1993, p. 15). Such extra-conscious operations are widespread, normal, and underpin everyday life (Spender, 1998). Assuming this concludes that there are several different types of memory. While the difference between short-term and long-term memory is commonplace, Reber (1993) has helped us to understand the difference between the effects of explicit and implicit learning. Reber defined implicit memory as "evident when a subject displays memory of an earlier experience without being conscious that the experience took place […]" (Spender, 1998, p. 25). While applying an evolutionary perspective, Reber (1993) argues that the conscious system of cognition is founded upon, and emerges from, the deeper implicit system. Spender also suggests "having evolved 'later' the conscious system will be a 'higher order' system and have characteristics that differentiate it from the 'lower level' implicit system" (1998, p. 26). Thus, there should be less difference between individuals in their implicit cognitive capabilities compared to the greater difference between their higher order capabilities. More importantly, the implicit system in this study should be more robust and less prone to disruption (cf. the upcoming discussion on whether emotional elements) than the higher order conscious system (Spender, 1998). Given these distinctions we can now portray the various types of individual and collective cognition in a two-by-two matrix:

Table 5.2 Types of Individual and Collective Cognition

| | *Individual* | *Social* |
|---|---|---|
| Explicit | Conscious | Objectified |
| Implicit | Automatic | Collective |

Source: Spender (1994, 1995)

We can summarize the discussion held in the former passages with the support of Polanyi (1967), Reber (1993) and Spender (1998), with the proposition that there are four distinct categories of cognition. Hence, with reference to the initial level-of-analysis discussion, the discussion on the number of different knowledge types (i.e. the presupposition of only one type of knowledge), and the discussion on action versus cognition (i.e. knowledge as embedded in practice), we accept the idea of a collective or social knowledge in addition to the individual knowledge. However, we argue that it has both explicit and implicit dimensions in parallel to the individual knowledge.

Before moving forward with the development of this theoretical framework, a few concluding remarks concerning the critique of the mono-faceted or mental mapping approach and the dynamics between the levels of analysis will now be made. Critique towards (i) the assumptions of knowledge types and (ii) the relation between thought and action has been already put forth. However, one can also note that the mental mapping approach to cognition - whether at the individual, group or organizational level - seldom explores how the mental map came to be this way rather than some other way (Spender, 1998). In cognitive terms, learning is about getting the mental model to better represent the reality "out there", as "if this reality were available to us in some way that would allow us to monitor the congruence between it and the mental model" (Spender, 1998, p. 29). Learning in this study is instead about the creation of knowledge as a resolution of uncertainty for the "knower". This cannot occur without a "pre-existing level of consciousness and knowledge appropriate to the type of knowledge being newly acquired" (Spender, 1998, p. 29). This is why the actors' (individuals, groups, and organization) background needs to be explored, at least to some extent.

Table 5.3: Brief Back-of-the-Envelope Reminder of the Concept

| *Theoretical Concept, Idea, or Keyword* | *Brief Back-of-the-Envelope Reminder of the Concept* |
|---|---|
| Different individual and collective cognitions | (i) Explicit *individual* cognitions: Conscious cognitions<br>(ii) Explicit *group* cognitions: Objectified cognitions<br>(iii) Implicit *individual* cognitions: Automatic cognitions<br>(iv) Implicit *group* cognitions: Collective cognitions |
| Learning | The creation of knowledge as a resolution of uncertainty for the "knower" |

# When Reconceptualizing Dualism to Duality…

Following the ideas of Hellgren and Löwstedt (1998), I believe that a reconceptualization of dualism to duality can resolve some of the inherent contradictions within the field. By reconceptualization, it is meant that "instead of eclecticism or synthesizing efforts, the field needs a prosperous dialectic between the two" (Hellgren & Löwstedt, 1998, p. 41). Hence, structure is implicated in actions and action is implicated in structure.

Different aspects of cognitive structures are captured in a number of conceptualizations such as interpretive schemes (Ranson et al., 1980; Bartunek, 1984), beliefs (Donaldson & Lorsch, 1985), maps (Weick & Bourgeon, 1986), as well as schemas and scripts (Gioia, 1986). Referring back to the quest for duality, each one of these exemplifications can be perceived to represent extreme and one-sided views in the spectrum of *structure vis-à-vis action* and *continuity vis-à-vis transformation* (Hellgren & Löwstedt, 1998). Research here follows other important streams of thought in social sciences, which include Sjöstrand (1985) and Giddens (1984).

The aforementioned conceptualizations build upon the same assumption that structures facilitate and influence action, yet they express diverse views on the relationship between thought (mental structures) and action. One of the views (e.g. Donaldson & Lorsch, 1983) asserts that mental structures "determine action"[47], or mental structures "guide action" (Isenberg, 1986, p. 252); that is to say, mental structures are assumed to be thought driven in the sense they are the outcome of thinking processes that *praecedere* and, consequently, rule action (Hellgren & Melin, 1993). The opposite view turns this relation around by acknowledging mental structures as being predominately action driven and, hence, not a determining force on action. Weick (1983) and Bartunek (1984) take the argument one step further by stating that thinking and acting are simultaneous interrelating processes. Thus, individuals learn while they act instead of applying rational stage models of decision-making.

Whether mental structures are stable or continually change to accommodate new experience encapsulates the aforementioned other example of the dualism: i.e. one-sidedness (Hellgren & Löwstedt, 1998). For example, Weick and Bougon (1986) argue that people continuously reorganize concepts in order to accommodate new experiences, which is why mental structures often change. This change in mental structures must be differentiated into first and second-order changes where the former, i.e. incremental changes in ways of interpreting are far more common (Bartunek, 1984).

Donaldson and Lorsch (1983) hold an opposite view on the issue of continuity or transformation in the field of managerial and organizational cognition, although the one-sidedness is shared with Weick and Bougon (1986). Donaldson and Lorsch found that beliefs fill the function of providing continuity and stability in circumstances when change threatens to undermine lessons learned by experience (1983). According to

[47] Another example of thinking as a precedent of acting is the idea that mental structures "have an important impact upon management's strategic choices" (Donaldson &Lorsch, 1984, p. 111).

their study, managers are deeply emotionally committed and devoted to their beliefs. The mental structures consequently show a stability and permanence, which at most changes incrementally.[48]

In order to keep the consistency of this theoretical framework, a third one-sidedness must be redefined. The basic assumption of *freedom-of-action* (cf. the former agency discussion) that permeates the field of managerial and organizational cognition is that which Child (1972) embodies in his idea of *strategic choice*. The idea that individuals and organizations are able to make a strategic choice indicates that, by exercising power, actors become the explanatory factor behind social and economic change (cf. the field of strategy-as-practice).

Stinchcombe (1965) propounded a somewhat opposite idea: that the influence of actors exercising power is more or less constrained[49]. In other words, social actors make organizations, yet only when permitted by social structural conditions. Hence, the idea of freedom-of-action being structurally constrained rests upon the idea that organizations and other artifacts such as societies are made by individuals in the context of human meanings and rules, as well as material and non-material resources.

These ideas clarify that certain things other than the cognitive structures of individuals act as agencies on the shaping of organizations and societies, which increases the importance of whether mind-sets are changing or stable. Consequently, since individual and organizational freedom-of-action is contextually constrained, there are not only individual mind-sets but also "ideational structures" (Hellgren & Melin, 1993), thus, reducing the power of an individual actor in his or her quest of im-

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[48]To extend the discussion a little more, it is not hard to say that opinions differ regarding this question. Some scholars see changes in mental structures as highly unlikely unless in a very incremental and partial manner (e.g. Donaldson & Lorsch, 1984); others, such as Weick and Bougon (1986), see these structures as changeable. While leaning on the assumptions that continuity and stableness is one function of *beliefs*, Donaldson and Lorsch (1984) argue that beliefs diminish change proneness in times when lesson of experience is undermined (cf. Hannan & Freeman, 1984). More radical changes are the only type that could vastly affect the organization's way of acting. Lyles and Schwenk (1992) employ a similar strategy; they divide the relatively stable *core* and the more change-prone *peripheral* set of knowledge held by the management. However, they argue that radical change is initiated by change in the peripheral set and facilitated by the loose coupling between the two sets.

[49] It should be noted that his contribution to this idea of constrained freedom-of-action was on the organizational level.

plementing a solution (in an enacted situation). Ideational structures are patterns of shared beliefs in a community or, more important for this study, patterns of dominant logics (cf. social cognitions in a former table) within an organization (Löwstedt, 1993); this concerns organizational issues such as strategy, structure, and management style (Hellgren & Löwstedt, 1998).

As I have shown, agency exists both on the individual and collective levels; however, it can also be found in the form of dominant institutional structures. The institutional environment (e.g. a nation, region, or industry) produces the shape of a specific configuration such as a business system (Whitley, 1990, 1991).

## Summarizing by Moving From Either to Both

The fact that there are two conflicting views on the stability and change of cognitive structures has hopefully not escaped the reader. Some scholars argue that change in cognitive structures occur frequently due to the tight coupling between action and thinking, while others argue that they are stable and changes rarely, and then only incrementally. When applying the previously elaborated assumption that structure can act as an agency in societal processes, these two general and conflicting standpoints lose their importance. Given what has been said about agency and the ambition to shift from dualism to duality, a more plausible assumption is that managerial cognition should be characterized by stable and changing mind-sets. Thus, we assume a *both/and* and not an *either/or* standpoint. To paraphrase Hellgren and Löwstedt (1998), it is more interestingly to ask when, why, and how structures in different cognitive spheres become altered or not altered. While my research questions are clear expressions of these theoretical stances, the focal point of a subsequent section in this theoretical framework will be the issue of stability and change.

As noted in other studies (e.g. Löwstedt, 1993), the individuals on the management team and the board were exponents of new ideas; these could create tensions between different cognitive spheres (cf. Hellgren and Melin's (1993) idea of three cognitive spheres: an individual way of thinking, organizational culture, and industrial wisdom). Tensions that are not necessary per sé (but that) could produce counter-productive struggles for power and control, especially if no actor is able to exercise powerful agency in the social relationships (Barbalet, 1987). The agency that is influential in such a situation includes former and continuous behaviors and its contextual constraints.

Table 5.4: Brief Back-of-the-Envelope Reminder of the Concepts

| Theoretical Concept, Idea, or Keyword | Brief Back-of-the-Envelope Reminder of the Concepts |
| --- | --- |
| Two views on the propensity for stability and change of cognitions | Two diverging views encapsulate whether mental structures are stable or continually change to accommodate new experiences:<br>(i) People continuously reorganize concepts in order to accommodate new experiences, which is why mental structures often change. However, this change in mental structures must be differentiated into first and second-order changes where the former (i.e. incremental changes in ways of interpreting) are perceived to be far more common.<br>(ii) Beliefs fill the function of providing continuity and stability in circumstances when change threatens to undermine lessons learned by experience. Hence, managers are deeply emotionally committed and devoted to their beliefs. Consequently, the mental structures show stability and permanence, which changes at most incrementally.<br>I argue that it is more interesting to ask when, why, and how structures in different cognitive spheres become altered or not altered, rather than whether or not they change. |

## Learning: On Institutional Action and Negotiated Shared Meanings

As I have argued, a theory of managerial and organizational cognition without a theory or idea about learning is an unstable construction. According to Garvin (1993, p. 8), a learning organization is one that is "skilled at creating, acquiring and transferring knowledge, and at modifying its behavior to reflect new knowledge and insights". In parallel to this idea, a large amount of the organizational learning literature treats organizations "as unitary actors whose knowledge and skills feed into action" (van der Heijden & Eden, 1998, p. 59) (cf. the discussion regarding the separation of thinking and acting in decision-making theory or the formulation and implementation in strategic management theory). This idea overlooks the important distinction between individuals acting on the behalf of the organization and organizations as unitary actors. This is in addition to our previous discussion: that action follows thinking. As the level-of-analysis discussion has shown, the field is polarized; there are those who argue only individuals can hold cognition (e.g. Bougon, 1992; Eden, 1992, 1993) and those who say organizational cognitions are unproblematic, or at least the mapping of those cognitions (e.g. Porac & Thomas, 1987; Spender, 1989). Furthermore, it is not uncommon that models of individual learning are projected onto organizational learning. For example, Argyris and Schön's (1978) famous concepts of *single-loop* and *double-loop* learning are organizational projections of Piaget's (1971) two levels of individual learning: *accommodation* and *adaptation.*

In an attempt to solve these problematic issues of organizational and individual learning, I will turn toward an operational definition of organizational learning developed by van der Heijden and Eden (1998). This operationalization will account for, and emphasize the characteristics of, groups of individuals (such as those two groups I observe) that, together, develop corporate behavior. Thus, group learning will be emphasized rather than individual or organizational learning (that is to say, as a unitary actor). Van der Heijden and Eden's (1998) (group) learning model rests upon the extension of Kolb et al's (1991) theory of learning. Hence, by integrating the raison d'être of *the* three primary schools of strategy with Kolb et al's (1991) ideas, van der Heijden and Eden (1998) introduce the concept of institutional action, degree of sharing, and conversational process.

The three primary schools of strategy[50]—the rationalistic, evolutionary, and processual—are used to illustrate the different approaches to organizational learning (e.g. Whittington, 1993). The *rationalistic school* presupposes predictability, clear objectives, and intentions, as well as the separation of thinking and acting: the idea of implementation follows formulation. This view, which remains central in the strategy field, assumes that the strategist chose and realizes the optimal strategy. The *evolutionary school*, on the other hand, emphasizes aspects beyond the bounds of rational thinking (Lindblom, 1959; Mintzberg & Waters, 1985); it stresses the difference between intended and emergent strategy and that a winning strategy can be only formulated in retrospect/hindsight. The synthesis of the two extremes is encapsulated in the *processual school*, which takes a middle position. This school asserts that, while developing optimal strategies in a purely rational process is not possible, processes in organizations can be established (by managers) so as to make the organization more flexible and adaptable and, hence, to better learn form their/its mistakes. For a more profound discussion on these schools, see van der Heijden and Eden (1998, p. 59-61) or Mintzberg (1990).

Kolb et al. (1991) describe the nature of (individual) learning as a four-part loop: (i) concrete experiences feed into a process of (ii) reflection, which leads to the (iii) development of theories of how things work, which (iv) governs the plans and execution of new actions. This is followed by (i) new concrete experiences and, hence, the process assumes the traits of a loop or a cycle.[51] In parallel to Weick (1979) and others,

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[50]See Mintzberg (1990) for a larger taxonomy of strategy schools. This taxonomy can be mapped into the three views/schools mentioned here.

[51] See Kolb (1991) for a more profound elaboration of the learning cycle. For example, they argue that different individuals possess different skills/aptitudes and, hence, better master one of the four phases

they emphasize the importance of actions in order to create experiences and learning (cf. "how do I know what I think until…I see how I act").

With the support of the three strategy perspectives and Kolb et al.'s (1991) learning theory, van der Heijden and Eden (1998) extend the individual learning theory to institutional and organizational learning by introducing the notion of *institutional action*. They define institution as "a coherent set of individual actions, which are supported as a set by a self-sustaining critical mass of opinion in the organization," (van derHeijden and Eden, 1998, p. 61-62). Moreover, institutional action can only be discussed if a minimum level of sensemaking and response is shared. Without such a minimum level, there can only be unrelated individual actions that lead to individual rather than organizational (group) learning. Furthermore, a lack of consensus or shared meaning will repress the coherence of individual action that will ultimately leave the organization fragmented. Planning becomes a joint activity if this minimum level is attained, thus, an alignment of mental models between individuals exists within the organization (or group). Hence, experiences will be common "leading to joint reflection in the *group* and reinforcement of a shared mental model" (van der Heijden & Eden, 1998, p. 62, emphasis added).

The discussion of a minimum level of shared meaning required for coordinated and organized action is, and will remain, very imprecise and abstract; however, it is related to the demands for strategic opportunism. This strategic opportunism concerns the "ability to act fast with the confidence that the action will build appropriate strategic futures that can be set against the need for the creative tensions, which come from differentiated meanings: e.g. between the board and managers of Arrow" (van der Heijden & Eden, 1998, p. 62, e.g. added). This institutional version of Kolb et al's (1991) learning model introduces the degree of sharing of theories and meaning as an additional factor. Hence, once again, an initial critical mass must be present for the learning cycle to feed itself. Van der Heijden and Eden (1998) argue in parallel to Bood (1998), Lindell et

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than the other. They argue that assuming this will improve learning if the mix of people in a group is so diverse that all four aptitudes are included.

al (1998), and Spender (1998) that the inclusion of "action" in the loop underscores the need for shared theories about the world in order for institutional learning to take place. This need introduces the requirement of an effective process of conversation "through which strategic cognitions can be compared, challenged, and negotiated" (van der Heijden & Eden, 1998, p. 62).

Dunford and Jones (2000) are among those who inform us that strategic change involves the constituting of a new reality in the minds of organizational members. Language (through conversations) is heavily implicated in this process. This language "not only describe(s) the social world, but categorise [s] it [… and] bring[s] phenomena into sight" (Parker, 1992, p. 4). Hence, it has an active rather than passive relation to the reality. Furthermore, it affects what we consider to be objects of concern and the implicated actions; it also frames how people come to understand and act with respect to an issue (Pentland, 1999). D'Aveni (1994) argues that new language is of fundamental importance in order to enable managers to conceive of how to act in a hypercompetitive environment.

The conversational process cannot activate organizational learning without possessing the alignment between managers' ideas. In an earlier work, van der Heijden (1993) explained that this requires a process of rational comparison of competing ideas through the reference of a shared worldview from where the organization derives its purpose. This shared worldview constitutes "the platform on which a line of logical argumentation will be built to compare views on the specific situation in the strategic conversation process, leading to the view preferred by the group" (van der Heijden and Eden, 1998, p. 62). Rationality per sé is essential in the strategic conversation process although it may not be the way in which strategy is formed (cf. rationalistic school of strategy).

## The Methodology in Retrospect

I will briefly direct attention back to this study's methodological approach before continuing the development of the theoretical framework.

The objective here is to apprehend a deep knowledge of the actors' theories-in-use, rather than their espoused theories or their mere rhetoric of strategy. To put it in more specific terms, the empirical focus is the management team and the board's communication, interaction, interpretations, and actions: in other words, the strategic thinking or sensemaking in a strategic change process.

The task of strategic elicitation within the context of managerial and organizational cognition can be used to accomplish this. Several approaches to this have been utilized throughout this field's development; here, I will here briefly present the general modus operandi as well as one extended approach, as per van der Heijden & Eden (1998), that looks promising for process of detecting theories-in-use.

The procedure for strategic elicitation that has become commonplace among many researchers in the field of managerial and organizational cognition is the analysis of formal procedures through written documentation (e.g. board and other meeting protocols, annual reports, and business plans). This approach can be very telling of the ways in which an organization manages its bureaucracy, while conclusions founded exclusively upon the analysis of recorded statements can be a poor representation of institutional strategy. Hence, the analysis of formal procedures through written documentation misses important social processes of bargaining and negotiating about the future, as well as aspects of thinking and acting.

Another and more prosperous approach discards the unlimited trust of documentation and "seeks to understand the social processes of decision-making, of relating, of strategy in action" (van der Heijden & Eden, 1998, p. 67). This approach directs particular attention toward the more subtle aspect of shared meaning, thus, uncovering systematic patterns of meaning in the specific organization. In other words, the approach proclaims the importance of looking at decision-making in action, thus, watching decision-making and listening to stories. Using direct observations as a method of data collection, therefore, has the (possible) advantage of reaching the participant's theory-in-use rather than their espoused theory of action (Argyris & Schön, 1974, 1978). As Argyris and Schön argues, "when someone is asked how he would behave under certain circumstances, the answer he usually gives is his espoused theory of action for that situation. This is the theory in action to which he gives allegiance and which, upon request, he communicates to others. However, the theory that usually governs his action is his theory-in-use, which may or may not be compatible with his espoused theory" (Argyris & Schön, 1974, p. 7). Furthermore, the theories-in-use are to be inferred by observing organizational decisions and actions. The approach becomes even more promising in the rare cases when it is used to observe real strategic problem solving in real-time, as this study depicts. This provides the best assurance of detecting theories-in-use (van der Heijden & Eden, 1998). Hence, the approach chosen to modeling the theories in action emphasizes the direct attention to the processes of negotiating new meanings and to establishing shared meanings.

Table 5.5: Brief Reminder of the Concepts

| *Theoretical Concept, Idea, or Keyword* | *Brief Reminder of the Concepts* |
|---|---|
| Learning as a four-part loop | Concrete (i) experiences feed into a process of (ii) reflection, which leads to the (iii) development of theories of how things work, which (iv) governs the plans and execution of new actions. This is followed by new concrete (i) experiences and hence the process assumes the traits of a loop or a cycle. |
| Institutional action | Institutional action can only be discussed if a minimum level of sensemaking and response is shared. Without such a minimum level, there can only be unrelated individual actions leading to individual rather than organizational (group) learning. A lack of consensus or shared meaning will further repress the coherence of individual action that, in the end, will leave the organization fragmented. If this minimum level is attained, an alignment of mental models between individuals can exist in the organization (or group), and planning becomes a joint activity. Hence, experiences will be common leading to joint reflection in |

| | |
|---|---|
| | the group and reinforcement of a shared mental model. |
| Degree of sharing | Again, an initial critical mass must be present for the learning cycle to feed itself. In order for institutional learning to take place, the inclusion of action in the (learning) loop underscores the need for shared theories about the world. This need introduces the requirement of an effective process of conversation through which strategic cognitions can be compared, challenged, and negotiated. |
| Process of conversation | An effective process of conversation through which strategic cognitions can be compared, challenged, and negotiated. |
| Strategic language | In order to be effective, this process of conversation requires a language in which strategy concepts can be expressed. This language is influenced by many sources; most organizations develop an idiosyncratic (strategic) language.<br>This strategic language is primarily based upon the strategic experience that the organization has experienced in the past. The existence and development of jargon, labels, and concepts are manifestations of language building; they can only represent strategic problems of the past since they were generated to categorize particular occurred events.<br>This shared worldview constitutes the platform on which a line of logical argumentation will be built to compare views on the specific situation in the strategic conversation process, thus, leading to the view preferred by the group. |
| Espoused theories and theories-in-use | When someone is asked how he or she would behave under certain circumstances, the answer one usually gives is his or her espoused theory of action for that situation. This is the theory in action to which one gives allegiance and that he communicates to others upon request. However, the theory that usually governs the action is one's theory-in-use, which may or may not be compatible with his or her espoused theory.<br>This is interesting since it seeks to understand the social processes of decision-making, relating, and strategy in action. Hence, it helps to direct particular attention toward the more subtle aspect of shared meaning, thus, uncovering systematic patterns of meaning within the specific organization. |

# On the Dynamics or Temporality of Cognitions

We have now attended to several important components (including collective mind as embedded in practice), different types of cognition, and learning. These have unanimously touched upon or encapsulated the dynamic dimension of cognitions; therefore, we will now return to the temporal characteristics of cognitions. In other words, we will attend to the question of *stability* and *change* of managerial cognition (in action): that is to say, the unfolding of cognitions or "ways-of-thinking" (Lindell et al., 1998, p. 79) over time. Hence, the temporality discussion held at the outset of this theoretical framework to reframe the perpetual level-of-analysis debate will now be used to elaborate upon the propensity for change of cognitions. This section will draw heavily upon the ideas regarding the iterative (temporal) process of sensemaking and sensegiving, as conveyed by Gioia and Chittipeddi (1991).

As I have argued, action and change take place in an organizational reality that is socially constructed, in the sense that individuals with dissimilar mindsets and (subjective) worldviews interact. By assuming these individual differences, focus cannot be exclusively directed towards action or cognitions; it must include the interplay of both managerial cognitions and action since "these chains of thinking and acting shape strategic processes" (Lindell et al., 1998, p. 77). The locus of this research is this processual outlook on how chains of thinking and acting influence the strategic (here, change) process (es). More directly, how the interplay between thinking and acting (or interpretations and actions) on Arrow's management team and between management and the board influences and is influenced by the strategic change of the firm. The term *socio-cognition* rather than cognition could have been used here, given this constructionist outlook and my firm belief that cognitive and social properties are reciprocally connected and intertwined, I will, nonetheless, use the term cognition in order to maintain the consistency in this text.

Mental structures are said to help us create meaning and make the world understandable by organizing and interpreting information. They are also said to possess inherent uncertainty-reducing traits due to their ability to simplify information in circumstance when information environment is too complex and fill in missing parts in situations of information gaps (Lindell et al., 1998). Consequently, cognitions are usually referred to as being purely emotion-free knowledge structures, molded by past experience. Sims and Lorenzi (1992) acknowledged this lack of components such as emotion, hope, and value. They argued that affect and emotion influence both behavior and cognition in social settings. Lindell et al (1998) go on to stress that a top leader's or manager's way-of-thinking consists of a thematic set of values, assumptions, beliefs, ideas, and thoughts concerning strategic development and other adjacent areas. This is further shaped by the manager's personality, history, earlier management experiences, and interpretation of the environment. Therefore, managerial cognitions are not only closely interrelated with actions; they are also constructed by human beings with emotions, hopes, and values.

## Attaching and Re-Attaching Meaning to Strategic Issues: On Cognitive Change Proneness

While the links between organizational action and individuals' cognitive representation (of the environment) has received a lot of interest (Daft & Weick, 1984; Dutton & Jackson, 1987), the process of how decision makers impose (their) order on the environment is perhaps even more interesting. Dutton and Jackson (1987) argue that strategic issues are identified (by managers) to impose that order. However, this could assume that the meaning of strategic issues is inherent in external events; it is, in fact, the internal organizational characteristics that determine what and how meaning evolves for a specific issue (Lindell et al., 1998). The process of attaching meaning, classifying the strategic issues, and deciding upon how the organization should act and react is governed by the use of linguistic labels (Dutton & Jackson, 1987). An empirical example of how linguistics is used explicitly in a change process through the use of labels (e.g. center) loaded with meanings and changes (e.g. security, participation, and competence) can be found in Lindell et al (1998). The sensemaking process in this research (Lindell et al., 1998) is explicated by studying how a Managing Director (the strategist) of a large hospital introduces new concepts and redefines concepts already in employed in the organization. Thus, how different organizations respond to similar environmental events might vary extensively since their actions regarding these strategic issues follow from the meaning to which they are attached (Dutton & Jackson, 1987). This is subsequently governed by the values, assumptions, beliefs, and ideas of the ones (i.e. managers) imposing the interpretations (cf. interpretive dominance). This parallels the view of Gioia and Chittipeddi (1991) who explained the processes of sensemaking and sensegiving. *Sensegiving* is labeled as the progression of imposing interpretations or the manner in which managers attempt to influence "the sensemaking and meaning construction of others toward a preferred redefinition of organizational reality" (Gioia & Chittipeddi, 1991, p. 442). *Sensemaking* concerns the construction and reconstruction of meaning "by the involved parties as they attempt to develop a meaningful framework for understanding the nature of the intended strategic change" (Gioia & Chittipeddi, 1991, p. 442).

The iterative processes of making and giving sense of the organizational reality (and other issues, for that matter) fits neatly into to the issue of stability and change in managerial cognition. As argued in the duality to dualism discussion, both sides of stability and change of cognitions are represented well in the field. The assumptions that set the different standpoints apart are of primary interest. Hellgren and Melin (1993) have included emotional factors in their concept of a top manager's way-of-thinking. They argue that *emotional factors* are change resistant when confronting new situations. Donaldson and Lorsch (1983) similarly view stability in mental structures, partially as a result of commitment to beliefs reinforced by emotional elements. Interestingly, Lyles and Schwenk's (1992) perception of knowledge structures (which they separate into a stable *core* and a *peripheral* set of knowledge) is that they are free from emotional elements and are, hence, "more subjective to change" (Lyles & Schwenk, 1992, p. 157). Thus, the inclusion or exclusion of emotional elements in knowledge structures or cognitions vastly affects the change proneness of managerial cognitions and the strategic change process.

Table 5.6: Brief Reminder of the Concepts

| *Theoretical Concept or Keyword* | *Brief Reminder of the Concepts* |
|---|---|
| Mental structures | Mental structures help us create meaning and make the world understandable by organizing and interpreting information.<br>They posses inherent uncertainty-reducing traits due to their ability to simplify information in circumstance when information environment is too complex and fill in missing parts in situations of information gaps.<br>They might also blind us through directing our attention to some parts and exclude others.<br>A manager's way-of-thinking consists of a thematic set of values, assumptions, beliefs, ideas, and thoughts concerning strategic development and other adjacent areas. This is further molded by the manager's personality, history, earlier management experiences, and interpretation of the environment. Therefore, managerial cognitions are not only closely interrelated with actions; they are also constructed by human beings with emotions, hopes, and values. |
| Imposing order (attaching and re-attaching meaning) | The process of attaching meaning, classifying the (strategic) issues, and deciding upon how the organization should (re)act is governed by the use of linguistic labels (thus, paralleling the sensegiving and sensemaking concepts). |
| Sensegiving | Sensegiving is labeled as the process of imposing interpretation or by which managers attempt to influence the sensemaking and meaning construction of others toward a preferred redefinition or organizational reality. |
| Sensemaking | Concerns the construction and reconstruction of meaning by the involved parties as they attempt to develop a meaningful framework for understanding the nature of the intended strategic change. |

## A Concluding and Summarizing Note on Sensemaking

In line with the strong and growing constructivist stream of research, a fundamental and underlying assumption of sensemaking theory is that individuals actively construe the reality, which they act upon (Berger & Luckmann, 1966). Creating sense and meaning is both a cognitive and social process (Weick, 1995). I argue that studies of sensemaking must be concerned with both the social process involved in sensemaking, as "sensemaking occurs, and can be studied in the discourse of social members, rather than simply occurring in their minds (Gephart, 1993, p. 1470) and the interpretive schemas, as systems of meaning that the sensemaker has developed through socialization and experience (Weick, 1995).

Gioia together with his colleagues (Thomas et al., 1993, 1994; Gioia & Thomas, 1996) less tacitly define (strategic) sensemaking and sensegiving as two complementary and reciprocal processes. As mentioned earlier, the former concerns the construction of meaning by the involved parties; the latter concerns the process by which managers attempt to influence the sensemaking and meaning construction of others toward a preferred redefinition of organizational reality. Hence, sensemaking has to do with the way managers interpret, understand, and create sense for themselves based upon the information surrounding a specific issue (Rouleau, 2005). Sensegiving is concerned with the managers' attempt to influence the outcome, to communicate their thoughts about the change to others, and to gain their support (Rouleau, 2005). Consequently, the boundaries of both of these process permeate each other; thus, they are mutually dependent.

Sensemaking in the context of a strategic change can, therefore, be defined as "[…] the meaning construction and reconstruction by the involved parties as they attempt to develop a meaningful framework for understanding the nature of the […] strategic change" (Gioia & Chittipeddi, 1991, p. 442). The studied actors use sensemaking in an attempt to resolve the uncertainty and ambiguity of strategizing a strategic change. Weick et al. (2005, p. 409) describe sensemaking as "[…] an issue of language, talk and communication. Situations, organizations, and environments are talked into existence. […] Sensemaking is about the interplay of action and interpretation." Hence, Weick positions sensemaking as a *conversational process*. Sensemaking consequently allows these actors to create rational accounts of what, why, and how to change, which enables action (Maitlis, 2005).

Research from a strategy-as-practice field (more in the subsequent section) and the sensemaking perspective leads us to believe that understanding how different organizational responds to strategic change requires an insight on the individual level (Stensaker & Falkenberg, 2007). The individuals' sensemaking processes are believed to affect the strategic change and the responses to that change. Based upon this assumption, the focus will be directed toward the accounts and interpretations that actors provide during the strategizing. As a consequence, the trace of the sensemaking processes will not be in the limelight per sé; the focus will instead on the conversational processes, the individuals'/actors' accounts of the change, how they have made sense of the change, and how and why one should implement change. The individuals'/actors' account of the strategic change formation, its content, and the subsequent actions (or non-actions) can be perceived as their interpretive responses (Stensaker & Falkenberg, 2007).

## Bringing Human Actors and Their (Inter)Actions as Well as Interpretations Into Strategy – on Strategy-as-Practice

A central idea within this research project is the social aspect of strategizing. Drawing on the seminal work of Mintzberg (1973; Mintzberg & Waters, 1985), Pettigrew (1973, 1992b) and others the attention to these social aspects has increased in intensity. The strategy-as-practice field has in particular helped us to uncover important practices and processes that have received little attention in the mainstream strategy research (Whittington, 1993, 2003; Johnson et al., 2003; Jarzabkowski, 2005). This includes a wide variety of streams including a more profound understanding of how strategy processes consist of numerous kinds of social processes and micro-activities (e.g. Whittington, 1993, 2003; Johnson et al., 2003; Jarzabkowski, 2005) and of how strategizing occurs in explicit social contexts and thus is socially constructed (e.g. Whittington, 1993; Hendry, 2000).

The strategy-as-practice as a research topic or research field is, hence, concerned with the doing of strategy. More precisely, "who does it, what they do, how they do it, what they use, and what implications this has for shaping strategy" (Jarzabkowski & Spee, 2009, p. 69). The growing interest in the social aspects of strategizing or, in other words, the dissatisfaction with conventional strategy, have inspired this field of research. As I had mentioned at the onset, while it is *people* that do strategy, in contrast to the multivariate analysis of firm or at the industry level that populate most strategy research, there is an interesting absence of human actors and their actions in most strategy research (Jarzabkowski & Spee, 2009).

Jarzabkowski and Spee (2009) are among those who inform us that mainstream strategy research has left little room for living beings whose emotions, motivations, and actions shape strategy. Consequently, strategy research has been influenced to an increasing extent to humanize management and organization research by means of re-introducing the individual (Weick, 1979; Whittington et al., 2002). The still growing field of strategy-as-practice has made its raison d'être to "bring human actors and their actions and interactions to the centre stage […]" of its field (Jarzabkowski & Spee, 2009, p. 70). The field is perceived as a part of a broader culmination influenced by the constructivist shift in strategic management research.

Numerous research streams have tried to break with the hold that economics-based research has over strategy; several are influenced by the constructivist shift within strategic management (Mir & Watson, 2000). Strategy-as-practice could be seen as one contributor to this broader culmination. Hence, the field could be seen as a contributor to the quest to further illuminate the social complexity and casual ambiguity in strategy research (Jarzabkowski & Spee, 2009).

## A Concluding Note on the Term Strategizing

The research community of strategy-as-practice distinguishes the concept of strategy from the concept of strategizing. Jarzabkowski et al. (2007, p. 7-8), amongst others, inform us that *strategy* has been defined "[…] as a situated, socially accomplished activity […]", while strategizing "[…] comprises those actions, interactions and negotiations of multiple actors and the situated practices that they draw upon in accomplishing that activity".

# Chapter 6

# How Changes in the Minds of Managers can Result in Strategic Changes

I have now presented the theoretical lenses in chapters 3 and 5, the methodological approach in chapter 4, the language arsenal in chapter 3, and the business model of buyout firms in chapters 2 and 3. Therefore, it is time to move forward to the empirical and analytical part of this thesis.

In line with the research questions put forth and the methodology-in-use, this is where the story of moving beyond the mere rhetoric of strategy-in-the-making will begin. Hence, the narrative is about listening to stories and watching decision-making concerning strategic change in real-time, thus, observing how the two actors' theories-in-use - rather than their espoused-theories of action (Argyris & Schön, 1974, 1978) - develops intentionally and unintentionally over time during strategic change in the making. Thus, the story will illuminate how a wide set of interpretations, actions, interactions, and beliefs develops within and between the two different actors – the board and management team – and how they affect the development of the portfolio firm, Arrow. By following the development process of Arrow and its two strategic actors, I will elucidate whether these strategic changes follow an intended or emerging path (Mintzberg & Waters, 1985) or even a hybrid in-between.

An originality of this empirical chapter, and perhaps this entire study, is founded upon its uniqueness of observing organizational and strategic decisions and actions in real-time in a context of the still covert and highly contemporary buyout or private equity arena during a time of several large strategic changes in one of Bay Lake's portfolio firms: i.e. Widget producer, Arrow. The process of communicating, acting, interacting, interpreting, as well as negotiating new meanings and establishing shared ones during this strategic change is as aforementioned the focus of this study or to paraphrase the title of this chapter: How changes in the minds of managers can *affect* the development of the strategic change.

## Evaluating the Viability of Arrow as an Investment

The chapter will begin with an in-depth elaboration on the background and process of acquiring Arrow.

### The Lack of Fit With Bay Lake's Investment Heuristics

Since Bay Lake's executive team is comprised of individuals with extensive industrial and financial experience, their network is comprehensive. This network of a variety of constituencies such as management teams, investments shops/boutiques, banks, entrepreneurs, and various private equity actors; it contributes with a large annual deal flow of acquisition opportunities. In fact, it has averaged 100 investment opportunities per annum over the last decade. The majority of these investment opportunities are discarded rather quickly on the basis of Bay Lake's two investment fit test, hence, based upon the outcome of their back-of-the-envelope test and fit to their investment heuristics, in that order.

Firstly[52] a back-of-the-envelope test, which is Bay Lake's initial test, is deployed where the rationale is to positively answer at least two out of three basic or guiding questions:

Table 6.1: Guiding Questions Prior to Investment Decision

| *The Back-of-the-Envelope Test Questions[53]:* |
|---|
| Why does the seller want to sell the firm, subsidiary, or division (hereafter called firm), thus, is it a logical sale such as succession or a changed group strategy? |
| Can we in any positive way change the fundamental prerequisites of/for the targeted/acquired firm? |
| Can we contribute with any important resources in terms of competence, network, experience, founds etc.? |

As we have seen and will see further on numerous answers to the first question – *the rationale for selling Arrow* – seem to exist. The ones most extensively used by Bay Lake is that Goliath, the selling firm, where exiting all niche segments in their pursuit of a scale-of-economy strategy as well as wanting to send a message/signal of their power to act to the stock market due to its less than satisfactory share price development. This was also an answer with which Bay Lake was more than satisfied. The second question, concerning the changes in Arrow's prerequisites was satisfactorily fulfilled since a separation from Goliath would open up to the possibility of selling to new customer segments. Due to intra-group competition within Goliath, Arrow was restricted to approach certain segments. A newly dedicated sales force could be developed, which was thought to be more efficient than the shared sales organization in the Goliath group that Arrow currently was utilizing. Lastly, in terms of resource contribution, Bay Lake foresaw the strength of a new board com-

[52] On numerous occasions, the CEO of Bay Lake has mentioned that there is one preceding investment fit test, which he refers to as FIA (i.e. First Impression Analysis).
[53] Cf. the other investment fit test in the Why Invest in Arrow — The Bay Lake Rationale sub-chapter.

prised of experienced CEOs and other executives from the Widget industry. This combined with the fact that they had previous transaction experience from remote (yet to some extent, as Bay Lake has argued) adjacent industries. Given the outcomes of this first basic test, Arrow was still a viable investment alternative for Bay Lake.

Secondly, the outcome of the more extensive investment fit test (i.e. their investment heuristics) indicated a less fortunate fit; in fact, it was perceived to be a very bad match with Arrow. As mentioned in the actor description, the primary reasons for this were three-fold. Arrow was very sensitive to the business cycle and it was capital intense; thus, it had a heavy balance sheet and was remote from the end-customer on the industrial value-chain. These three factors stood in stark contrast to Bay Lake's investment philosophy.

Due to the outcome of the second investment fit test, Bay Lake did not perceive Arrow as a viable investment and, hence, discarded the idea of acquiring Arrow. In fact, more than 90 % of the acquisition opportunities in Bay Lake's deal-flow do not pass these two tests, which is why approximately only ten firms are further scrutinized per annum - of which four to five are usually acquired.

When a seasoned industrial expert who had spent more than 40 years working in the Widget industry approached his former colleague and university classmate who happened to be one of the few senior partners at Bay Lake, this specific investment opportunity re-emerged as a viable option only a few weeks after being discarded. He convincingly argued that the market in general, and Bay Lake in particular, had misunderstood Arrow, its position, and how it could be developed as a stand-alone firm. Hence, he convinced the senior partner who subsequently persuaded Bay Lake's investment committee to proceed with the scrutiny/analysis of Arrow as an investment opportunity.

## Several Months of Intense Negotiations

The decision to take Arrow to the next level of scrutiny lead to a prolonged process involving numerous intense meetings with the seller, serious number-crunching in the data room that the seller had set up containing all of Arrow's historical data, numerous interviews with Arrow's customers and suppliers, as well as with industry and legal experts. Although officially unaware of each other, five other players were analyzing Arrow alongside Bay Lake; this included both financial (i.e. buyout firms) and industrial ones.

All this interaction and examination, which were conducted by Bay Lake executives as well as by consultants and lawyers, converged into a large set of reports; these included a financial, legal, and commercial due diligence. In order to simplify the decision for the investment committee as to whether or not Bay Lake should place a bid on Arrow, Bay Lake summarized the due diligence and numerous other reports into an Investment Memorandum that was presented to the investment committee in accordance to Bay Lake's ordinary investment process.

The outcomes of this intense and vast scrutinizing resulted in an Investment Memorandum[54] of 109 pages that, not only described the "factual" data of Arrow's historical development; it also noted the mutual or negotiated view that Bay Lake had of Arrow's current position and future possibilities in the form of a proposed value enhancement plan (more on that in the subsequent section). Bay Lake initiated the discussions with potential board candidates on whether or not it would be interested in investing in Arrow alongside Bay Lake (more on that later) and, perhaps more importantly, becoming members of Arrow's board. This memorandum was the foundation for how the external board members initially encountered Arrow and, thus, probably shaped their first perceptions and thoughts of the company, its opportunities and risks,

[54] The investment memorandum is the internal investment proposal that the buyout firm compounds. This 109-page document includes information from commercial, financial and legal due diligence, as well as financial forecasts, identified key value drivers, proposed financing of the acquisition, and projected yield of the investment.

as well as the development trajectory they foresaw. The next section of this empirical chapter will elaborate upon how the owner (i.e. Bay Lake) and, subsequently, the board candidates' perception of Arrow, its history, and its future opportunities and risks were primarily based upon Bay Lake's Investment Memorandum.

Even though Bay Lake had invested a considerable amount of time, energy, and funds on consultants, legal expertise, and personal interaction (the transaction cost including consultants and legal expertise was approximately SEK 10 million), the fit between Arrow as an investment and Bay Lake's investment heuristics still had this three-fold discrepancy. However, as we will see in the forthcoming description, this divergence was de-emphasized on behalf of other industrial traits, such as a foreseeable shift in the industry specific business cycle, an opportunity to strategically re-position Arrow, and an opportunity to improve the operational efficiency, which neatly fits Bay Lake's business model (see Appendix B). The primary argument or reason was to act upon these opportunities (all of which have been described in the second chapter of this thesis). As mentioned in the chapter that discusses the acquiring and acquired firm, Bay Lake had the opportunity to obtain Arrow vastly below book value, which decreased the downward risk in the investment and also gave Bay Lake some leeway in the process of changing (adapting/reorienting) Arrow since the badwill (or negative goodwill) strengthened the finances with approximately 135 million SEK per year during the initial three years of the investment. Hence, Bay Lake presumed that it would take three years or less to "adjust" or change Arrow through the primary change facilitators: Beta and badwill. Hence, this created a protection toward the financial covenants that one of the lenders had established for Arrow (i.e. the commercial bank)[55]. This badwill together with the other loan terms created a financial situation that Bay Lake called *unsinkable*.

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[55] The covenants for Arrow were three-fold: (i) interest coverage-ratio, (ii) debt/equity ratio, and (iii) equity ratio in %.

## The Culmination of the Six-Month Long Negotiation: The Final Act

Although the interaction with Goliath concerning Arrow was initiated in October 2005, we are now in March 2006 and the private equity market in general and the buyout market in particular has risen to (even) new heights (SVCA, 2007).

This was a particularly dark and rainy night in the end of March. Several months of intense negotiations between Bay Lake and Goliath was culminating. The time had reached 4:00 am and the marathon meeting between the buyer and seller, which was being mediated through each party's team of lawyers, had been going on since lunch the day before. This specific meeting had been on the verge of crashing the whole deal on several occasions during this night (this harsh climate continued after the acquisition as well; in fact, Bay Lake did consult a Professor in civil law on one occasion to undermine Goliath's references to force majeure). In fact, Bay Lake and Goliath had negotiated several deal-breakers during the six months that were breached from both parties' perspective. On this specific rainy night, Goliath had left the negotiation table on no less than three occasions due to the tough and sometimes unreasonable demands of the buyer. One of Bay Lake's negotiators said to one of Goliath's negotiator "he speaks when he should be quiet", in reference to a famous mafia movie.

However, a few hours before the sun rose, both Goliath and Bay Lake signed the Share Sales and Purchase Agreement (SPA). Hence, the buyout firm Bay Lake became the new proud owner of the Widget manufacturer Arrow. What might also be interesting to know here is that the industry expert who might have acted as Bay Lake's tipping point in the Arrow acquisition not only invested in Arrow alongside Bay Lake; he also joined Arrow's management team shortly after it had been acquired. The senior partner who had been Bay Lake's driving force for this acquisition was also the industry expert's former colleague and classmate. It was he who assumed the position of Chair for Arrow.

## Why Did the Stars Align?

No less than 1,064 days after Goliath and Bay Lake had signed the SPA and Bay Lake had become Arrow's new owner, a process of negotiation was once again initiated. In contrast to the first Goliath/Bay Lake negotiation when Arrow, although it had a lot of potential, was positioned as an old tired cost-oriented production center in a large industry group, Arrow was now positioned as a highly successful, commercial, cost-efficient, and well-positioned autonomous Widget firm. More importantly, Bay Lake now sat on the other side of the negotiation table: a seller negotiating with a large North European Widget group about acquiring Arrow. Moreover, a few months into the negotiations, Arrow achieved the best EBITDA result ever attained in its lifetime – and Arrow is not a young firm; in fact, it neither originates from this century nor from the former one. The EBITDA had grown with 440 % in the first quarter of 2009 compared to the first quarter of 2006 and with 825 % compared to the second quarter of 2006 (adjusted for seasonal variations): that is to say, the first full quarter that Bay Lake owned Arrow. This could be perceived as somewhat of an achievement since a climate of severe economic recession characterized the first quarter of 2009, and Arrow is very sensitive to the business cycle.

The story can take numerous paths; the most conventional approach would probably be to scrutinize the actual structural changes, the deployed strategic frameworks, and the performance and value (i.e. financial) consequences. I am strictly guided by my research questions and, therefore, focus on the conversations, interpretations, and actions, thus, the sensemaking as well as its effects in and between the two strategic actors: Arrow's board and management team. Hence, I will observe and elaborate upon group belief systems, strategic and environmental sensemaking, as well as managerial decision making in the context of this strategic change through the use of cognitive, behavioral, managerial, organizational, strategic, and financial underpinnings.

## A Note on the Composition of the Two Actors

I will put forth a quick description of the two actors' composition before describing the disposition and layout of the rest of the empirical chapter. At the outset of this study, before Bay Lake acquired Arrow, its management team was comprised of 14 individuals. The majority on the original management team - in fact, 10 out of 14 - had production-oriented functions. Finance and procurement where not represented on the team; however, it reported to the Administrative and HR Director who held a position on the management team instead.

Furthermore, Arrow was a production center in the Goliath group; therefore, it did not have a board prior to Bay Lake's acquisition (except for a "paper" board in order to fulfill legal requirements). As I mentioned in the actor description, after the acquisition, Bay Lake established a board for Arrow containing three owner representatives (i.e. Bay Lake employees/partners, three industrial experts, two union representatives, and Arrow's CEO).

Table 6.2: The Board of Arrow

| *Board Role:* | *Origin:* |
|---|---|
| Chairman of the board (Chair) | Bay Lake partner |
| Board member | Bay Lake partner (and CEO of Bay Lake) |
| Board member | Bay Lake partner |
| Board member | Board professional |
| Board member | CEO within the Widget industry |
| Board member | CEO within the Widget industry |
| Union representative | |
| Union representative | |
| Arrow's CEO | |
| Arrow's CFO | |

The fact that the board contained three owner representatives (the CEO of Bay Lake, one senior partner, and one partner) is unusual for Bay Lake; however, this was motivated by the considerable size of the investment and that one of them (i.e. the Chair) was newly employed. Bay Lake has usually one or two representatives on their portfolio firm boards rather than three. Moreover, the Chair was the only one of them with extensive experience from the Widget industry. In fact, he had held several executive positions in this specific industry. The three external board members (i.e. members of Bay Lake's industrial network), whom Bay Lake had recruited, consisted of two seasoned Widget industry CEOs and one board professional who had severed on the board of more than 40 Swedish and international firms. These three individuals invested in Arrow alongside Bay Lake. The two union representatives represented the two large unions at Arrow and were not given the opportunity to invest in Arrow. Lastly, we have the CEO who is formally not a member of the board, yet was a central participant at all board meetings. Arrow's CFO was co-opted as secretary and financial rapporteur at all board meetings.

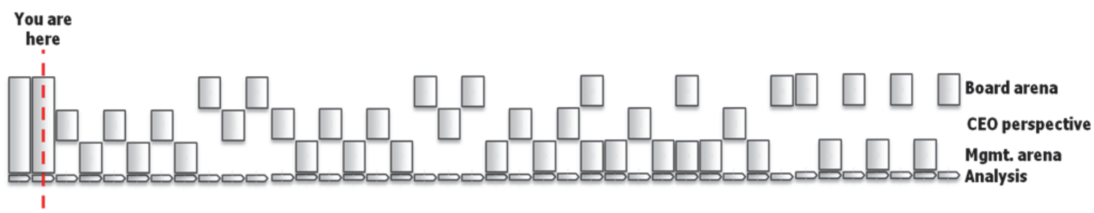
## The Rationale and Disposition of the Rest of the Empirical Chapter

The rest of this empirical chapter will be divided into three reoccurring general sections, with the exception of the following part, which represents the base for the board's mutual perception. The ambition is to understand the way in which organizational, or perhaps strategic, change (intentionally or unintentionally) can be attained by *changes in the minds of managers* with an emphasis on the groups or actors controlling the strategic agenda. Therefore, the rationale is to direct attention to the stories and actions that take place in the arena of these two actors. Hence, in order to illuminate how a wide set of beliefs and strategic thoughts develop within and between the two different actors and how this affects the development of the portfolio firm, these two actors hold a central role in this study. In other words, I will focus upon three sections, which will be named after the actors in order to illuminate the process of interacting, negotiating new meanings, and establishing shared ones within and between the two actors during this strategic change, hence, to find out how changes in the minds of managers affect the development of the strategic change.

Three arenas will be structured as empirical sub-chapters where cognitions, senses, and beliefs concerning Arrow's strategy and environment will appear in chronological order over the 36/48-month scope of the study. Hence, these arenas equate the conversational processes: those that happen in and between these arenas.

Certain themes emerge and create consequences in each and every arena  and for others. Hence, these arenas are not mutually exclusive; rather, they develop in parallel to each other and are often intrinsically entangled and intertwined. There is consequently an interest in how senses, ideas, interpretations, beliefs, meanings, and so on emerge in and between the different arenas, how it affects other arenas as well as individuals, and how people affect the development trajectory of the different arenas.

Figure 6.1: Illustration of the Empirical Disposition (the Three Different Arenas): Board, CEO, and Management.



## Analytical Summary: Sidestepping Your Formal Procedures to Build a Case

Goliath's sale of Arrow was presumably logical and Bay Lake's ownership fundamentally changed Arrow's game plan in terms of its prerequisites; therefore, the requirements of the back-of-the-envelope test were satisfactory fulfilled. The more extensive investment heuristic, indicated although a less fortunate fit due to Arrow's capital intensiveness, business cycle sensitivity, and remote distance from the end-customer: three characteristics that will be aggressively targeted during Arrow's strategic change. The deal was not proprietary. Hence, if the personal relationship between an investment professional at Arrow and the industry expert had not existed, the investment would probably have been immediately discarded.

The fact that the aforementioned industry expert also assumed one of the most important roles on Arrow's management team (given the strategic change) established even greater covert access for Bay Lake. This considerably affected the development of interpretive dominance.

The vigilant reader has probably noticed the discrepancy between the number of sections (i.e. three) and the number of actors (i.e. two). A third actor will consequently be carved out in this study. In contrast to the other actors that are represented by groups, an individual (namely Arrow's CEO) represents this third actor. The rationale for complementing the two actors with the CEO, who in fact already is a part of the management team, is that he holds an important position as gateway and intermediary between the board and the management team (i.e. between Arrow and its principals). While being a gateway and intermediary, Arrow's CEO is the one who disseminates thoughts and ideas between the principal (read: board) and the agent (read: management team). More importantly, he has the interpretative prerogative of the information and sentiment that is transmitted between these groups, which sometimes intentionally or unintentionally becomes distorted when transcended between the groups.

We tentatively assume that the CEO has the strongest impact on the interpretive dominance of the management team and that he is also the one who spends the most time and energy interacting with external constituencies for support, advise, and uncertainty reduction. Most importantly, the CEO and I had one-on-one discussions after more or less every important meeting as well as weekly or bi-weekly summarizing meetings where he shared his interpretations, reflections, and any concerns with me.

Some attention will now be devoted to what is thought to be the foundation of the board's mutual outlook on Arrow at the outset of the acquisition. This is also the stance that collided with the position of Arrow's CEO and management team. As I previously discussed, a 109-page investment memorandum represented Bay Lake's mutual or negotiated view – perhaps even a collective belief agreement – of Arrow's current position and future possibilities in the form of value enhancements. This memorandum provided the first information that the external board members encountered on the subject of Arrow. This memorandum consequently constituted the framework that shaped Arrow's first perceptions and thoughts, its opportunities and risks, as well as its potential trajectory. Some board members complemented the sentiment projected in the memorandum by tapping into (and utilizing) the experience of their respective networks; the memorandum is perceived to be the strongest influencer of and upon their mutual views.

The memorandum was condensed into 109 pages. This indicates that several of Arrow's perspectives were intentionally and/or unintentionally excluded from the material. Since the prime purpose of the memorandum is to present to the investment committee a suitable investment case, the material was probably positively slanted; hence, it accentuates the opportunities and whitewashes the risks (without presenting a too bullish scenario). While the sole purpose of the following section is to depict this agreed/negotiated outlook on Arrow, the effects will permeate subsequent sections. More explicitly, we will see further on in this chapter that the investment memorandum became a mental iron cage of sorts, which defined both the boundaries of the decision possibilities and the plausible actions.

# An Overview of the Investment Memorandum

With the exception of the historical financial data, the following description is the owner's and, subsequently, the board's negotiated and renegotiated view of Arrow at the outset of this research. This is in contrast to the more "factual" description in the chapter that describes the acquiring and acquired firm at the start of this study. As we will later see, this view changed on numerous occasions during the period in which Bay Lake owned Arrow. I should also emphasize that the memorandum contains hundreds of references to trade organizations and consulting reports as well as to customer and supplier interviews.

## The Investment Rationale Revisited

Arrow is a world-renowned producer of Widgets and a European market leader with a market share of approximately 15 % in its specific niche (following the acquisition, it was debated whether Arrow had 15 % or 18 % of 15 %, that is approximately 3 %). The firm, which is a well-established actor in the industry as well as one of the oldest Widget producers in Europe, is well invested (low future capex) and operates three Widget machines (potential for scaling down). Arrow's products, which are sold under the brand names M-Widget and S-Widget are suitable for a handful of narrowly defined application areas and are primarily sold through merchants. Even 18 months after the acquisition, they still argued about the relevance of these application areas, and it was later revealed that the majority of the products were sold as a private label. In fact, approximately 65 % of the volumes were sold through merchants at the time of the acquisition (a figure that was later revised to 90 %).

Within the scope of the acquisition, Bay Lake had negotiated a bridging agreement with Goliath to continue to source Beta from the Goliath group on very favorable terms during the nine months that followed the acquisition. This bridging agreement, which had an estimated value of 60 million SEK and, hence, decreased Arrow's equity price with the same amount - from 400 million SEK to 340 million SEK - was perhaps the issue closest to breaking the deal between Bay Lake and Goliath. A few weeks before the SPA signing when Bay Lake realized that Arrow's primary cost components had skyrocketed the last quarter (the CEO had distributed this report two months earlier) they wanted to back out from the deal. This lead Goliath to threaten to take them to court. The compromise was that Goliath would subsidize Arrow's Beta consumption: a subsidy with a market value of the aforementioned 60 million SEK.

Arrow's financials were portrayed as low in the memorandum; however, they were quite good compared to their peers since the majority of firms already showed very low or negative profits in 2005; this was a trend that accelerated during the period of this study. Arrow's sensitivity to the economic business cycle becomes apparent in the following growth figures:

Table 6.3: Growth 2001-2006

| | *2001* | *2002* | *2003* | *2004* | *2005* | *2006B* |
|---|---|---|---|---|---|---|
| Revenue growth | n/a | 4% | -8% | -3% | 7% | 2% |
| EBITDA margin growth | n/a | 8% | -46% | -56% | 32% | 49% |

With regards to personal rationalities or motives, it was also mentioned both internally and externally on numerous occasions that the geographical position of Arrow's production-center was located in the same area as where Bay Lake's CEO (Bay Lake actually acquired another firm in the same area a year later).

## Bay Lake's View on the Opportunity, Rationale, Transaction, and Value Creation Analysis

Bay Lake was presented with the opportunity to acquire 100 % of Arrow. The firm was one of the oldest in its industry (and, hence, assumed to be very adaptable to changing environments); it was sold by the Goliath group due to its decision to exit certain niche segments within the Widget industry in order to focus on high volume and low-cost production in other industry segments (cf. other motives). As one Bay Lake partner expressed it:

> "A firm that has existed for so long and survived numerous changes and recessions must have an inherent survival strength."

The proposed transaction valued Arrow at 710 million SEK (enterprise value, excluding transaction costs), implying 5.5x EBITDA multiple on actual 2005 figures. Bay Lake expected to finance the transaction with 160 million SEK in bank financing and two vendor notes amounting to 250 million SEK in total. Hence, Bay Lake's equity investment was in the region of 300 million SEK: 240 million SEK in a shareholder loan and 60 million in ordinary equity. This financial setup results in a gearing (i.e. debt-to-equity ratio) of approximately 60 %. Arrow's management team (including external board members) was expected to invest approximately 6 million SEK in a sweet equity program giving them an ownership share of approximately 10 % (i.e. 10 % of the ordinary equity). Bay Lake expected to have in IRR of >25 % (cf. with their average IRR of >70 %) and CGM of >2.5 times at the outset of the investment. The acquisition was in line with Bay Lake's investment criteria since Arrow was the following: (i) a Nordic firm with a long tradition in its niche, (ii) it had a market leading position in Europe, (iii) it delivered a positive cash flow, (iv) it was a leveraged buyout together with Arrow's management team, (v) the management team was thought to be capable and proven (even if the team was vastly diminished and the CEO as well as the Sales Director were exchanged within the first 6 months), (vi) Arrow's annual sales of were below 10 billion SEK, and (vii) Bay Lake was the lead investor. Furthermore, Bay Lake's investment rationale was motivated by the confidence of having the management team invest alongside Bay Lake (all but two management team members invested). This was positioned as an opportunity with significant upside potential and well defined downside risks as well as a financially unsinkable construction. Lastly, it was argued that Bay Lake had extensive previous industry experience and had partnered with a leading expert that was currently active in the industry. As a valuation reference in the memorandum, Bay Lake compared Arrow's transaction multiples with eight industry peers quoted on European stock exchanges; this comparison fortified the view that the acquisition price of Arrow was very favorable.

Table 6.4: Arrow's Transaction Multiples Compared With Eight Industry Peers

| | *EV/Sales 2005* | *EV/EBITDA 2005* |
|---|---|---|
| Average for the 8 quoted industry peers | 1.2 | 12.2 |
| Median for the 8 quoted industry peers | 1.2 | 9.2 |
| Arrow | 0.3 | 5.5 |

From an exit perspective, Bay Lake assumed what it called a conservative approach with regard to the financial value generation in the Arrow investment; it expected an EBITDA multiple contraction from the entry multiple of 5.5x to 4.5x at exit. Capital gains were expected to originate from EBITDA growth as well as repayment of senior debt and vendor notes. Dividends or recapitalizations were not expected. Given these assumptions, the shareholder value generation was expected to look as follows:

Table 6.5: Expected Share of Monetary Value Creation

| *Expected Share of Monetary Value Creation* | |
|---|---|
| EBITDA growth (value creation) | 47 % |
| Decrease in net debt (value creation) | 31 % |
| Multiple contraction (value reduction) | -22 % |

## Aim of Arrow's Value Creation and Intended Value Enhancement Plan

Three different sets of favorable conditions that affected Arrow were presented: external factors, internal factors, and favorable terms with the seller.

The global increase of Widget capacity was projected to be very low due to the economic conditions and the low profitability in Arrow's specific niche of the Widget industry. In fact, capacity increases were only projected in the Asian region whiles the rest of the world in general and in Europe in particular was thought to go in the opposite direction, creating a net reduction in capacity. Conversely, the Beta industry (i.e. Arrow's primary input factor) was expected to expand its capacity in certain regions, which would decelerate its price development. The demand of Widgets was expected to increase with a compounded annual volume growth rate for the upcoming four years of 4 % in combination with expected Widget price increases. Consequently, the external factors looked favorable for Arrow.

With regard to the internal factors, the positive consequences of the Goliath separation, the cost-reduction potential, and the favorable terms negotiated with the seller were presented. The separation from Goliath would give the opportunity of creating a customer-oriented organization that, according to Bay Lake, was unusual in the Widget industry. This would open the possibility of directly accessing customers, hence, bypassing the margin-consuming merchants, as well as approaching customers that Goliath had previously restricted. A separation from Goliath would also open up for consolidating the target geographies to markets closer to the Nordics since these markets generally offered higher prices and stronger margins due to lower logistic costs. Lastly, the separation would mean that Arrow could leverage and market more extensively and aggressively its two brands. Moreover, it was stressed that Arrow's management team had recently launched an extensive cost-reduction program and that the investment needs were moderate or low.

The terms with the seller was compounded of favorable financing of the acquisition with the seller's vender notes as well as an improved liquidity for Arrow due to better payment terms for Beta.

Bay Lake's view on their value generation or enhancement process neatly parallels the three value generation phases described in the value generation chapter: entry, enhance, and exit. These were explicitly communicated at the outset of the acquisition. The major characteristics of the pre-acquisition period or the entry phase were that it was a limited auction (which it was not in fact) that Arrow's management supported, that Bay Lake was well positioned in relation to the transaction type and its inherent characteristics, that Arrow's management team was experienced as well as competent, and that an industry expert invested alongside Bay Lake. The last phase (i.e. the process of exiting the investment) were also carefully defined by naming a set of industrial and financial actors that had large potential synergies with Arrow and were, therefore, suitable exit alternatives. Some of them actually participated in the initial bid process of Arrow.

The middle phase, that is the post-acquisition period or *enhancement phase*, was more industrially oriented. Primary focus areas included the development of the leading European niche position, improving the margins by consolidating the geographical focus, continuing with the organic growth, and quickly repaying the senior debt and vendor notes with Arrow's internally generated cash flow. While the former areas could be seen as a means rather than an end, the quantitative goals of Arrow could be categorized according to the three value creation components elaborated upon in the value generation chapter. The overriding operational efficiency goal was to increase the EBITDA margin with >45 %. The strategic positioning goal was to organically strengthen the topline with 2.5 % annually over the investment period (Arrow's management team's forecast was 5 %). Lastly, the financial efficiency goal was to quickly repay the acquisition debt and vendor notes with the internally generated cash flow. Bay Lake also emphasized that its overriding goal for Arrow's performance was comfortably below the more aggressive goals set by the management team at the outset of the negotiations (see the last part of this section).

The means or the key elements in the value enhancement plan to fulfill the aforementioned goals could be subsequently clustered into four segments:

First, the *general* emphasis was on Arrow's transformation from being a corporate production and supply center within the large Goliath group to becoming an independent customer-focused autonomous firm. In parallel, the customer/market and business-orientation would be accentuated and, as leading European Widget producer within its niche, confidence would be established. This new orientation and focus would also be supported by a strengthened and more innovative product development capability.

Second, a new sales organization would be built around a set of newly recruited key competencies and direct contacts. Relations with new sales channels and direct customers would be also established. The sales force and, subsequently, the production capability would also be driven by contribution per order rather than volume or sales. More importantly, a yield perspective would be introduced where contribution per production-hour rather than volume would govern the incentives for the sales force and subsequently the whole firm.

Third, the primary profitability drivers were projected as being four-fold; it was paramount to establish a business plan with targets focused on sales and cost leadership. The geographical consolidation was aimed at finding markets with the highest possible contribution in order to ensure the EBITDA margin growth. Moreover, the procurement department that had been much entangled with Goliath's corporate procurement function was to become more goal and commercially-oriented. Lastly, optimizing Beta and currency flows would decrease Arrow's cyclicality.

Fourth and finally, applying a lean approach to the balance sheet and capital expenditures would generally lead to an increase in cash flow; the excess from this approach would be used to rapidly decrease the senior acquisition debt and the vendor notes.

Given the large set of aforementioned activities, a projected increase of the EBITDA and downward development of the net debt was expected. Of the expected EBITDA growth of >45 % roughly one sixth was to come from strategic positioning: that is to say, revenue growth and the rest from efficiency gains (i.e. operational efficiency). The majority of efficiency gains were expected to come from reduced overhead and organizational changes that were mainly related to the separation from Goliath; however, no gross margin improvements were expected or presented in the memorandum. Moreover, Bay Lake expected that the net debt would decrease by 515 million SEK over the expected 4-year investment horizon. In discussing the EBITDA and net debt development, it should be underlined that a back-of-the-envelope calculation for which Bay Lake and other buyout firms usually apply actually appreciate the value of a firm: multiple* EBITDA – net debt (cf. the formula on page 23). Hence, both the EBITDA level and the net debt are important parameters. When summarizing the essence of Bay Lake's and subsequently the board's assumptions and beliefs it could be elucidated as follows:

Figure 6.2: Bay Lake's Assumptions and Beliefs

| | SITUATION |
|---|---|
| Facts (or fairly certain points) | Current price levels on Widgets are low in a historic perspective.<br>European demand is slowly recovering from a decline; however, there still is overcapacity in production.<br>Price levels on Widgets are expected to improve slightly as European demand increases.<br>It is very unlikely that price levels of late 90s will be achieved.<br>Arrow is a small-specialized manufacturer. |

| | REVENUES | COSTS |
|---|---|---|
| What Bay Lake believes in | Demand in Europe will (continue to) increase faster than capacity.<br>Merchants will not capture a larger increase in price share than it had in the past.<br>Arrow can grow volumes in Europe as an independent player.<br>No major competitive disadvantage of being a small niche player.<br>Arrow's product portfolio is competitive and has an edge over competitor products. | Raw material costs will develop in Arrow's favor.<br>Beta prices will decrease in the mid to long term.<br>Other raw material prices will remain constant or will decline.<br>Exchange rate effects will not worsen the situation.<br>Other costs will remain at current level or will decrease (e.g. IT and logistics).<br>A stand-alone sales force can operate roughly in line with current commission paid to Goliath. |

In addition to the aforementioned value enhancement activities, Bay Lake mentioned numerous factors that were included in the memorandum, however, not in the financial calculations. These included making the organization even leaner and less expensive than in the initial forecast, reducing maintenance department personnel or outsourcing it off the balance sheet and making a substantial off the balance sheet energy investment that would lead to yearly savings of 30 to 66 million SEK.[56]

[56] By off the balance sheet, it is meant that the value of the asset (that is to say, an energy investment or a refinement machine) is located on someone else's balance sheet, such as a leasing firm. The implication of this is that, while the assets of the firm (i.e. Arrow) decrease, so does the need for financing (i.e.

## Bay Lake's View on the Primary Risks and its Proposed Mitigants

Numerous large potential risks with the Arrow investment were identified at the outset. Arrow was a "supply unit" with limited customer contact in the Goliath group. Hence, the challenge was to establish an independent and commercially skilled firm with a strong customer focus. The primary action(s) for mitigating the risk of being unsuccessful in transforming Arrow to a market oriented and autonomous firm was to capitalize on the excitement and devotion of Arrow's management team, who had a relatively substantial ownership in Arrow. In fact, most of them took loans to acquire their shares that were subsidized by Bay Lake's bank contacts. One Bay Lake partner expressed it as follows:

> "It's all about forming a management team that feels: damn it's up to us!"

Another Bay Lake partner summed it up in this way:

> "It can really go to hell if we have a weak management team and the board will start govern the firm!"

The management had planned for the separation for more than six months and, hence, had invested a lot of time, energy, and pride into this. Bay Lake had complemented its competence and devotion by bringing on the aforementioned industry expert. The generous bridging agreements from Goliath to facilitate a smooth separation process were also perceived as an important risk-mitigating factor.

Merchants were the most important customer group for Arrow. They were thought to represent 65 % of sales at the outset of the investment; however, it was later realized to be approximately 90 % on the markets upon which they wanted to focus. Therefore, a risk was that a relatively small independent firm such as Arrow could be shut out since

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the right-hand side of the balance sheet), which consequently sets free the same amount of cash flow. This can be used for debt repayments.

merchants strive to limit their suppliers. This risk of being shut out from important merchants was mitigated by Bay Lake who had established early contacts with the two most important merchants that represented approximately 40 % of Arrow's European sales; this was done to ensure that these merchants had sincere intentions to continue the relationship. Both merchants indicated early on that Arrow was an important supplier with unique products, which they prioritized.

Given the fact that the Widget prices had fallen with 25 % since the beginning of the millennium, a large risk was a further negative Widget price development. Widget prices were expected to recover after the slight improvement in 2005, and the large opportunity could be found in margin expansion by refocusing Arrow's sales activities to markets that were adjacent to Nordic Europe.

In light of the fact that Beta is by far Arrow's largest direct cost, a negative Beta price development was one of the largest risks. Bay Lake forecasted that the price on Beta would decrease in the medium to long term since Beta capacity was increased in some parts of the world. In fact, this trend could already be seen on the derivatives market. Due to this, Bay Lake requested a Beta subsidy when the negotiations with Goliath had stranded to bridge the period from the acquisition point to the point in time when they expected the Beta price would start its downward journey. The length of the requested Beta subsidize (i.e. 9 months) could also indicate the amount of time that Bay Lake expected it would take to adapt or re-orient Arrow (cf. the badwill dissolvement). Furthermore, as a single entity, Arrow was expected to be a strong purchaser with large purchasing power on the spot markets for both Beta and other raw materials. Bay Lake had planned for Arrow to implement a new financial policy that would include currency hedging since the currency exposure of Arrow was intense due to the fact that its export sales represented 93 % of the revenues and that many raw materials were purchased in currencies other than SEK. The last major risk (i.e. the one of increased Widget capacity in the market) was de-emphasized since no new capacity had been announced in the market; this is common practice, as several large Widget groups announced capacity reductions.

Bay Lake assumed that it had a good overview of the primary risks for the Arrow investments and felt comfortable with the situation and the proposed mitigants. Several of the risks included macro factors that were somewhat uncontrollable to Arrow (cf. the aforementioned financial term *beta*); the forecast were that many, if not all, were headed in the right direction. Thus, primary emphasis was directed to the changeover from a cost and production orientation to a market/customer and profitability orientation.

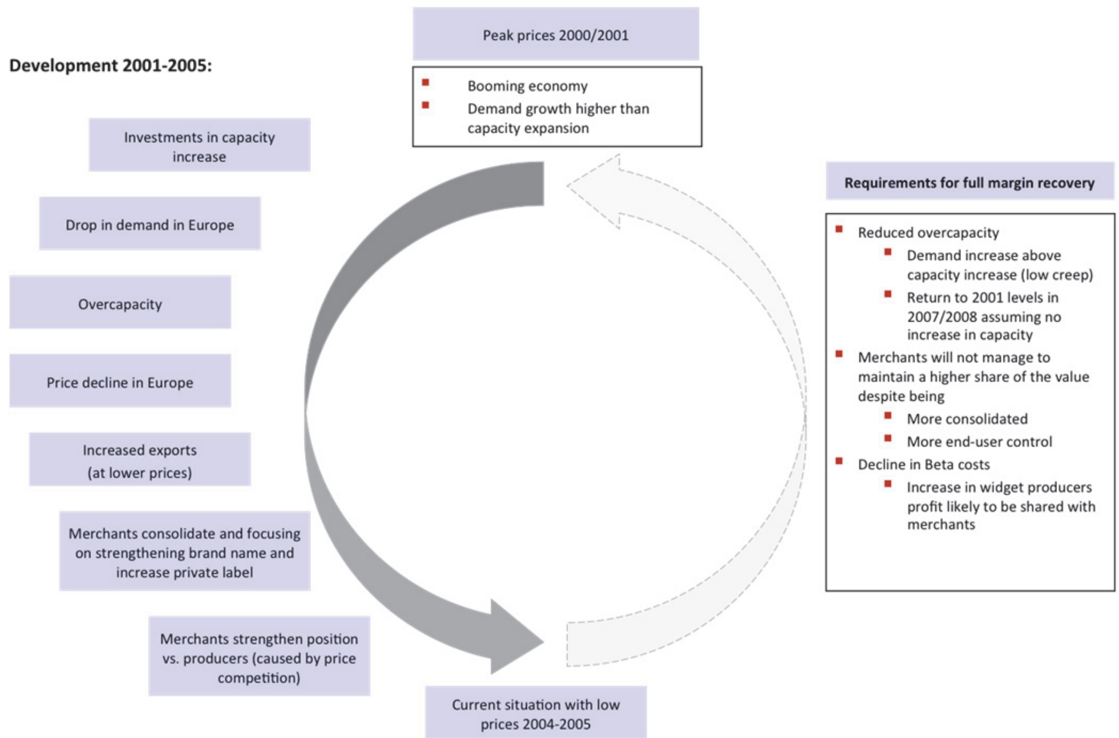
## Bay Lake's Initial View on the Industry and Arrow's Position

As aforementioned, Arrow is a European market leader with a market share of approximately 15 % of its arguably well-defined market niche. This specific niche is compounded of six much delimitated sub-niches within which Arrow is currently active in three of them. While the distribution channels are numerous, merchants play an important role in the European Widget industry since approximately 50 % of the distribution is channeled through them. Even though the strength of merchants has grown vastly over the last decades, shifting margins from the producers to the merchants, Arrow is more dependent upon them than the industry since more than 65 % of Arrow's sales go through merchants. Despite this, Bay Lake had an outspoken ambition to decrease sales through merchants in order to expand Arrow's margins.

Bay Lake assumed that three direct and two indirect growth drivers would lead the growth of Widgets. The first of the two primary ones was the European GDP growth that, in hindsight, developed in the opposite direction; the second saw a trend shift in Widget usage where Arrow's specific niche would grow at the expense of the Widget variants upon which Goliath focused. In fact, a Widget shift was forecasted where Europe would transcend to Widget consumption to be more in line with

Arrow's products while the rest of the world would transcend to a more generic Widget consumption that was more typically " Goliath". Moreover, Bay Lake had created a model indicating that the Widget demand essentially followed the growth of Uscados perfectly. Many renowned consulting firms and industry organizations expected to grow in excess of the strong European GDP, which was forecasted to be between 3-4 % per annum going forward. Looking at the historical figures, Arrow's niche had grown by 8 % annually until the downturn between 2000 and 2003. Consequently, several factors needed to be in place for a significant price recovery even if the market conditions peaked in 2000-2001 and growth as well as industry recovery were projected for the coming years. Even as the prices for Widgets in Arrow's niche had declined by 25 % since the peak in 2000, Bay Lake forecasted a slight recover in 2006-2007 and a sizeable increase in 2008.

Figure 6.3: Market Development 2001-2005



As indicated in the illustration above, certain conditions were required for the full margin recovery in the Widget industry. Interestingly, Bay Lake expected the majority of these conditions to develop in Arrow's favor.

## On Arrow's Strategic, Operational, and Financial Position

During the 10-year period prior to Bay Lake's acquisition, Arrow had invested more the 1.6 billion[57] SEK whereof approximately 20 % represents maintenance expenditures. Arrow's management team had planned to invest around 100 million SEK per annum during Bay Lake's ownership in order to increase the Widget capacity with approximately 15 %. Bay Lake was very explicit in its memorandum that all future capacity investments in Arrow would be compared to increases in production capacity through acquisitions. In fact, when matching Arrow's (capacity) investment proposal to the acquisition price per ton (acquisition price of Arrow/produced tons), it was concluded that it was more than 2.5 times more expensive to invest in production capacity than to acquire the same capacity.

When benchmarking Arrow's profit to its seven primary competitors, assuming the segment or niche belonging portrayed in the memorandum, only one competitor outperformed Arrow. The rest of the competitors were in line with or slightly below Arrow from an EBIT margin point of view. Excluding the best and worst competitors, all remaining five revolved around the zero mark.

As I previously mentioned, one of the primary drivers for expanding Arrow's margin was to reallocate its geographical focus closer to its home markets and, hence, increase its market share on the more lucrative European markets. Bay Lake forecasted that, through increased sales and marketing efforts, Arrow could strengthen its European sales with >19 %

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[57] Arrow invested more than SEK 500 million during one single year in the late 1990s.

between 2006 and 2008. In fact, Bay Lake depicted the exact expected increase on Arrow's six most important markets.

When it comes to Bay Lake's view on Arrow's primary strengths and weaknesses as well as opportunities and threats they were relatively explicit, as depicted in the following:

Figure 6.4: SWOT Analysis of Arrow

| STRENGTHS | WEAKNESSES |
|---|---|
| Significant market share in its European segments.<br>Main product (M-Widget) has a strong and widely known brand name.<br>Competitive advantage in Widgets with high density.<br>Efficient production and high production competence.<br>Low/moderate investment needs. | Lacking experience of being an autonomous firm.<br>Weak sales and marketing organization.<br>Limited prior direct contact with customers.<br>Weak purchase organization. |

| OPPORTUNITIES | THREATS |
|---|---|
| Create an efficient sales and marketing organization, which will build and prosper upon Arrow's already established position in the market.<br>Improve profitability analysis.<br>Improve margins by shifting sales from lower to higher margin markets/customers.<br>Price differentiation.<br>Address customers who do not buy from Goliath based on the separation from Goliath.<br>Improve purchases.<br>Cost cutting in production and maintenance. | Being "shut out" from large merchants due to Arrow's small size as an autonomous and independent firm.<br>Being squeezed between lower market prices on Widgets and increased Beta, energy, and other raw material costs. |

This traditional SWOT analysis was well interconnected with the intended value enhancement processes depicted earlier.

Arrow's sales development has shown volume growth for the past five years (i.e. 2001-2005), however, with substantially decreasing average revenue per ton. This decrease in average prices was an effect of a general price pressure and a change in Arrow's geographical mix from high-price regions (i.e. Europe) to low price regions (i.e. Asia). The prices recovered slightly during 2005 as an effect of changes in the geographical mix rather than an underlying price increase.

Even though Arrow's gross profit development had decreased by 25 % during 2001-2005 due to both the geographical mix as well as the price decline in Europe and North America, their focus on decreasing costs had offset this development to some extent.

In terms of the largest cost components – Beta and (other) operational costs – the former was expected to increase with up to 10 % during 2006 and a comparable decrease in 2007 due to global capacity increases. Having this Beta price development in mind as well as the Beta subsidy that Bay Lake negotiated with Goliath, the board put forth their wish on numerous occasions that a global Beta price increase would be beneficial to Arrow since this might extinct some of their competitors during the 9-month period in which Arrow's Beta consumption was subsidized (and often labeled as the window-of-opportunity). Meanwhile, the (other) operational costs had been flat despite increasing volumes due to Arrow's creativity and ingenuity when it comes to absorbing costs. The steep increases in other raw materials than Beta had partly been offset by rationalizations in raw material and energy consumption. The fixed costs had further decreased per ton due to increased plant efficiency.

## The Diverging Outlooks on Arrow's Future Financial Performance

The memorandum included several extensive calculations on the potential value capturing and value creating outcomes that the Arrow investment could undertake. While the whole memorandum was built upon the assumptions that Bay Lake had of the investment the memorandum included an appendix describing two different financial executive summaries: one Management Case and one Bay Lake Base Case. The outcomes between Arrow's management team's projections (i.e. the management case) and Bay Lake's base case deviated extensively. The following table indicates some of the different assumptions between the two actors:

Table 6.6: Assumptions of the Management Case and the Bay Lake Base Case

| | Management Case | Bay Lake Base Case |
|---|---|---|
| Profit and loss (CAGR 2005-2009) | | |
| Total revenue | 5.7 % | 2.5 % |
| EBITDA | 33.3 % | 12.8 % |
| Cash flow (CAGR 2005-2009) | | |
| Cash flow from operations | 18.7 % | 4.0 % |
| Free cash flow | 13.5 % | (8.7) % |
| Ratios (CAGR 2005-2009) | | |
| Net debt / EBITDA | (1.5)x | (0.2)x |
| Cash conversation ratio (FCF/EBITDA) | 63.1 % | 54.1 % |

In summary, it could be seen that Arrow's management team's ambitions or projections are more aggressive than Bay Lake's ditto. Whether this is due to the management team's insider information or just to the fact that the management team wanted to dress-the-bride so that Bay Lake would buy them is up for debate. Another explanation could be that Bay Lake wanted to lower the expectations toward their investors (i.e. the Limited Partners or LPs).

## Analytical Summary: The Embodiment of the Board's Mutual Perception or Belief Agreement

As aforementioned, the investment memorandum came to constitute the mutually held view that Bay Lake had an investment opportunity in Arrow: a notion that matured during the six months the partners at Bay Lake spent on scrutinizing Arrow and compounding the memorandum. Thus, it conveyed and accentuated the facts, ideas, and projections that Bay Lake held as believable or desirable and blinded what was assumed to be irrelevant, unlikely, or less beneficial to portray in an investment proposal. Whether these augmentations and diminutions were intentional, unintentional or a mix in-between will not be commented upon here. In some sense, the investment memorandum affected/established both the boundaries of the decision terrain as well as the navigation heuristics for those individuals who not only came in contact with the memorandum, but who were also utilizing it as a foundation for deciding whether or not to invest in Arrow and become actively involved in its upcoming journey.

The memorandum consequently portrayed numerous facts and assumptions; some more than others will have larger implications on this study. These will be portrayed in the following paragraphs.

Arrow is assumed to be a highly focused niche actor with a market share of approximately 15 % and has outlived numerous economic downturns and recessions. While the statement is interesting, the assumed characteristics are even more interesting. Seeing as Arrow has survived so many economic downturns, it must not only have an inherent strength for survival and change proneness; it must also be due to its niche position and large market share, which also possesses the ability to set or at least affect the market price of its products.

Moreover, the memorandum also indicated several of Arrow's strengths - including its solid and proven management team (which quickly was reduced by 50 % and two of its most important members were exchanged) and the financial construction with vendor notes, which made it an unsinkable construction; it also disregarded those factors that did not fit Bay Lakes investment criteria. Moreover, it posed numerous assumptions on the internal and external development, as well as the activities that would be deployed after a potential acquisition; these include more or less all value creating mechanisms elaborated upon in the value generation chapter. Issues that can be accentuated are the owner's wish to bypass the merchants and establish a direct contact with the end-customers, leverage on its strong brand, and change the contribution view. While the expected gross margin and revenue growth were depicted as being marginal or absent, the improvements in the operational efficiency – that is to say, the costs - were large in comparison to the theory of value generation. Moreover, all external factors affecting Arrow and its projected trajectory indicated a favorable development; however, as we will see, in reference to one of the Bay Lake's partners: "Almost all uncontrollable factors have gone in the wrong direction."

Lastly, as aforementioned, Arrow was depicted as an actor with a significant market share in its core market. In fact, Arrow, with a focused product-strategy compared to its competitors, was depicted as the second largest player within its specific niche, yet was considered a small player in the overall Widget industry. While the board's perception of the delimitation between the different segments or niches was very explicit and unambiguous in the memorandum, the delimitation's ambiguities grew over time. This lead to a conflicting perception of Arrow's market share in the sense that, while the board perceived Arrow as a market leader and a price setter, the management team perceived themselves to be a small actor who had to take the market price as given.

The sole purpose has been to depict the agreed/negotiated outlook on Arrow; however, as aforementioned, the effects will permeate subsequent sections. Hence, we will see how the investment became a mental iron cage of sorts that both defined the boundaries of the decision possibilities as well as the plausible actions. We will also see how the management team in general and the CEO(s) in particular spent months, if not years, trying to break free from the memorandums' explicit and sometimes premature preconceptions. This process further affected the relationship between the Chair and the CEO to such an extent that the relationship deteriorated rapidly.

## Exploring the Development and Consequences of the Conversational Processes

Bearing in mind the board's mutual outlook (that is to say, the former sub-chapter) and Arrow's viability as an investment opportunity (the sub-chapter prior to that) the remainder of this empirical chapter will illustrate and elaborate upon the conversational processes that took place during this study. Three chronologically structured arenas of conversational processes will guide the reader through the journey of thoughts, discussions, interpretations, and actions during Arrow's strategic change. We will follow the thoughts, discussions, interpretations, and actions of the board, management team, and CEO starting two weeks prior to the actual acquisition and going two years onward. Since these conversational processes affect, and are affected by, each other, it is of utmost importance to understand the chronology of what happens, when it happens, why it happens, and by whom.

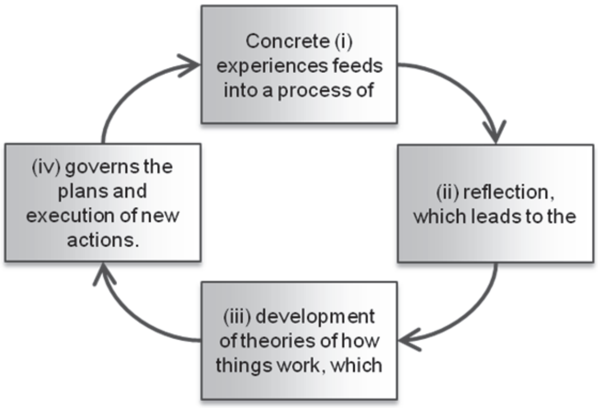
The first arena represents the discussions that took place during the management meetings and other contexts or settings where the management team, including the CEO, interact. As we will see, the management team changes both in size, composition, and fundamental beliefs during this time period. These meetings took place weekly or bi-weekly, and the context for these meetings will be referred to as *the management arena*. Hence, this arena is where the thoughts, reflections, and actions of the management team develop through a conversational process.

The second arena resembles the first with the primary difference being that it is on the board level rather than the management ditto. This conversational process develops during the board meetings between the board members (i.e. the owners as board representatives and the external board members), the union representatives, as well as the CEO and the CFO. Hence, the process of contrasting the thoughts and intentions of the board and CEO is at play here. The twelve consecutive board meetings included in this study took place approximately bi-monthly or quarterly during the first two years after Bay Lake acquired Arrow.

In contrast to the two former arenas, which are actually conversation, interpretation, and/or power-based, the third one concerns the CEO's reflections, standpoints, and uncertainty minimization. The CEO continuously interacted with actors other than the board and management team to seek guidance and support; he also sat down with me on a regular basis to give an account for his reflections of the past, present, and future of the company. Hence, instead of being a process of *interpretative dominance* and *temporal dynamics* on a group level, this is about his individual interpretations (cf. interpretative dominance or sensemaking) and how these change over time (cf. temporal dynamics). Furthermore, he was the CEO, the board participator, and the primary (overt) intermediary between the board and the management team (while the industry expert will be the covert ditto). This arena will be referred to as the *CEO perspective*.

The ambition is to make sense of how ideas, interpretations, and thoughts develop into taken-for-grantedness and actions as well as back into ideas, interpretations, and thoughts (cf. Kolb's learning loop) during the entry and enhancement period (cf. value generation chapter). Therefore, I must elucidate and describe the chronological course of events.

Figure 6.5: Kolb et al.'s (1991) Learning Cycle




This will force the reader to jump in and out of arenas to follow the order of the meetings, so as to follow the development paths and effects. In order to simplify things, the arena at play will be clearly indicated in the heading: management arena, board arena, or CEO perspective.

## The CEO Perspective: Is this Even Achievable?

I spent numerous weeks during this study at Arrow's headquarters, which is situated in the Northern parts of Sweden. In order to strengthen my encounter with the cultural and geographical dimension, I stayed at a hostel situated in close proximity of Arrow's headquarters[58]. With the exception of my discussions with the owner in Stockholm and the CEO over the phone, my first indirect encounter with Arrow was on the evening before I arrived at Arrow's headquarter for the very first time. I spent the evening at the hostel discussing Arrow with the other residents with-

[58] Since the hostel did not supply an Internet connection and I was entrusted with an office access card to Arrow's headquarters, I often spent late evenings going over my data at Arrow's office and then just walked back to the hostel.

out revealing my connection to the company. My strongest memory from these discussions was the answer to my question whether anyone of them worked at Arrow:

> "Of course we don't work at Arrow; jobs are inherited there."

When I arrived at Arrow's headquarters the following morning, there was a cheerful atmosphere in the office. The CEO introduced me to a large variety of co-workers and employees. While over the phone with the owner, he had used the word *strategic change;* he introduced me to his staff as a researcher who will study Arrow's *change-over* (Sv. "omställningsarbete") - and not its strategic change. Throughout this day, which also was one of the first days after it had been agreed that Bay Lake was going to acquire Arrow, the CEO had numerous meetings with various stakeholders. The CEO's tone was very secretive throughout the day, which seemed to be a manifestation of the fact that he did not want to worry his co-workers and employees about the fact that a lot of activities and changes would come about within the near future.

## Meeting with the New Bank: Minimizing Your Personal Risks by Taking Hostages

One of the first meetings during that day was when the CEO and CFO met with the new "house bank" to discuss currency hedging. The CEO explained to the bank that Goliath had supplied Arrow with a lot of corporate services, such as currency hedging (hedging is totally new to them); this was a responsibility that Arrow was obliged fulfill itself from that point on. After he had given to the bank a presentation on Arrow and its operations, he said:

> "It is fundamental that we earn money on our financial activities since our operational challenges are too tough."

The CEO explained that Arrow is very currency sensitive and that a good hedging agreement could be the difference between Arrow's success and default. He continued to explain that Bay Lake expected Arrow to enter long-term currency agreements (Bay Lake has, in fact, a non-formalized habit of red fencing, thus, locking everything that is unaffectable so its management team will focus upon what it does best: i.e. operations); it is of fundamental importance that Bay Lake is involved and accepts all decisions due to their financial expertise:

> "…so that we can hold Bay Lake hostages for any bad decisions."

Shortly after this meeting is concluded, the CEO brings his Sales Director to a new meeting with a headhunter focusing on the Widget industry.

## Meeting The Headhunter: Do I Believe in Our Future?

The CEO explained to the headhunter that they need to recruit Sales Managers to several European clusters; the headhunter had actually been a HR Director at Goliath several years prio. He continues to position Arrow's Sales Director of as the one handling the day-to-day activities while their new Sales Consultant builds the new sales organization (the Sales Consultant was previously referred to as the industry expert in the investment memorandum). The CEO continues to inform the headhunter that Arrow's performance was much worse now than when Bay Lake decided to acquire the company. He continues to explain that he worked at Arrow for many years and that he has been able to decrease the costs with 5-6 % during the millennium, however, the cost-pressure continues to be enormous. He says this, among other factors, will lead to the total reduction of 78 full-time equivalents (FTE) or 8 %.

Arrow's perhaps paramount short-term objective is to have an in-house sales organization up and running within five to eight months after closing (the closing will take place within two weeks if everything goes as planned): Otherwise, the CEO says they will not survive. Only weeks after the letter-of-intent (LOI) was signed between Goliath and Bay Lake, Goliath's Director who was responsible for Arrow visited the headquarters and said:

> "Wow, this is a really nice Widget site; I really should have come here earlier!"

The CEO continues to explain that the reason for choosing to be acquired by Bay Lake (did they really choose?) was that they seemed to have the strongest long-term engagement/commitment of all the (private equity) firms that placed a bid. He adds that the first time he had heard about Bay Lake was from the Sales Consultant and their new bank.

The CEO continued: "Moving back to our requirements on the Sales Managers we are looking to recruit, I believe it is important that they have a strong track record and vast experience from the Widget industry since everything must be up and running instantly. And the fact that my Sales Director and I will be exchanged someday ought to be a strong career incentive. I have to admit that my ambition was to handle these recruitments myself, but I realized quickly that this will be too time consuming and hard. Lastly, I have to argue that it is vital that we keep a good relationship (with) Goliath, which is why I am reluctant to recruit from them."

The CEO continues to present Arrow including their chief competitors as well as the company's primary strengths and weaknesses. He continued: "Our new primary focus areas will be to build the new sales organization, increase our income base, reallocate sales to Europe, access some markets that formerly were restricted to us by Goliath, and increase the number of produced tons to 310,000. Another thing that we might have to address is the fact that a very small fraction of our products are sold under our own brand."

Before this meeting is concluded the CEO explains to the Sales Director and the headhunter that he is concerned his co-workers in general and management team in particular are so calm regarding the sales organization: "This is, in fact, the most important thing to me. However, I am very pleased that Bay Lake does not meddle in any production issues, thus, letting us do what we do best. I am also very pleased that I have such a good and docile secretary. The one I inherited from my predecessor focused solely on strategic plans instead of transcribing my notes. I need someone reactive rather than proactive." The CEO also whispers to the participants that, by privately investing (i.e. buying stock) in energy firms, he is hedging his own job if something should go wrong.

The CEO very quietly explained during the lunch that followed this meeting to the six other management team members who participated that he must assume control of market and sales from the Sales Director.

## Meeting a Friend: Seeking Advice and Comfort

The CEO spent his afternoon meeting with a good friend who would support him in addressing the question of how a good sales organization could be built. The friend, who is also the CEO of a similar firm, not only has experience from setting up sales organizations in Europe; he is also an acquaintance of one of Bay Lake's senior partners (Arrow's Chair). Arrow's CEO explains to his friend that Bay Lake is opportunistic and that it has a genuine belief in the forecast that the Widget industry will turnaround in 2008. He continues to explain that Goliath never should have sold Arrow, but should have developed a strategy fit for Arrow's niche instead of trying to fit all Widget producers in one generic corporate volume strategy: "Goliath should also have developed a unique pricing strategy for us."

The CEO continues to explain that he is convinced that Bay Lake will build a small Widget group of highly focused niche actors (cf. the buy'n'build strategy in the value generation chapter). He also stressed his conviction that the market is unwilling to pay extra for quality (no benefit from being niched) "but that we still have to substitute our volume focus to a price focus. We must, furthermore, understand what the implications are from the increasing merchant strength." This is a contradictory view to that of Bay Lake. The two CEOs have a long discussion on how the products should be positioned and how one quickly and vigorously could set up the sales organization. However, the friend strongly emphasizes that Arrow's CEO should start of the work by formulating a sales and marketing plan, so that the governance is not blindfolded.

## Analytical Summary: Finding Your Place in the New Context

### How Cohesiveness is Kept

The arena starts off by indicating the communal association and, subsequently, the assumed cohesiveness of the people who work at Arrow. This assumed cohesiveness also probably fortifies and harmonizes the assumptions and beliefs of the co-workers and strengthens the idiosyncrasy of the language, which could also move the CEO to use such words as change-over rather than strategic change: this in an attempt to avoid upsetting the organization and the community.

### We are Implementers and not Formulators…

The CEO spent a vast amount time during the initial days interacting with several stakeholders (both private ones and those connected to the firm) to seek advice on how one should act towards a private equity firm and how its general modus operandi should look. One reason for this is to minimize his uncertainty and form a view of what he could expect from the journey ahead of him. Throughout this interaction, he positions Arrow and its operational chance of success as being weak and says that he wants Bay Lake to be involved in all decisions. While there might be numerous reasons for this (including creating an alibi if the decisions prove wrong and a way to lower the expectations within the organization), a more interesting explanation is that Arrow and its CEO (as well as the management team) is used to focusing upon implementation and not formation (i.e. both formulation and implementation). Those involved are accustomed to having others make the decisions for them.

## I'm a Cost-Cutter Who Accomplishes My Work With Heavy Interference

The CEO positions himself to the external people with whom he interacts as being an individual who primarily focuses upon internal issues in general and costs in particular. When he presents the measures he has taken to increase the competitiveness of firm, all of which are below the gross margin on the firm's profit and loss statement, he implicitly positions cost decreases/efficiency as the firm's most important means to stay competitive.

He also expresses the vastly increased workload and the fact that his interaction with the principals has transcended from very seldom (bimonthly) under Goliath's ownership to being daily under Bay Lake's ditto. Thus, in accordance with the value generation chapter, the private equity actor vastly diminishes the distance between the board and the CEO. He also reflects his view and concerns that no one but himself is worried about the firm's current negative development and that the establishment of one of its most important goals – deploying a sales organization – is progressing too slowly. He simultaneously presents his view that he needs to assume more control of the sales organization deployment, probably since by the board perceives this to be important. Hence, by assuming control of this activity, he strengthens his interpretive dominance of the firm's development. He also expresses his concerns that the owner believes Arrow's brand to be stronger than it actually is since a lot is sold as a white/private label: a fact of which the board was currently unaware. The CEO is reluctant to be tough toward his former employer, Goliath: something that will later prove to be difficult in his contact with his current owner, Bay Lake.

## Sales Consultant Seems to Persuade Both Parties

Lastly, he explains that the division of labor between the Sales Director and the Sales Consultant is that the latter will assume the more long-term strategic role with focus on deploying the owner's ideas (including establishing a sales organization) while the former will handle the day-today business. He also portrays the Sales Consultant as the one presenting Bay Lake for the first time. Thus, the Sales Consultant seems to be the one affecting both sides of the investment.

## The Management Arena: Shift in Power Structures

The following day is carefully planned to include one separation-oriented meeting and two management meetings.

### The Separation Team Meeting: The Urge of Accomplishment

The separation-oriented meeting constitutes of a small group of management team members and other key employees focusing upon issues that pertain to the separation from Goliath under the parole: The To-Do Team. The team focuses on issues such as the closing process, currency positions, firm name, legal interaction, product calculations, insurances, homepage, bonuses, and brand names. In fact, the list of outstanding issues concerning the separation from Goliath includes more than 100 bullets set up in a GANT schema ranging from business card layout to collecting the 70 million SEK of outstanding cash from Goliath. The participants are very detail-oriented and thorough with the 100-point list, while their technocratic engineer culture becomes apparent through their careful and accurate treatment of every outstanding issue in a very calculative and rational way, as they seldom or never discuss the larger picture or the interrelation between activities. There is a strong follow-up tradition and a collective urge to tick off the activities on the list.

## Loosing Short-Term Power While Gaining In-Group Interpretive Dominance

Although the CEO informs the other participants that he will subsume from the CFO the responsibility of the firm's currency positions, it becomes obvious that the CFO's position and power has vastly strengthened due to her superior understanding of Bay Lake's (financial) language arsenal, their interests, and how they evaluate Arrow's performance (this conflicts with Arrow's language). This language and interest is also beginning to permeate Arrow's internal meetings, if only marginally.

## Shifting the Power Balance

The CEO also informs the other participants that the new Chairman of the board (hereafter referred to as Chair) is exceptionally detail-oriented and is interfering in very small issues. The Chair's large interest in branding and other non-technical issues has also strengthened the position and, hence, the time devoted to softer non-technical discussions.

The participants express their reluctance throughout the meeting to the Chair's decision to split the current very production-oriented management team into two management teams: one that is financially-focused and one with an explicit production-orientation. Instead, they emphasize the strong need for collaboration in times such as these when everything that they have come to know as normal will be probably turned on its head.

After penetrating all bullets in the GANT-schema, the CEO concludes the meeting by expressing his disappointment when it comes to governance and work instructions between him and the board. He continues to say: "I need a strong and explicit governance model and CEO instructions from the board, so I understand what they request from me and how large actually is my autonomy." In fact:

> "…They are currently meddling in everything I do."

## First Management Meeting With New Financially-Oriented Team

The CEO starts off this inauguration meeting by explaining that, from now on, they will try this new management team composition. He continues to say: "I have separated the management team into two groups, one technical or production-oriented with exclusively production people and one (who is) financially-oriented."

The CEO presents the top three bullets and the only non-formal ones on the agenda including the following: (i) goal follow-up in production terms, (ii) investments, and (iii) problem issues. The goal follow-up was purely internal; investments are seen as the mean of survival; and problems, rather than opportunities, are discussed. He says: "While these monthly meetings will take place on the same day, we will always start off with the financial management team and continue with the production team after lunch. We have six preparation committees to the management team including the following:"

Table 6.7: Preparation Committees

| *Preparation Committees* |
|---|
| IS/IT |
| Quality |
| Competence |
| Production management |
| Development |
| Marketing |

While the participants discussed the purpose and objective of the preparation committees, it became more and more obvious that the attitude was shifting. In some sense, the management culture started to transcend from modus operandi driven to outcome driven. In other words, rather than exclusively discussing how things were supposed to be done; they started to talk about its implications, hence, an input focus had become an outcome focus.

The meeting continued by with CEO and CFO explaining the remaining steps of closing the deal between Bay Lake and Goliath, in terms of numerous agreements. While several of the participants asked the CEO and CFO where all agreements would be stored, the CEO repeatedly stressed how good it had been that Bay Lake acquired the company, but that Goliath were much too soft in its negotiations with Bay Lake, especially concerning the Beta subsidy. One of the participants, with support from the rest, once again raised the question of agreements; they agreed that the management team would be gathered and presented with all the agreements (in fact, it seems as though they were demanding more control now that they are going to be shareholders). Another participant continues:

> "Bay Lake is really bad at explaining the agreements."

The CEO informs the participants that the Bay Lake team would arrive at Arrow's headquarters a week before the closing/signing, and this concludes this part of the meeting. He continues to hand out assignments that should be accomplished and presented to Bay Lake when they arrive on March 23rd. Several participants request that someone more than just the CEO participate at the signing ceremonial. While this makes the CEO somewhat annoyed, he ends the discussion by saying that he is very reluctant to invest the amount of money that he is expected in Arrow since he really needs the money for other purposes (interesting message to send to your co-workers and potential partners).

## Being Reluctant to Change and Projecting all Problems on the New Owner

After a short break, the Sales Consultant initiates the meeting by arguing: "we have to become more creative and try other Beta suppliers and Beta variants." This statement is met with silence and several participants were feeling noticeably provoked. The sentiment was that this is impossible. According to one of the participants: "We have used the same Beta from the same supplier for decades and we have adjusted our production capability and product portfolio to this kind of Beta."

In order to keep the good spirit of the meeting, the CEO tries to redirect the participants' attentions to Bay Lake's flaws. He continues: "Bay Lake is not very involved (Sv. "insatta") in our business. They are very ambiguous, both when they ask questions and when I ask them questions." He adds:

> "Evenings are your best friend."

The CEO concludes this discussion by informing the rest of the management team in confidence that he, on several occasions and without success, has tried to convince Bay Lake to include another board member with whom he has a personal relationship.

## Future Planning and Defining What Should Be Done

The Sales Consultant informs the rest of the participants that he and the Sales Director are currently formulating a sales plan. The primary activities in this plan include:

Table 6.8 : Primary Ambitions of the Sales Plan

| *Primary Ambitions of the Sales Plan:* |
|---|
| Reallocating quantities from overseas to Europe |
| Approaching customers that were earlier out of the permitted scope. |
| Increase focus on Eastern Europe and Russia |
| Establish a new sales organization. |

He explains that the new sales plan will be complete by July 1st: "Furthermore, the division of labor between the Sales Director and me will be according to a short versus a long-term perspective. I will handle the long-term view and building the sales organization, while the Sales Director will handle the day-to-day activities." The CEO adds that he needs to be more involved in the project since this actually is his responsibility (he assumes control of more and more activities). The Sales Consultant gently ignores the comment; he adds they are currently selling their Widgets below marginal costs on oversea markets:

> "We have no control of where we earn money. Product calculations must be our top priority right now!"

The sales consultant continues to say: "We have to start scrutinizing our logistics apparatus. If it is okay with you, I will assume responsibility for the logistics side." The management team unanimously agrees upon this (he knows where the board will focus next).

## The Current Performance and Problem Issues

The CFO shallowly presents the profit and loss statement for February and concludes that this is not an amusing reading even though the production levels are satisfactory. The financial discussion takes less than 5 minutes of the otherwise 85-minute meeting. She adds: "We must stop focusing on production and redirect our view to sales." While some participants agree with her, the rest of the discussion is purely directed to produced volumes and production costs.

This rather lengthy discussion is followed by talk of control, long-term planning, and the need for a business plan. The Sales Consultant, who is the motor of this conversation, argues that they need a business plan in order to survive. The CEO quickly terminates the discussion by stating that this is a future problem: "Now I have to make sure that we increase the control and structure of our work process. I will make sure that we have orderliness in our work."

Before the meeting ends, the Purchase Director addresses the question of how the management team should work going forward. While an explicit answer is not delivered, the management team agrees that separating the management team into two will be detrimental. One participant stresses that this will probably create two camps with different agendas, as well as weakened communication and interaction between the internal and external side. Another participant adds that they might experience a decoupling between the production and financial side. While the CEO agrees, he argues that this is not his decision, but rather the decision of the Chair.

## The First Management Meeting With New Production-Oriented Team

The production-oriented management team meet directly following the financial management meeting. The meeting was characterized by cost saving, loss of authority, and a very strong consensus spirit; it started off with a key employee being invited into the meeting to present the 80 potential saving areas that the production capability had identified. While these are scrutinized *in extension,* the team is very finicky that everything they have already accomplished should be taken to the protocol. The CEO then explains to the participants that this management team split was the Chair's decision and not his. However, as this only is a test period, the teams could be merged at any time.

The CEO continues to explain that the reason for this split is that the financial objectives of the new owner need to permeate the management team. He explains: “I will assume responsibility for sales and all sales related activities. I also want to remind you that you have the important decision to decide whether or not you want to buy stocks in Arrow. Remember: you are not obliged to buy stocks and you might lose everything if it goes wrong.” While no one responds directly to the CEO’s comment, several participants worry that the time horizon for the debt repayment is too short.

## Are We Really Playing On The Same Team?

After a short coffee break, the participants start to discuss Bay Lake’s liberal view on outsourcing. They seem rather worried about this, and primarily show their skepticism to the fact that Bay Lake has not communicated its standpoint on this issue and what operational functions it wants to address. In association with this discussion, the CEO adds that he wants everyone to present their presentations to him first before they do for Bay Lake on the 23rd of March, since he does not want to be held hostage for anything that they promise. He says: “They will ask you two questions: (i) What is your proposal and (ii) What are the consequences.” He also adds that he does not know what is expected from him since the governance structure is not settled. Furthermore, he says, the Chair is constantly harassing him with very detailed questions.

Another participant adds that it feels strange that Bay Lake tries to distance itself when it comes to operational issues. Although one of the Bay Lake partners has actually provided them with an excellent financial model that they can use in the operational and strategic governance of Arrow (a DuPont model), the CFO adds and receives support from other participants (the management team seems to greatly appreciate models interconnecting strategic actions with financial outcomes).

The discussion is concluded with the CEO saying that the business press is continuously writing about the capacity reduction in the Widget industry, which feels really detrimental.

## Should We Perhaps Start to Challenge Ourselves?

After another short break, the production team starts to discuss their two overriding concepts: goal fulfillment and total efficiency. Several participants think that they should increase the ambition of the production and cost objectives since they continuously meet or surpass them. While the majority of the participants agree, others seem bothered. One of the most senior participants adds: "Our employees always fulfill the objectives; hence, we must raise our ambitions and challenge ourselves." The CEO looks content and says:

> "And I will stop being a technician and start being a CEO of a customer-oriented firm!"

A mix of shock and delight can been seen in the participants' faces following the CEO's outburst. After the meeting, one of the participants said that this might actually mean that the autonomy of the production capability can be heightened.

The CEO asks all participants what are the major current problems, and concludes the meeting. Each and every participant has the same comment, namely that it is a very bad idea to split the management team into two. They argue that this will have negative effects on stock levels, variable and fixed cost savings and, most importantly, the feeling of losing the market perspective. One participant explained:

> "You feel that you're not in the boat anymore."

## Analytical Summary: Changing the Historical Modus Operandi

### Control is a Zero-Sum Game; Hence, I Need to Regain What I Have Lost.

Most activities within Arrow are directed internally and toward costs; this becomes apparent during the to-do team's session as well as during the first management team meeting. Activities such as revenues, margins or overall performance are absent in their discussions. The CEO has begun to assume more control over the sales development is now also stretching his control into the financial matters. In fact, there seems to be a correlation between the Chair becoming increasingly executive and the CEO's desire to widen his scope of control. In other words, when the CEO feels like he is losing autonomy and power to the Chair, he tries to regain it in other places such sales, marketing, and financials. Thus, it has become apparent that the one holding the insights and data on financial (and commercial) matters seems to hold a strong position on the management team and is perceived as valuable in the board's eyes.

### I Need to Control Issues The Board Finds Important

There is a power shift on the board when it comes to those who hold a financial and value generation view. The CEO tries to assume this position, while the CFO, who is quite new to Arrow, possesses a language arsenal that parallels that the board. This greatly strengthens her position (a race for assuming control over the matters the board perceives to be important is initiated). Although it is interesting that the financial discussion takes up approximately 5 of the 85 minutes in the meeting, its importance has yet to become apparent to the team members. Furthermore, it becomes increasingly apparent that the CEO is insecure of what the board expects from him and what are his responsibilities.

The CEO informs the former management team, which consists of 14 individuals, that they will be split into two teams: a production-oriented team and a financial-oriented one. The idea from the board's perspective is to establish a management team that is compounded to be able to best address the upcoming key value drivers (KVDs) in the investment memorandum and, hence, not any production-oriented activities. However, the focus is about to transcend from an input and output focus do an outcome ditto.

## Exploitation is a Normal Modus Operandi; Exploration Should be Circumvented if Possible

The new Sales Consultant reflects his view during one meeting that, in order to become competitive, the firm should explore new Beta variants in order to increase flexibility and decrease costs (hence, transcend from a pure exploitation modus operandi to an exploration ditto). The rest of the management team perceives his statement as ridiculous since it is impossible for Arrow to exploit Beta variants other than the one currently supplied by Goliath.

The CEO's perception that the board is not making any sense due to its lack of understating of Arrow's business logic is another interesting notion. Is there actually a lack of knowledge on the board and what are the effects of this? One of the Bay Lake partners actually expressed:

> "We learn as we go."

It will later on become more apparent that the board's questions in general and the Chair's in particular are unintentionally ambiguous since they utilize another language and are seemingly less bounded by the business logic within the Widget industry.

## Anticipating The Board's Focus and Adapting Responsibilities Accordingly

The Sales Consultant has assumed responsibility of the activities earlier defined as most important in the investment memorandum: building a sales strategy and a sales organization. He continues to assume control of other areas that will prove to be important from the board's perspective;

these include the logistics apparatus, which drive costs of approximately 400 million SEK per annum.

### Why Marginalize Our Possibilities To Survive?

The production-oriented management team meets their primary worry, which is the projected debt repayment projected by the board that will hamper the possibilities to invest; this is major concern since, from its perspective, investments are what differs the competitive Widget producers from the dead dittos. In fact, the team sees that many of their market peers or competitors close down production capacity as a threat to their possibility to invest instead of as seeing it as something that will probably improve the supply and demand balance in the market.

Furthermore, it is interesting to note that, while the CEO experiences an increased involvement from the board in general and the Chair in particular, the production-oriented management team feels that the board distances itself. We will see how this changes when the performance drops, and the interference from the board will never concern issues that it feels run smoothly – such as production – but only that which that they believe should be improved to create value: sales, marketing, logistics, costs, financial setup, and so on.

Lastly, we see that the team focuses upon problems rather than opportunities and that its own ownership affects the view on what they should be accomplishing. Hence, the team increases its ambitions in terms of production goals. In its former form as a group unit, it was important to never fail; thus, the goals were modest.

## The CEO Perspective: I Do Not Understand…

On the morning of the March 22nd (the day before Bay Lake comes to Arrow), the CEO, Sales Director, and Sales Consultant meet to discuss the sales organization and the recruitment status of the new Sales Managers. The CEO is informed by the other two that during the next week they will meet with the CEO and President of one of the largest and most successful Widget producers in the Nordics (although in another segment). The reason for this is two-fold: the CEO and President is both a friend of the Sales Consultant and, more importantly, they built a similar sales organization a few years ago. The Sales Director and Sales Consultant inform the CEO that they have a very good candidate in mind to assume sales responsibility for the Nordic countries. During the course of this meeting, it became obvious that the Sales Director and Sales Consultant had become really coordinated.

The Sales Consultant emphasizes that the product calculations at Arrow are extremely un-commercial. For example, waste in the production process, which varies with the product type being produced, is not included when zero prices are calculated (the employees and the management team have different definitions on contribution). He also repeats that Arrow is selling below cost on some markets overseas and that the internal control of logistic costs is close to non-existent.

The CEO interrupts the Sales Consultant and stresses that the process is moving in the right direction, but the progress is to slow. While the Sales Consultant denies this, he does argue that this is a board decision. He also adds that they need to define a pricing policy so that they can communicate how they will control the company's Sales Managers. The CEO once again interrupts him and says that they must present a tentative sales plan the next day, and that the Sales Director should be well prepared since he will be in the line of fire at tomorrow's meeting with the owner.

The CEO expresses his anxiety over not understanding the Chair: "He continuously harasses me regarding the construction of Arrow's business plan, but I have to admit that I do not know what a business plan is."

> "I don't understand what he is talking about. Goliath never asked me for a business plan."

The Sales Consultant immediately asks the CEO if he can be responsible for creating the business plan. The CEO accepts this at which point the Sales Consultant shows him a business plan template that he received from Bay Lake. The CEO adds that he feels really ashamed that he neither knows what a business plan is nor what its purpose is for.

The meeting continues by discussing different candidates for the Sales Manager positions and action plans for the different markets. The CEO adds that he has received several hints from the owner that they should be investigating new products. Hence, it is decided at the meeting that the Development Director will investigate the viability of producing a D-Widget. He stresses that it is extremely dangerous to mention new products to the owner since "they might lead us in the totally wrong direction. This firm was built to produce M-Widgets and S-Widget, and not a palette of products."

He continues to stress the need for flexibility in the firm: "We need to be able to instantly fire our new Sales Managers if it does not work out, which is why we need to find an intelligent construction. He rejects the recruitment approach that the Sales Director and Sales Consultant advocate due to the risk of falling into the collegial trap (i.e. hire people you know).

Throughout the meeting the CEO compliments the CFO (who is not participating), on her work, and her new thoughts. The CEO concludes the meeting by saying that he does not want any surprises during the meeting the following day with the new owner and that he is somewhat worried that the new owner will argue the information that Arrow supplied in the presented material in the bidding process is a promise.

After the meeting, the CEO and I have a one-on-one discussion were he explains to me that numerous internal and external stakeholders had tried to convince him that he should exchange the Sales Director due to his inability to build and handle a new autonomous sales and market organization. He informs me that, after discussing this with the Sales Consultant, he is even more convinced this is the case.

## Analytical Summary: Adapting to the Chair's Covert Wishes…

### This Goes Against Our Raison D'être

The fact that Arrow has been tuned/nurtured to focus upon and measure all production related activities at the expense of earning related dittos is becoming increasingly evident. Furthermore, it is evident that there exists reluctance in the firm in general and with the CEO in particular to change some of the most fundamental setups, such as the number of produced products. However, flexibility and change is sought; it is not within the incumbent setup; rather, it is in the new part of the organization, such as the ease to fire new employees.

### Continue to Accommodate That Which is Important

The Sales Consultant has covert interaction with the Chair; this is also becoming increasingly evident. The Chair's words that are primarily transmitted through the Sales Consultant are that the Sales Consultant more frequently mentions logistics as a problem area. The similar goes for the fact that the Sales Consultant tries to persuade the CEO that the Sales Director has played out his role at Arrow: an idea first presented by the Chair. Lastly, the board tries to convince the CEO that a business plan is urgent and the CEO expresses his lack of experience with business plans (in fact, as previously stated, he does not even know what one is, which stresses him enormously). The Sales Consultant suggests that he will be responsible for the work. The Sales Consultant shows the CEO a business plan template that he has covertly received from the Chair. In sum, it could be stated that there seems to be a vast language, expectance and relational gap between the CEO and Chair.

# The Management Arena: the Day of Deliberation

It was an early spring morning on March 23rd, and tension and excitement was already high at Arrow's headquarters. Management team members had already arrived at 7.00 am seemed to have high expectations. The activity level at the office this last hour before Bay Lake arrived widely surpassed any normal morning.

## The Owner Meeting: Shifting Priorities

At 8:00 am sharp, the three partners from Bay Lake, who were also on Arrow's board, entered Arrow's conference room. The Chair set up his laptop and quickly presented the agenda for the day:

Table 6.9: The Agenda for the Day

| *Agenda:* |
|---|
| Ownership agenda |
| Shareholder program |
| Finance, cash flow, and budget fulfillment |
| Currency handling, Beta, and energy |
| Administration, IT, HR, and organization (savings plan) |
| Sales and marketing, organization, and future plans |
| Purchasing |
| Production (incl. development and quality) |
| Potential new investments |
| Other separation issues (i.e. from Goliath) |
| Energy and environment |

## Building Confidence, Pressure, and Ownership of Your Own Destiny

The Chair starts off his presentation by asking the participants i.e.(the financial and production-oriented management teams) what is a firm's long-term goal. Without waiting for any response from the participants, he says:

> "A firm's long-term goal is survival."

Continuing his speech, he adds that several local newspapers have used headlines such as "The occupation is over" to depict Arrow's liberation from Goliath. He continues by quoting the former Swedish Prime Minister by saying:

> "The one who's in debt isn't free."

Without explicating the analogy of the quote – he refers to the fact that Arrow now has a lot of debt to the bank in the form of loans, to Goliath in the form of vendor notes, and to Bay Lake in the form of shareholder loans as well as the personal loans that most of the management team members will have to take on to buy sweet equity, he continues to elaborate on the difference in values and norms between Arrow and Goliath as well as the national differences. The Chair continues to stress that a success factor in the upcoming journey of value creation is to have a customer-oriented passion in every issue at hand and establish cost superiority in everything one does. Increased employee participation will further establish the job satisfaction, which is paramount for success, especially in combination with a holistic perspective. He says:

> "You have to remember that time is the only resource that cannot be recouped, which is why we have to get started immediately."

In order for them to accomplish this, the team has to vastly decrease the distance between thought and action. He continues:

> "For the first time in ages you own your own legs and your own future."

The Chair concludes this cascade of buzzwords and motivational anecdotes by stating the primary success factors. You have to make sure that you succeed with the following:

Table 6.10: Key Success Factors

| *Key Success Factors:* |
|---|
| Commercial transition (keeping the customers) |
| Administrative transition |
| Financial transition |
| Strategic turn-around |
| Defining the goals and vision |
| Benchmarking the operational success factors |

The Chair says: "I argue that the key lies within the strategic turn-around that is transcending the perception of us and our stakeholder perceptions of Arrow. We have to transcend from being a production-oriented cost center in an inertial industry giant, such as Goliath, to becoming a customer and result-oriented autonomous firm. Thus, moving from being a small fraction of a giant to an apparent leader within a well distinct niche. Hence, we have to focus on sales, the sales organization, and the customer interaction."

While another partner describes the components of a business plan, the CEO asks the Chair what they want to accomplish with Arrow over a 5-10 year perspective. The Chair responds that, even though we want to see growth, it is not up to us.

> "We want you on the management team to tell us what you what to accomplish over the next three years and not the other way around."

Bay Lake's third and most senior partner adds that the focus areas for the upcoming years are: (i) general management, (ii) sales, (iii) profitability, and (iv) cash flow. He also says that, while the primary short-term objective is to restore the profitability of Arrow, the long-term objective is survival. "However, we must formulate and implement a competitive business plan for Arrow in the mid-term. More explicitly, you will have to separate your focus according to three key value drivers."

Table 6.11: Key Value Drivers (KVD)

| *Key Value Drivers (KVD):* |
|---|
| Operational Efficiency: |
| Increase the EBITDA margin with 250 % |
| Strengthen the yield: |
| (i) Gross margin / order |
| (ii) Gross margin / hour |
| Strategic position: |
| Growth, i.e. revenue increase |
| Financial efficiency: |
| Repayment of acquisition debt |
| Repayment of vendor notes |

The Chair adds that Arrow's business plan needs to be presented at the board meeting on the April 18th or on June 28th. Another Bay Lake partner elaborates upon the rationale of sweet equity (cf. the explanation in chapter describing Arrow as a portfolio firm). The sweet equity program, in contrast to options, secures a direct and visible ownership from day one:

> "More importantly, if we are successful, you are successful. But if anything goes wrong, we are all in the same boat."

He continues: “But since we have based our calculations on the information you supplied us in the bidding process, you should feel confident that this will be a success story. Based upon these calculations, you will earn 42x your equity stake in the best case and 12x in the worst case.” Another Bay Lake partner stresses again that the calculations are based upon the information received from the management team. The most senior Bay Lake partner summarizes everything by stating:

> “We are good to those who are good to us!”

The CEO adds that Bay Lake has made sure that our ‘home bank’ will supply them with zero-margin loans so anyone who wishes to invest in sweet equity can do so on very favorable terms. The CEO address the Bay Lake partners by saying that this is very interesting and useful, but that they “need to use a ‘Winnie the Pooh’ language so that we all can understand what you are saying”. The Chair concludes this discussion by asking the management team to start their functional presentations according to the agenda.

## The Management Team’s Presentation

The CFO starts off the management team’s presentation by presenting the profit and loss statement and the cash flow situation. She says: “It feels really depressing to present our financial situation after the long and motivational presentation by our owner. The truth is that we neither see any price increases in the near future nor any reallocation opportunities from oversea markets to Europe. We have been forced to write down our stock with 3.8 million SEK. Lastly, energy and Beta represents the two largest deviations from the forecast we presented to you during the acquisition process.” One of the Bay Lake partners says that even though this is very disappointing, it is of fundamental importance that they reallocate as many of their expected and unexpected costs as well as rationalization expenses to the first quarter (i.e. the quarter prior to Bay Lake’s acquisition). “While we should not do any accounting violations, we have to make sure that the development story of Arrow between 2006-2010 looks as good as possible."

The CFO continues: "On the cash flow side, we have large negative effects pertaining to the large bonus payments we do every year in the first quarter to our merchants." Once again, the Bay Lake partner stresses that all costs and expenses that can be moved to the first quarter should be moved there. The Chair says that the management team will have to present a new forecast at the board meeting on April 18th. When the CEO takes over to present Arrow's currency flows, the Chair quickly interrupted the presentation by suggesting that external consultants should develop this for them.

After a few minutes of intense discussion about consultants, the Purchasing Director presents an overview of the Beta, energy, and the purchase situation. The owner shows a large interest in this presentation, the board seem very surprised by the overall objective to maintain the price levels Arrow that had during Goliath's ownership. The Chair loudly and straightforwardly said that the management team should set their ambitions much higher than that: "We have given you the opportunity to find new creative solutions such as partnering with a Beta supplier and pay them based upon our gross margin, hence, splitting both the risk and the opportunity. The most senior Bay Lake partner adds: "We have to remember that all finite resources will continue their costs/increase trajectory, which is why we must increase the flexibility in our system." A very ambiguous and indirect answer from the Purchasing Director on the question of how many alternative suppliers we have and how we perform benchmarking concludes the discussion.

This is followed by a short presentation by the Administrative and HR Director (hereafter referred to as the HR Director). He quickly browses through the intended organizational changes - that is, the decrease in full time equivalents - and the cost/savings plan that is currently being developed. The owner shows a large interest in these activities and stresses the importance of cost leadership. The HR Director, who is rather new to Arrow, encapsulates his presentation in conventional management models and explicit connections to the impact of margin and EBITDA. This pleases the owner.

The participants at the meeting then split for a short break where after the Sales Director and Sales Consultant assumes control of the meeting. The Chair quickly asks the Sales Director if discussions with any new customers are taking place, to which the Sales Director negatively responds. He presents the sold volumes on different markets and the average prices. The Chair quickly interrupts him by stating that prices and volumes are uninteresting since contribution per market is all that matters. The Sales Director continues to present the focus areas that will be addressed including product variants, product calculations, payment terms, and logistics. While the participants agree upon these focus areas for the time being, one of the Bay Lake partners requests a thorough presentation of the most important customers at the next board meeting. The Chair quickly adds that he would like to accompany them to meet with the most important customers. A somewhat anxious Sales Director argues that the prices will increase with approximately 200 SEK during the second quarter, hence, a profit amplifier with 40-50 million SEK concludes this part of the presentation.

The Sales Consultant takes the stage directly after lunch to present the progress and ambition of the intended sales organization. He starts off by arguing that the distance between the customer and the decision maker at Arrow under Goliath's ownership has been unreasonably long. "We have to decrease the time lag between queries and tenders. We have also decided not to establish sales offices in several European locations; instead, we have chosen to mimic Sand Mountain Inc. and Quick GmbH, which have established one local sales office at the headquarters and several Sales Managers locally represented in specific clusters. The rationale for this is to keep and strengthen the close interaction between sales and production as well as keep the costs down." To answer the Chair's question why they have started a limited firm for each Sales Managers, the CFO explains it by saying the words *tax advantages*.

A long, explicit, and factual presentation and discussion concerning the production unit and Arrow's development capability takes place before this meeting is ended. Before all notably exhausted participants leave the conference room, the Development Director stresses her concern that Arrow might become even more shielded from the environment now that it is going to be autonomous. She illustrates this by giving a descriptive example:

> "My incoming emails were reduced by 50 % the day after Goliath sent a press release communicating that we were sold."

## Analytical Summary: Transcending the View of Themselves and What is Accomplishable

### Establishment of Success Story Through Commitment, Empowerment, and Fiction

The Chair starts this symbolic day whose name should represent Arrow's autonomous rebirth. In fact, from the board's perspective, the rebirth is seen in the agenda for the meeting, thus, all prioritizations are turned on their heads. The otherwise prioritized areas of production investments and other related issues have been downgraded at the expense of financial and commercial issues. The dotted line in the agenda was not present in the Chair's version, however, represents this paradigm shift to the normal prioritization of the management team where production and investments always have at the top of the agenda. Hence, this agenda will hold the key to difference of perspectives been the two groups.

The board continues to emphasize a holistic view on the full organization instead of pure production and job satisfaction; it also stresses employee participation as a means to achieve the goal of value creation. While a lot of symbolism is utilized to convey this message. the board is very explicit and unambiguous when presenting the factors upon which the management team needs to focus in order to achieve this value creation. Many of Arrow's characteristics need to initiate its change trajectory. The board emphasizes that the initiative should not come from them but rather the management team should educate the board instead on what it wants to achieve, how it will be achieved, and what the expected outcome will be. However, it becomes obvious that the management team has a hard time changing the view of themselves from being implementers (i.e. executing other decisions) to becoming formators (i.e. formulating as well as implementing the ideas). Even if this is the story the board tries to convey, the activities the management team should focus upon are very unambiguously communicated by the board; the focus areas have a perfect fit to the three value creating areas described in the value generation chapter.

They gently yet firmly try to establish commitment and cohesiveness by stating: “More importantly, if we are successful, you are successful. But if anything goes wrong, we are all in the same boat.“ Thus, the pressure is on the management team to deliver what it promised during the acquisition process when management presented themselves and the potential growth trajectory of the firm. The board’s guilt creating stick-and-carrot strategy becomes even more evident when they state “We are good to those who are good to us!”

During the management team’s presentation, it also becomes evident that building a success story right off the bat is paramount for creating a successful exit at the end of the holding period. Thus, the board in general and the owner representatives in particular are very explicit that, from an accounting perspective, all costs that can be reallocated to the period before Bay Lake’s acquisition of Arrow should be reallocated there (without violating any accounting rules). This is so the value creation journey can receive a steeper development at the end or, in other words, start from rock bottom and make a fantastic journey.

## Governing Through the CEO and Not on the Side of Him to Solve Problems of the Former Useless Owner

There is an outspoken strategy the board expresses: using the best possible resource for the larger tasks at hand in their portfolio firms. The board does not want to govern the organization on the CEO’s side (c.f. the Chair’s relation to the Sales Consultant); instead, it wishes to do it through him. This is why the board tries to convince the CEO and CFO on numerous occasions to lean on consultants to solve the currency issues rather than making them do the same. The board argues that they cannot afford not to lean on professional assistance: "It's too expensive to lose 10 million SEK on currencies when you pay professionals to establish a financial policy for 1 million SEK that might mitigate the potential loss."

The board continuously expresses its view of the former owner (i.e. Goliath) as being useless, non-interested, and conventional. Thus, a lot of emphasize is spent on infusing the management team with confidence and ingenuity so that they come up with solutions and a means for value creation that was unthinkable earlier, such as the creation of competitive strength by increasing the flexibility in the cost structure through reinventing Arrow's energy solution.

## Liking Your Reflection, Discarding White-Washers, and Focusing Upon Outcomes

The meeting ends with some management team members presenting the current situation within their respective area. The board implicitly praises by nodding appreciatively. When the HR Director speaks about cost reductions, reduction in number of FTEs, and other EBITDA expanders, board members seem to have an aversion to this; they unappreciatively roll their eyes. The Sales Director appears to be grasping for straws when he says that he sees price increases of approximately SEK 200 per ton, while the CFO explained just an hour earlier that the company does not see any price increases in the short term. Board members become even more annoyed when the sales presentation revolves around sold volumes on each geographical market and their average prices. They argue that the measures used under Goliath's ownership are too blunt since volumes are irrelevant in contrast to margins and profits. This last change of opinion will continue to develop throughout Bay Lake's ownership period.

## The CEO Perspective: Are we in the Eye of the Storm?

Directly following the meeting, the most senior Bay Lake partner, the CEO, and the CFO entered a private meeting to discuss cost reallocations. The partner asked the CFO in a gentle yet firm way to reallocate the unexpected costs of 56 million SEK to the first quarter (i.e. before the acquisition). He continues to say: "Even though this will have no legal effects, it will strengthen our possibilities to build a success story around Arrow and protect us from breaching our three bank covenants: i.e. interest coverage ratio, debt/equity ratio, and equity ratio in %." He says that the acquisition rationale in buyout investments is to buy asset light firms who are closely positioned to the customer.

> "…And to be honest, your fit to those requirements is really bad, but we got hell of a price."

Bay Lake's partner continues to give the CEO and CFO some pointers on how the financial reporting can be made as favorable as possible. An interesting notation during the meeting was that the CFO prevented the CEO from speaking on several occasions.

The CEO tells me after the participants leave that the outcome of the day's meeting vastly exceeded his expectations: "I wonder why Bay Lake was so soft in their questions. I was, in fact, sure that they would ask much tougher questions regarding the new sales organization." In the hallway after the meeting I heard the CFO tell one of her colleagues how tired she is with the situation and the workload.

## CEO Debriefing: I Wonder What is Actually Expected of Me?

A few days later, the CEO called me and apologized that we have not met or talked in a few days. He explained that his short-term concern was that Bay Lake is pressuring him to reallocate costs to the first quarter, but that Goliath strongly opposes this. Furthermore, "due to all of the owner's meddling regarding the sales organization, I have started to take formal minutes of all meetings between the Sales Director, the Sales Consultant, and myself" the CEO says.

The CEO continues on to say: "Perhaps more importantly, the acquisition almost went down the drain three days ago. I sent the quarterly forecast to Bay Lake by March 6th. Even though I was extremely worried that they would call and instantly fire me due to the weak February result and the weak forecast, they did not contact me. I realized just a few days ago that they had been on vacation and missed my forecast. Last Thursday (it is Monday today) Bay Lake realized how the situation looked and informed Goliath that they wanted to back out of the deal. Goliath who threatened with a lawsuit refused to abort the deal, but agreed after several days of intense negotiations to subsidize Beta over three quarters at a value of 60 million SEK. The CEO adds he genuinely believes that Goliath was too weak in its negotiations.

The CEO concludes the update by informing me that he has finally changed the management team composition from a separate production and financial management team to single management team, thus, mirroring the financial one with one production representative.

The CEO calls me again two days later explaining that he is really worried about the effects of the exchange rates and that they cannot compensate for it through increased prices since Goliath's sales offices (which are still being used as a sales organization) are reluctant to this. He adds that the production has been increased with 8 000 – 10 000 tons, but that the drop in sales is becoming unmanageable. The uncontrollable costs are skyrocketing with several hundred million SEK.

After five additional days have elapsed, the CEO calls me and sounds very bothered. He explains that one of the Bay Lake partners is calling him constantly and asking him very strange and irrelevant questions. The questions vacillate between being very strategic and very scattered.

> "I have no idea what they expect from me."

The CEO says: "They ask me why the customers cannot pay the cost of freight, which makes me wonder if they know anything about our industry. They do not realize that we are a very small actor in a gigantic industry. We cannot ask our customers to do that." He concludes the conversation by saying that he is worried about the future.

## Analytical Summary: Adjusting the 'Reality' and Bridging the Two 'Worlds'

### The Blurriness of Real and "Real" Changes

The aforementioned construction of a success story continues to be an important issue for the board. In fact, the reallocation of the unexpected costs not only lowers the start of the trajectory (and, hence, its potential steepness); it also protects Arrow from potential covenant breaches during the period. Therefore, even if the accounting changes are only fictive, they have real implications on the value generation of the firm. Thus, the board leans heavily upon adjusting Arrow's preconditions to fulfill its goal of value generation (in contrast to pure value creation). The board explains to the management team that it would not have acquired Arrow if it were not for the very attractive price since the fit to its invest heuristics was weak. This in contrast to what was communicated to its limited partners in the investment memorandum.

The CFO's position and power has changed radically since the acquisition, and this accounting discussion confirms this. Not only has she become a part of the management team; her financial insights, language and tools, as well as her analytical skills have pushed her up on the interpretive dominance ladder. To the surprise of all during the meeting, it was she who lectured the otherwise domineering CEO.

## The Downward Spiral or Decay Has Started

The fact the CEO expressed his relief that that the board was so soft in their questions and comments concerning the new sales organization only indicates that the board has given up on the idea of making him a commercial CEO for an autonomous firm. There is, indeed, a large gap between his view on Arrow and that of the board. He expresses his concern with the board's constant questioning; there seems to be a decoupling between the actors' perceptions and language arsenal since he neither understands what they mean nor what they want. The CEO believes some of their ideas to be absurd and totally opposite of conventional wisdom. For example, the board wants the customers to pay all freights costs: a notion he thinks is absolutely absurd! The CEO argues that the board does not realize that Arrow is a very small actor in a gigantic industry. The probable reason for this discrepancy is that the management team described Arrow as a niche actor during the acquisition processes, which the board equals to being dominant in a specific segment, hence, possessing price-setting power. Is the board perhaps just trying to question and demolish ideas that are widely assumed as well as not very favorable to Arrow and, hence, the owner. Thus, are they trying to widen the perception boundaries?

Last, but not least, the CEO's notion that the uncontrollable costs are skyrocketing is an important issue since the view of what is controllable will shift extensively throughout the studied period.

# The Management Arena: Aiming to Create a Breathing Space

One afternoon at the beginning of April, the management team meets in their new composition for the first time. Prior to the meeting, the CEO excuses himself for not yet distributing the protocol from the last meeting. He also informs the team that three internal individuals have reported their interest in the position of Production Director and that he will use a recruitment firm to evaluate them.

## Discussing the Upcoming Board Meeting

The CEO explains that he has assumed full responsibility for all currency issues and that the CFO is removed from this responsibility. This makes the other participants somewhat surprised. He justifies this with the complex currency flows and the need for a thorough analysis. He continues to present a list of Arrow's top ten competitors and their production volumes. After a few seconds of scrutinizing this list, the HR Director asks what is the purpose of the list: "Should we benchmark ourselves to them, or what?" While the participants have a short discussion concerning the list's rationale, neither any conclusions are drawn nor does a mutual outlook emerge.

The CEO continues to present the tentative headlines of the upcoming board meeting including closing the accounts, the separation process from Goliath, governance, management, and organization, as well as the business plan. He adds that he will present an investment policy proposal at the board meeting that mirrors the former one. Before proceeding with the meeting, the CEO lowers his voice and explains in a very sincere tone that he is clueless about the purpose of the upcoming board meeting: "I really want some instructions from Bay Lake as to what is expected from me. One of the management team members asks whether it would be a good idea to place the management team meetings adjacent to the board meetings. "In fact, I believe we should have the meeting a few days before the board meeting, so we can control the input to a larger extent and support you," he says to the CEO. In a very openly manner, the CEO agrees and stresses his frustration with the constant questions from the board.

Before moving on to the actual agenda of the board meeting, the CEO informs the other participants on how close it was that the deal fell through a few days ago. While describing the story, he compliments Bay Lake on its strategy to attack the Beta prices and negotiate a Beta subsidy. He also explains that his former Directors at Goliath almost dissolved with anger when this happened.

### Update on Sales Organization and Market Situation

The CEO swiftly mentions the cooperation between the Sales Director and the Sales Consultant seems to be strong and that he feels really comfortable with the situation. He stresses that the Sales Managers that are going to be employed should be so in the European subsidiaries and that this should be accomplished before May 1st. While the CFO agrees, she argues that this should be a question for the board.

The CEO raises the questions of how the incentive structure for the Sales Managers should be construed and how quickly they can be fired if the situation develops unfavorably. While the rest of the participants agree that these are fundamental questions, one participant wonders if the first question could be answered since we do not have a strategy on what we should sell to whom and how. A lengthy discussion takes place on the fact that the management team is currently very short sighted and that they need to extend the view.

The Development Director continues the meeting by presenting an overview of the current suppliers and the goals to vastly decrease this list. The Purchasing Director adds that he has started to renegotiate all prices in response to Bay Lake's requirement to decrease all purchase prices with >5 %. The CEO adds that the Purchasing Director should prepare a really good defense speech to the board if he is unsuccessful in decreasing the prices. One of the participants stresses the need just before the coffee break for a long-term strategy and a business plan. He says: "We continuously have to look at the business plan template that the Sales Consultant has received from Bay Lake and make sure that everyone is participating. We should do everything according to the book."

The Sales Director and the Sales Consultant, who is co-opted to the management team for the rest of the year, start to describe the market outlook. They argue that the market supply and demand will be in perfect balance by the end of 2008 due to the increasing consumption of Widgets. They see that there will be a market shortage of Widgets in the years following 2008. This outlook relieves the participants, yet one stresses that the only time they have to change the sales and marketing side is right now. Another participant asks if they really have a sales and marketing strategy. This is followed by a long discussion, which concludes with the need for more long-term thinking and that the CEO will dedicate his time to the external side.

### Scrutinizing the Financials and Other Operational Activities

The CFO briefly goes through the financial situation by explaining that the electricity hedge is currently strengthening the result and that the fixed costs – maintenance, sales, and miscellaneous costs – are lower than forecasted. The EBITDA result still looks very unsatisfying. The balance sheet situation looks even worse, she says: "We have been unable to decrease our stock due to high production and low sales and our account payables have unfortunately also decreased." The CFO concludes this brief overview by stating that she wants to distinguish the costs in the profit and loss statement so as to increase the level of detail and increase the understanding on the management team. The CEO adds that Bay Lake is too profit and loss oriented.

Since one of Arrow's primary cost drivers is the Beta price and the Beta consumption, the CEO asks what is the outcome on quality from the decreased Beta share. The Development Director answers that the tests have not yet been initiated since she is awaiting an okay from the Sales Director (she wanted the decision to be market-driven). The CEO becomes furious when he hears this. “I have already presented the board with a profit and loss statement including this decreased Beta level” the CEO says, adding “Fix this right now!” The Beta share is a crucial factor for their survival, he concludes. The CFO agrees, and adds that she will be responsible for all financial issues in the new cost-savings program while the HR Director will be responsible for the operational ones. The HR Director informs the other participants that symbolism is rather important right now for employee morale, which is why all employees will receive new work clothes to reinforce the new profile and firm name.

## How Should We Regain the Control of the Driver's Seat…?

After a short break, the participants enter the meeting room again whereupon the CEO once again points out his inability to communicate with the owner. He argues that he is bombarded with unqualified questions and that Bay Lake is very anxious.

> “We are only given the opportunity to extinguish fires.”

“I have no idea what is the rationale of the board meeting” the CEO continues. He gently mentions that she thinks they should be as open as possible with Bay Lake. “We have to be given time to do something properly. The CEO, the Purchasing Director, the two sales Heads, and I are observed right now and we are constantly being questioned.” What makes this really annoying, the CEO adds, is that the questions revolve different things all the time, thus “I am unable to understand what they perceive as important.”

One of the participants tries to calm the others by saying that they have a lot of strategic thinking on paper already: “We have, for example, a well-defined vision: to produce 300 000 tons.” The CEO adds that the owner emails him and demands him to use other Beta suppliers and other Beta variants, which is shocking. On the same subject, the HR Director suggests that they should have a private planning day (i.e. without the owner) in order to develop any long-term planning. He continues:

> "We have to become more proactive and stop asking Bay Lake for help all the time. I mean, we are still the experts, which is why we must start to act rather than react."

A participant adds that Bay Lake is very operational rather than strategic: "We have to be able to set our own goals and not lean so much on our principals (in order to regain the control). As the HR Director mentioned, we are the experts." The CEO adds that Bay Lake wanted to increase the prices without involving the marketing department since they are too reluctant to price increases. Everyone in the meeting laughs at this.

The HR Director asks the CEO if he can ask Bay Lake for some breathing space, so the management team can conduct a planning day and then present a more proactive plan on what they want to accomplish at the next board meeting. Several participants stress the need of being in the front seat and really show Bay Lake that they are pursuing numerous projects. One of the participants add that it is of fundamental importance that they understand what they should focus upon even though "all of us understand that our focus will have to shift with the new owner." The CEO also reveals his annoyance with the fact that the Sales Consultant has played two roles: he has had direct (covert) contact with the Chair and reported to him on the side. While the participants seem rather unsurprised by the CEO's statement, it is decided that a planning day will be carried out. The participants also agree that they will start to distribute a monthly report to the board; both as a means to diminish the continuous questions from the owner, as well as a way to tighten the outlook of the management team. The CEO states that their only focus involves putting out fires right now instead of working more strategically. With that, he concludes the meeting.

## Investment Meeting: Why Invest When You Can Buy

The CEO, the Development Director, and all production-oriented managers (i.e. the former members of the production-oriented management team) also had a meeting concerning investments in general and energy investments in particular. The participants discuss several volume and quality improving investments when the CEO interrupts the discussion by saying:

> "Bay Lake will never agree to invest in these volume enhancements since they cost more than twice as much as the cost of buying another Widget firm and their volumes."

He continues to say that they have even been offered to buy another Widget firm at a 50 % lower price/ton than they paid for Arrow. Moreover, they are realizing that Arrow is selling more than 20 % of its volumes on markets that are unprofitable - overseas markets - so why should they invest in new volumes? He says: "We must quickly focus on two things: firstly, increase our gross margin levels by reallocating sales to Europe, and secondly, to decrease the Beta and energy costs. This is also the reason why we are having this meeting. Should we or should we not invest the quarter of a billion SEK (cf. the acquisition price of Arrow) in a new cheaper energy solution?" One of the participants stresses the need to decrease the dependency upon non-renewable energy solutions. He says: "I have been informed that they evaluate this investment based upon its long-term savings. For example, the investment needs to save us at least 56 million SEK per annum in order to be interesting; hence, the investment-horizon surpasses the owner-horizon if the investment is 250 million SEK and they assume an exit multiple of 4.5x EBITDA." The CEO goes on to ask if the team has made a profitability analysis on this. The participants answer negatively. However, one states that a preliminary forecast is that the investment is profitable as long as the oil price surpasses USD 50 per barrel. Before the meeting ends, several cost-saving activities are discussed: the consequences of hibernating some of the machines used to refine the Widgets. A sentiment of the participants seems to be to build in cushion in all investment proposals in order to save some acting space for the future.

The CEO tells me after all the participants leave the room that he will devote his time more or less exclusively to the sales and marketing. He will immediately create an itinerary so that he can meet with all of Arrow's strategic customers. Just before we part ways, he also informs me that Bay Lake lacks confidence in one of the management team members: "he is not tough enough."

## Meeting with Union Representatives

The CEO, CFO, and HR Director meet with the union representatives on a monthly basis to discuss a variety of issues. The CEO is very frank in his description to the other participants. He says: "We can do so many things to strengthen the situation, but we do nothing. The CFO gives the run-through of the financial situation and states:

> "We are much better at producing than selling."

He says they have failed to sell as many Cubicles as they had forecasted, which severely decreases the EBITDA. He then presents a table of their twelve Widget variants.

Table 6.12: Different Widget Variants

| *Main Products:* | *Main Variants:* | *Sub-Variants (Density)* |
|---|---|---|
| M-Widget | Cubicles / Spheres | Low / Medium / High |
| S-Widget | Cubicles / Spheres | Low / Medium / High |

One participant asks why are they unsuccessful at selling whereby the CFO answers: "I actually do not know, but the Sales Director is never here so I cannot ask him." Another union representative asks the CFO to add EBIT and EBITDA to the profit and loss statement so it becomes clearer for what they are aiming. He continues: "I receive questions daily on what actually is EBITDA." The CEO also tells the story of Bay Lake almost defaulting on the acquisition a few weeks earlier.

The participants' sentiment is that there will be a marginalization within the business in the upcoming quarters due to the industry's bad performance and that they have to adapt the organization accordingly. Before the meeting is over, the CEO informs the participants of the upcoming board meeting. He continues: "I guess that the primary focus will be on the forecast for 2006. The board will also present something suspicious they call Key Value Drivers (focus areas arranged around the three primary areas within the value creation component), which I think they mentioned at our last meeting. They are requesting a business plan for Arrow from me, but I have to admit that I actually do not know what a business plan is."

## Preparing for the Board Meeting and the 2006 Financial Forecast

Besides discussing the actual forecast along numerous dimensions including fixed, semi-fixed, and variable costs as well as volumes, market-mix and product-mix, the general agreement between the CEO, CFO, and financial controller is that nothing should be painted in pink. The CFO reformulated it by saying that we should use the precautionary principle. She says: "My ambition is that no costs will surpass our estimations. It is easier to take some heat in the beginning and be glorified in the end, than the opposite. The CEO responds in a less diplomatic way:

> "This is like building stock. Hence, if you pee in your pants, it gets warm and cozy at first but then wet and cold in the long term."

The CEO propagates that a forecast should be a best guess based upon their mutual experience and not a worst-case scenario. The HR Director is invited in at the end of the meeting. He requests to validate all assumptions with the concerned managers, so as to increase the reliability of the forecast and so all decision-makers can justify their assumptions to the board. He asks how the forecast would look if they excluded the subsidized Beta prices. He then adds: "It is better that we are open and proactive on this issue and explain the current outlook to the board." The participants agree and, with that, the meeting ends.

## Analytical Summary: Assuming More Control Without Reflection

### Grasping for More Control

As the board's financial focus and interest becomes more predominant, it becomes increasingly apparent that the CEO widens his span of control toward the financial issues and, hence, curtails the CFO. He further widens his (and the entire organization's) rather introvert view toward external factors - such as the volumes that competitors produce - without really being able to explain the reason for this. Hence, not only does the management team observe factors the board finds irrelevant (volumes instead of margins); it is done so without intention.

The CEO continues to express his dissatisfaction with the company's relationship with the board and his genuine lack of understanding of what it means; the rest of the management team tries to find supportive solutions for him. Another more interesting interpretation is that the management team craves more information from, and a need to supply input to, the board meetings. Parts of the team also request the board's input on some decisions as a means to bridge the two functions.

According to the CEO, an interesting question is whether the board's seemingly unstructured questions and scattered approach is affecting the CEO and management team in any way. Are they intentionally or unintentionally unstructured and scattered? Is it only a discrepancy in logics or factors that are deemed relevant according to their different rationales? Does it widen the view and perception of the management team?

The CEO and the management team's view has become obviously conventional and is in accordance with the industry logic of the Widget industry. For example, output in terms of volumes is *the* relevant factor since big is beautiful, while outcome in terms of margins and profits are more in line with the board's logic. In fact, its vision is a pure volume statement and not an intriguing and exciting future that tickles the employees. The idea that the board wants the management team to try a new and more accessible and cheaper Beta variant is perceived as shocking and absurd to the team.

## Doing What You're Told Without Reflection

The board's view that the time for change (the window-of-opportunity) is now becomes increasingly widespread on the management team; a notion of being reactive rather than active spreads among them. Several participants question during a meeting that they are employing sales managers, as the board has told them to do, without first formulating and implementing a sales strategy. They are beginning the feel as though they are back-seat drivers. This creates the need for a long-term perspective as well as the hope to become more proactive. In fact, the participants propose to take the initiative to start distributing a more detailed and elaborated monthly report to the board as a means to diminish the board's pressure and to regain control; hence, to create some breathing space so that long-term planning can be accomplished.

Although the change proneness seems to be growing, the diminished need for their most important activity – i.e. volume investments – is still limited. When the CEO explains to the participants about the now dissolved production-oriented management team, the thought of more than 20 % of their volumes being sold below marginal costs is unimaginable to them. Hence, his recipe (or the recipe given to him) to quickly reallocate sales to other markets in order to increase the gross margin and decrease the Beta costs in order to eliminate these zero-margin volumes is ungraspable. The management team sees only a future with volume investments, which has been their means of survival for centuries (i.e. Widget producers that were allowed or had the opportunity to invest were the ones who survived).

#### Decoupling Between Input and Outcome or Operations and Finance

While the financial discussions still consume a diminutive part of the management meetings, the interest in the coupling between financial consequence and operational decisions seems to be growing. The CFO seems to try to build a mental bridge between current or old production-oriented language and new ditto, which leans heavily on financial concepts. There is resistance to this, however, which becomes obvious through statements such as: "Bay Lake is too profit as well as loss oriented".

# The Board Arena: Triggering the Strategic Change

## First Board Meeting: Formal Inauguration of the Mutual Outlook

### On the morning Before the First Board Meeting: The CEO's Reflections

It is very early in the morning on April 18th, 2006. While it is still quite chilly in the air, the birds are awaking outside the main conference room. Only a few hours remain before the board arrives at Arrow's headquarters for the very first board meeting. The tension in the office is pronounced. Arrow's participants will always consist of the CEO as Arrow's main representative, and his CFO as the board secretary and the rapporteur of financial issues. Other members of Arrow's management team will be invited on occasion. A long time ago, the CEO had granted the CFO this week off, unaware of the fact that it would coincide with the first board meeting. While the financial controller was to take the CFO's place, he pulled his Achilles tendon the night before the meeting and, hence, had to cancel his participation. This stressed the CEO.

The CEO reflects upon the probable outcome of today's meeting by mentioning that Bay Lake "wants us to announce a price increase for our customers since they will have to pay all logistic costs from now on. Bay Lake does not seem to understand that we are a small actor in an enormous industry. We are going to make a fool out of ourselves if we demand our customers to pay for the logistics."

> "It will probably be my last day today."

The CEO calls the financial controller to prepare all financial data that will be presented to the board. It is obvious that even though they know the data and conclusions, neither has full control over the underlying assumptions for the calculations. The CEO indicates to the controller that he will need some time to scrutinize the data.

> "I scrutinize and recalculate everything that you [the controller] and the CFO do, since this is what a good manager should do."

The CEO and the controller continue to discuss the major risks and caveats that exist in the data, concluding that the Beta assumptions are very fragile. This is worrying due to their large impact on the performance.

### Formalities: Swinging the Century-Old Board Gavel for the Very First Time

Shorty after the board arrives and sits down in the conference room, the Chair opens Arrow's first board meeting by swinging a century-old board gavel and going through all the formalities associated with opening a board meeting. A brief discussion follows concerning work procedures for the Board of Directors, the CEO's instructions, and the instructions for reporting to the board.

## CEO: Investments are the Primary Component for Survival in the Industry

Right from the start, the CEO wants to amend the investment policy and argues persuasively that they should all agree upon keeping the investment rules that Arrow followed during Goliath's ownership. Investments are ceteris paribus: the key to our success. The CEO's prerogative was to decide upon annual investments of 30 million SEK, whereof each individual investment were limited to 10 million SEK. This topic was intensively discussed; the owner and the board were resistant to such high levels due to Arrow's weak performance. The decision was that the CEO is autonomous concerning investment decisions of <2 million SEK, and that he should discuss investments in the range of 2-6 million SEK with the Chair. The entire board should be consulted for investments in excess of 6 million SEK. This decision made the CEO notably dissatisfied since, according to the management team, investments have always been perceived as Arrow's most strategic issue. As the CEO formulated it:

> "Widget firms that don't invest usually die!"

## Winning the Small Wins and Minimizing Arrow's Non-Operational Risks Through Hedging

With regard to the board's question of whether all monetary transactions associated with the acquisition have been resolved between Arrow and Goliath, the CEO explains that everything is resolved except that Goliath expects a payment of 80 million SEK and that Arrow is expecting a payment of 12 million SEK. One board member has an explicit idea on how this should be handled:

> "It would be a good idea if you delayed the 80 million SEK we owe them, but rushed the collection of the 12 million SEK."

The participants laughed at the statement, but it was obvious that it was not a joke – and the participants understood that. The CEO asked the board whether it had heard anything from Goliath since the Goliath representative that handled the acquisition process had told Arrow's CEO that he would probably be fired due to this deal.

The meeting continued with intense discussions concerning hedging as a means of minimizing Arrow's non-operational risks. After a long and sometimes complex presentation by Arrow on their currency flows, it becomes apparent to the participants that exchange rates had a make-it-or-break-it effect on Arrow; they had neither a good overview of the actual currency flows nor sufficient knowledge of their effect. Hence, the board decides that it would use a well-known consulting firm to support the management team in order to establish a financial policy that includes currency and Beta hedging. As the owner expressed it:

> "Let's use [the consulting firm] so that we can sue them if something goes to hell!"

The board comes up with several ideas on how the currency exposure could be diminished through reallocating risk to the suppliers and customers by invoicing and receiving invoices in SEK rather than in EUR or USD. This is something that Arrow's management had never thought of.

During a technical break, the owner representatives stand alone discussing how the CEO and management could have such a bad understanding and control over such fundamental issues as currency flows.

## On Key Value Drivers and the Wish to Disseminate Them Throughout the Organization

The board explains that it has a value enhancement plan (from the information memorandum) that includes three sets of key value drivers (KVDs): operational, strategic, and financial. The board is very explicit in saying that the key elements and the goal assumptions were based upon the projections that Arrow's management team had supplied during the due diligence process. Hence, "these are the assumptions by which we decided to acquire you. In order for you to survive you must start to manage by objectives." The CEO becomes noticeably annoyed that the board seems to assume that it did not manage by objectives right now, however, it was obvious that he did not want to start an argument at the first board meeting.

The Chair informs the CEO that, from this point on, they need to implement a new way of thinking and starting to leverage on Arrow's production capabilities: "You really need to embrace the idea of key value drivers and disseminate it throughout all departments since it will govern all our future actions. With all due respect, your focus is currently too tilted towards production while the market and financial issues are very much neglected. You have to change your market position quickly. Perhaps you also should redefine your view on contribution and measure it per hour instead of per ton."

### Initiating the Process of Embodying the Strategy: The Assignment of Formulating a Business Plan

The meeting continues with the board explaining to the CEO that they must establish or formulate a business plan. Today will be the starting point for the development of Arrow's business plan as an autonomous firm: "The idea is that you start the process and when you have reached halfway or so, we will reserve one or two strategy exercise sessions with the board so that the new strategy can be crafted." The Chair asks the CEO if the first strategy exercise could be on June 28th. Noticeably stressed, the CEO asks how far ahead they are expected to be by then; the Chair says that they do not expect a full-fledged business plan.

### The CEO Report: The First Overview of the Market, the Sales Organization, and Arrow's Position

The CEO sends a monthly report to the board every second week each month. The CEO augments this report as a recurring issue on the agenda at every board meeting. During this first presentation, he informs the board that most parts of the transition from Goliath are finalized and the majority of his time is currently spent on building a sales and market organization within Arrow. He continues to describe the sales channels (i.e. 65 % through merchants) and the delivery and rebate practices that are in place. The board questions why the customer bonuses have doubled the past four years and why the bonuses are volume-driven rather than contribution-driven. The short replay is that it always been like that.

The CEO continues to add that they will use Goliath's sales offices for the next six months, during which they almost double the commission to increase Goliath's sales incentives. Arrow's sales and market organization should then be deployed. The Chair adds that the objective is to leave Goliath as soon as possible. The CEO adds that they have segmented Europe in four geographical clusters and established one sales office with one Sales Manager for each cluster to circumvent particular tax issues. The Chair says the fundamental change is that the Sales Manager now has only two products to focus upon: M-Widget and S-Widget. This is in contrast to the sales office at Goliath, which focuses upon hundreds of products. The CEO also expresses his need for help in designing an incentive system for Arrow's sales force. One of the board members continuously expresses the need to fully understand the commissions, rebates, discounts, and bonuses that are currently in place since these deteriorate the margins. The Chair then adds:

> "We have to move the market into this room."

The CEO expresses his disappointment that there have not been any price increases on Widgets during the year: "Although I believe that the market will be balanced in 2008 since no new Widget capacity has been announced and some capacity is planned to close. The forecast is that 15 % of the European capacity will disappear. The price discussion continues with the board stressing that Arrow is a niche player and should, hence, be able to attain a larger price premium (by raising the price). Without any conclusions and a noticeably stressed CEO, the discussion continues with the size of the market. The board argues that the European market is 1.2 million tons of Widgets, while the CEO gently argues that the amount of substituting products is larger than that. A short discussion ensues where the CEO educates the board on how the Beta prices are decided in market place.

## The Financial Situation: The Only Opportunity is Now, but is Anything Correct?

Along with the CEO report, this is a recurring issue on the board agenda. This discussion starts off with a detailed scrutiny of the profit and loss statement, the balance sheet, and the cash flow situation. The steep bonus development to the merchants is one of the things that captures the interest of the board participants. The volume-driven Goliath, which has autonomously governed these levels, is an explanation for this development. One of the board members argues intensively that they cannot wait to change these levels:

> "This is the only time we will have an opportunity to fix this."

He continues by stating that this is such an important area that they must come back to the 150 million SEK. The most financially experienced board member stresses that the account receivables has increased to such a disproportionate extent that the company might call itself the Arrow Bank.

The CEO regains control of the meeting and presents a forecast for 2006 following a lengthy discussion on the profit and loss statement and the balance sheet. He tries his best to diplomatically lower the board's financial expectations and states that he does not want to sugarcoat anything.

Several board participants look very concerned when the assumptions behind the forecast are scrutinized since more or less every cost position on the profit and loss statement has increased or is estimated to do so. Most attention is directed toward logistic and Beta costs. The board seems resistant to the idea that customers should carry the 22 million SEK in increased logistic costs; this seems to be a very distant notion for the CEO. With regard to the increased Beta costs of approximately 54 million SEK, the board bombards the CEO with questions and is not content with his answers. The conclusion is that, in the limelight of the skyrocketing costs, the profit and loss statement's top line holds the key to Arrow's success; this is why Arrow must present how the market looks, its dynamics, and how the contribution structure regards different markets.

## Market Outlook: Burning Personal Bridges

As in the case with the CEO report and the financial situation, the sales and market outlook is a recurring issue on the board's agenda. For this very reason, Arrow's Sales Director and Sales Consultant (who was earlier labeled in the investment memorandum as the industry expert ) are invited to participate.

The Sales Director is asked how Arrow's pricing mechanism is construed immediately after the two professionals enter the room. Unprepared and somewhat stumbling over his words, he replies:

> "Some markets have good prices… while other markets have bad prices…"

Noticeably dissatisfied with the vague and ambiguous answer, the board continues with questioning the bonus structure for the customers and the immediate need to understand the market structure and the competitive situation. The Chair adds:

> "The only time to change our pricing policy is now!"

The Sales Consultant adds that all profitability calculation per customer and market was a disaster under Goliath's ownership: "We have to start from scratch by scrutinizing all customer contracts, deploy an EBITDA perspective, and discard the pricing model that has been used in the past. The Chair adds that the bonuses need to be stopped instantly impended. One of the board members asks the delicate question of pricing power, which implicitly has been hanging in the air throughout the meeting:

> "Can we have a pricing policy that deviates from the market?"

Neither the Sales Director nor the Sales Consultant answer, so the CEO reformulates the question by asking what will happen if Arrow were to raise its prices by 5 %, hence, increasing its bottom line by approximately 180 million SEK. The Sales Director looks nervously around table and says:

> "We would lose between 20 and 30 % of our customers!"

One of the board members bursts out that never, in a million years, could any firm lose so many customers if they raised their prices with 5%, especially not a niched firm such as Arrow. Another board member wonders why the management seems to presuppose that Arrow has so many substitute products.

The board continues to argue that Arrow is the market leader in its niche and that a very small fraction of the customers would terminate their contact with the company if it raised its prices by 5 %. The members continue to stress that they must choose a market upon which to test this price hypothesis and that the decision falls on one of Arrow's largest European markets that have shown margin contraction and low profitability for a long time. "We are market leaders in contrast to others who are production leaders, thus, we have to raise the price now!" The CEO mentions that all the eyes on Arrow right now, and the Chair adds: "You should feel safe since you have a board and a strong owner who supports you. Lastly, you have to remember that this is a cyclical business and, if we are unable to raise our prices and earn money in this economic boom, then we are doomed."

A discussion about production and energy investments then follows suit. The board categorically yet gently dismisses this due to its conception that the market activities should govern the investments and that Arrow currently neither understands nor controls the market. Regarding the production investments, the board argues that the management has missed the shareholder perspective since the contribution per ton from the investment is less than one third of the actual investment cost. The Chair concludes the board meeting by explaining to the CEO that the members used to have a management team above them, but that they do not anymore: "You are the management and we are the board!"

### The Expectation Gap

In the aftermath of the meeting and in a private discussion with one of the owner representatives (i.e. a Bay Lake partner), the board member posits his view that there is an obvious gap between the CEO's expectations and the board. The CEO seems unable to understand what they want and how it should be accomplished. I even had to help him prepare the board agenda as well as the slide set for the meeting. However, it is very fortunate that the union representatives participated without objecting to anything; hence, they are hostages now.

## Analytical Summary: Disparate Views – But are they Bridgeable?

### A Chasm Between Actors

Several differences in perspectives between the CEO and the CFO as well as with the board become apparent during this first board meeting: one of the biggest being Arrow's market position. The board has a firm belief that Arrow is a pure niche actor, thus, a large player in a rather small market segment. The CEO and CFO perceive themselves as small fish in the big sea, which is why the board's ideas price increases feel unattainable, if not ridiculous. The board hears the management team's perspective, and demands the members to try the hypothesis on one of Arrow's less profitable European markets. Instead of adjusting its ideas to the industry logic, the board wants to implement a trial-and-error strategy and try out its hypothesis in a market that is not that profitable (c.f. the learning-cycle). While the CEO accepts this, he still is confident that the number of substituting products is much greater than the board realizes; thus, it will undoubtedly fail.

This decision goes against everything the management team believes in; other decisions also go against the team's fundamental belief, such as the investment trajectory going forward. The CEO intensively argues to keep the investment heuristics that were in place during Goliath's ownership since (volume) investments are synonymous with survival or, to paraphrase the CEO, investments are ceteris paribus the key to our success. The fact that the last 10% of Widgets sold are done so below marginal cost is not convincing enough. If this last sentence did not persuade the board, it argues that investments correlate with performance. Therefore, investments can be discussed after the management team starts to deliver profits. Furthermore, the board demands the management team to distribute the costs of logistics to the customer once again; hence, it uses that as an argument for the proposed price increase.

Lastly, the board emphasizes the shareholder perspective is new to the management team; it argues that the investment contribution per ton is less than one third of the actual investment cost. The board continues to argue that the management team used to have a team above to inform its members what needed to be implemented: "Now that is gone and you must become both formulators and implementers. In other words, you must leave Goliath mentally and leverage on your new freedom and autonomy, and put new creative ideas into work such as our proposal to reallocate exchange rate risk to our supplier and customers."

## Still Widening the Span of Control

The preparations for the board meeting further indicate that the CEO control continues to increase in span and intensity. For example, the CEO is open to the fact that he must scrutinize everything the financial department has prepared for the meeting since he deems this as a part of his job. This rather widespread control rationale (that is probably inherited from a strong production-oriented technocratic culture) is in stark contrast to the idea of empowerment that the board discusses as being a key to success when becoming autonomous. The board still focuses attention to control expansion (i.e. the sales and marketing side as well as the financial side). Interestingly, it is the CFO and the HR Director - the two newest and, hence, least affected by the industry logic - who prepare the financial material.

## Learning From the Ideas in the Investment Memorandum and Bring the Market to the Boardroom

The board reveals to the CEO and CFO that it has a value enhancement plan built upon the three value creating components discussed in the theory chapter; these are built upon assumptions that the management team supplied during the acquisition process. The board continues to put forth the tough statement that Arrow needs to increase the EBITDA margin with 160 % in order to survive (250 % was communicated at the last meeting). Furthermore, it argues that Arrow needs to be more governed by objectives in order to be successful. This actually pinpoints a feeling that is present on the management team: that they are doing numerous things, but are unable to communicate them to the board.

The Chair also argues that the management team needs to implement a new way of thinking without really explaining what he means. He re-emphasizes this by stating that the market position needs to be quickly changed without explaining how or to what extent. It is probably obvious to him, yet it is not to either the CEO or the CFO. However, he is crystal clear in his idea that the whole organization needs to be involved in the work concerning Arrow's change and the key value drivers, and also that the internal view needs to be quickly substituted for an external ditto.

Moreover, the board seeks to implement a control and legitimacy tool to manage the value enhancement plan, as well as use as template when presenting the success story for an upcoming Arrow acquirer. This tool is a business plan that should be drafted as soon as possible. While the CEO agrees, he is noticeably stressed due to fact that he has no idea what a business plan really is.

Several subjects are discussed when it comes to the business plan: the lack of profitability focus that is evident when the merchant volume-driven bonuses are discussed (in contrast to contribution-driven dittos) and when the price elasticity is also mentioned. In fact, the board puts forth a question that cannot be interpreted other than rhetorically: "Can we have a pricing policy that deviates from the market?" The discussion is concluded with a statement from the board that must be interpreted as a vast deviation from its normal modus operandi: "We have to move the market into this room." The board, probably due to Arrow's lack in performance, widens the board's responsibilities to include execution-oriented activities. In this case, it practically contributes to the management team with sales and market-oriented guidelines and decisions.

Lastly, the intense financial and imperative focus on market and sales issues has not yet attained a strong foothold in the management agenda. Production, volume, and quality matters take up most of those meetings instead.

## The CEO Perspective: Despite all, They can Really Stretch our Abilities

### CEO Debriefing: Perhaps the Board is Right About the Competence Issue

One day in April just before lunch, the CEO calls to inform me that one of the board members is constantly questioning the competence of one of the management team members. The CEO continues: "I have to admit that I have had a total different opinion of the board member, but perhaps he is right. Perhaps we really need to exchange that person in order to reach momentum in our firm. Unfortunately, this is not the only person he is questioning and to be honest, I cannot lose two people in my team. On the bright side, our Sales Consultant is doing an excellent job." The CEO continues to say that he is really impressed by his approach and his extensive network in the Widget industry.

## Headhunter Meeting: Evaluating Candidates for the Role of Production Director

A week after the CEO debriefing, a long intense meeting between the CEO and the headhunter takes place in Stockholm. The purpose of the meeting is for the headhunter to comment upon the three internal candidates that she has met for the position of Production Director at Arrow. The CEO starts the meeting by introducing Arrow and presents the change in current ownership, including its implications. One of his key statements is that Arrow is really good at producing Widgets and that he is actually a genuine production and technology guy: "My interest and Arrow's position in the Goliath group has also been reflected in the management team composition. Now, due to the new owner, I have to deploy numerous changes whether I want it or not. One of these is changing the management team to become more business-oriented with only one production representative. The one we will chose will also be the Chair of the production management team."

Following this introduction, the headhunter gives her view on the tree candidates, their strengths and weaknesses as well as their ambitions and perspectives on this assignment.

After this rather lengthy discussion is concluded, the CEO adds that Bay Lake wants to change almost everything at once: "They have even started to indicate which employees I should let off. This leads to a lack of continuity in the organization. They want us, for example, to simultaneously build a new sale and market organization as we should change our pricing strategy. They lack the understanding that we have to invest before we can reach our ambitions. I guess I really have to start to snap back at them. On the positive side, all their questions and ambitions really stretch our abilities." He continues:

> "While it feels like earlier we were positioned in a box, the new owner is helping us to widen our options by pushing out the boundaries."

## CEO Debriefing: Was This The Last Nail in the Coffin?

On the morning before the second board meeting, I met with the CEO who told me that he had been at Bay Lake's headquarter the day before. He said: "While we discussed several issues, I finally gathered my nerves and explained to one of them that I could not tolerate the communication we have between us. Unfortunately, this led to an unpleasant discussion that resulted in no constructive outcome. The Chair also informed me that we only should take the best orders, but he has not understood that we are in no position to choose orders. Instead, we have to do all it takes to have our Widget machines running. They also complained that I am too reluctant to delegate to the management team.

> "I wonder how they can know how I act towards my management team."

On the positive side, they have finally understood that we are in no position to raise prices.

Directly after this meeting, I accompanied the Sales Consultant to lunch at the Arrow's headquarter when he informed me that the board has misunderstood the market position of Arrow's products: "They are, in fact, not as unique as they might think; rather, they should be perceived as bulk product. The products have a lot of substitutes and a weaker price premium than the board expects."

## Tête-à-tête Between CEO and Sales Consultant: Deploying Plan to Exchange Sales Director

Later in the same afternoon, the CEO explains to the Sales Consultant that the interaction with the Chair is not the best: "The owner is continuously telling me that we are producing and selling a niche product, which is why we should be able to instantly increase the price." He tells the Sales Consultant that he has drafted an action list with 16 activities on which he wants the Sales Consultant's views. He also explains that he has been instructed by the owner to let the Sales Director go and offer his job to the Sales Consultant. The Sales Consultant responds that he will accept this offer, but that the sales and market capability within Arrow lacks structure capital. Thus, the lion's share of all-important information is stored in the Sales Director's head.

After some discussions concerning an attractive setup for the Sales Director, the CEO asks whether the Sales Consultant knows anything about the action plan that the Sales Director is currently compounding with the HR Director. The Sales Consultant responds: "I have heard about it; however, I honestly do not know what they are planning. I actually think it is a bit strange that they do so without involving me." While they have brief discussion about this plan, the CEO says that he should reallocate someone from production to implement some structure and order in the sales and marketing department. The CEO expresses his frustration about the 90-day plan that the Chair is constantly requesting, and concludes the meeting: "The only thing we need right now are peaceful surroundings conducive to work." These are the CEO's last words before they part.

## Analytical Summary: Can I Really Change Who I Am?

### Being a Product of the Paved Cow Path

The CEO expresses his feeling that the board currently attacks everything right now, even which individuals should be on the management team. Even if the CEO states that he might be somewhat shielded from objectively evaluating his team members and that the reason for the board's attacks probably is the bad performance, he still feels somewhat depressed. He expresses his highly held belief that the board does not understand Arrow's need to invest before the key value drivers can ever be attained. The fact that the he also feels that the board's questions and approach removes his and his team's preconceptions makes it even more interesting.

He also perceives himself and the rest of the management team as a product of what the former owner saw as important (i.e. production and technology-oriented capabilities). This impedes his and his colleagues' possibilities to succeed in this new climate.

## On the Covert Relationship and Saying What is in Your Heart

After a few intense months, the CEO finally expresses to the Chair how discontent he is with their communication and relationship. The Chair responds quite harshly, yet he continues to use the price-setter hypothesis and demands that the CEO only to choose the best Widget orders. The CEO sees as being impossible since the total demand already is too low. The Chair requires that the CEO's delegation proneness be expanded, which makes the CEO wonder how he could have such detailed insight into his management team.

The source of the Chair's information (i.e. the Sales Consultant) started to lean more toward the management team's interpretation of Arrow, its position, and the products' position. He actually argued that the board has misunderstood Arrow's market position and that the products are not so niched. Hence, Arrow is less able to set the market price or, in other words, the products have so many substitutes that a price premium is hard to attain.

Lastly, the CEO's consideration that someone from the production department should support the sales and marketing department to implement some structure in order to achieve success reflects his view on the capacity of the production team in contrast to that of the new sales and marketing team.

# The Board Arena: Everything is Cemented in Routine Fashion

## Second Board Meeting: Does the Board Recipe Really Work?

In parallel to the former board meeting, this meeting is initiated by ticking off all formalities. This follows by a brief presentation by the CEO and CFO, which concludes that all outstanding issues concerning the acquisition of Arrow are settled. Board participants find this interesting, yet they show marginal interest in the details. All participants are relieved that everything is settled; the most financially experienced board member emphasizes that Goliath gave some warranties, which perhaps they should try to utilize due to Arrow's bad performance.

This warranty discussion leads to a discussion concerning the badwill of approximately 400 million SEK that emerged during the acquisition. The ambition from the outset had been to dissolve the badwill as a covenant protection during the initial five years; however, one of the board members convincingly argued that it might be more beneficial to dissolve it over three years. The conclusion was that the CFO was to make an analysis on the financial effects from this change.

### The CEO Report: Moving Sales from Europe Rather Than To Europe

The CEO starts by informing the participants that they have identified additional costs of 10 million SEK originating from currency effects. This initiates an intense and lengthy discussion among the participants were the CEO and CFO defend themselves by explaining that they have hedged both a fraction of the EUR and GBP flows, but not the USD flows. They say they have been in contact with the consulting firm as agreed upon during the former board meeting, but that it takes time to develop a financial policy.

The Chair annoyingly browses the financial data and wonders why they do not earn any money. The CFO responds by explaining that the price has decreased by 300 SEK per ton due to a decrease in European sales. “On the other hand”, she adds, “the production, quality, and complaint levels look really good. The fixed costs are also down by 12 %. So, in sum, what we should be worried about is our ability to strengthen the top line.”

## The Financial Situation: Should we Start Calling Ourselves the Arrow Bank?

The CFO jokes that they might skip the financial overview since the CEO already revealed everything whereby one of the most senior board members says that they are so sluggish that they need to have everything explained twice. The atmosphere of the meeting becomes notably colder and several board members shake their heads when the CFO presents a negative EBITDA result of 10 million SEK for the month; this includes the negative currency effect of 10 million SEK. Trying to remedy this bad news, the CEO quickly explains that they have launched several activities to counter-balance these effects, including a raw material project leading to monthly savings of 1 million SEK.

The CFO explains that the account receivables have grown yet again due to new customers demanding 90-day payment terms and the growth on the US market where checks are used as payment method. The Chair bursts out that we cannot afford to be a bank anymore:

> “This is the perfect and perhaps only time to change this!”

The CEO stresses that the reason for the high account receivables and low sales price is an unfortunate reallocation in sales (i.e. market mix from the profitable European markets to the less profitable oversea markets). The most senior board member concludes this discussion by saying: “Even if this news were more than disturbing, as an old CFO, I am quite impressed that the financial material is finished on the 10th day of the month.”

### One way to Strengthen Results Must be to Reorganize Management Team and Minimize Costs

The CEO says: "According to your expectations, I have now reorganized the management team. I have decreased the size from eleven individuals to seven and, while I have included the CFO and the Purchasing Director in the management, I have excluded seven Production Managers and appointed one Production Director." Hence, the current composition of the management is:

Table 6.13: Composition of the Management Team

| | *Employment Years at Arrow* |
|---|---|
| CEO | 11 |
| CFO | 1 |
| Sales Director | 20+ |
| Sales Consultant (i.e. the industry expert) | 0 |
| Administrative and HR Director | 2 |
| Purchasing Director | 25 |
| Production Director | 16 |
| Average years of employment (excl. the consultant) | >12 |

The CEO adds that no one has quit due to these changes or the decrease in head count of 42 full-time equivalents that has been deployed the last month. At this point, the HR Director is invited to the meeting to present the progress of the savings program that was launched when Bay Lake acquired Arrow. The HR Director informs the participants that savings are according to plan with a value of 90 million SEK for the next year and 110 million SEK for 2008. Upon hearing this, the board becomes very eager to assign responsibility, time, and outcome to each action so that a reliable follow-up can be accomplished. The primary focus areas are two-fold: a reduction in production costs (i.e. head count, purchase prices, consultants, etc.) and a marketing plan that is currently being formulated. While one of the board members expresses his satisfaction with the HR Director's unambiguous and measurable presentation, the HR Director adds that he is not pleased with the situation and that they are doing everything they can.

## Market Outlook: Breaking Routines and Growing Where it is Least Profitable

The Chair starts the meeting directly after lunch by saying that they should move along to the most important topic of the day: that is, the market discussion. Hence, the Sales Director and the Sales Consultant are invited into the room where they start to present a historical view of the market and how the supply and demand equilibrium currently looks. Since the raison d'être of the presentation is how tough it is, one of the board members mentions that it looks the same as it does in all industries.

The Sales Director continues to explain that the Widget industry consists of three general segments with numerous sub-segments. Arrow is positioned in one of these general segments; the Sales Director argues that customers are more or less indifferent to switch between segments. This argument makes the board twitch, but they do not interrupt him. When he continues to describe the profitability per market, one of the board members interrupts him by saying that the layout he is using in the presentation does not illustrate how bad the result actually is in the specific markets. He continues to describe the market growth in terms of Widget Spheres and Widget Cubicles while agreeing and stating that they will have to change it. One board member concludes the presentation by saying that Arrow consequently grows in the least profitable markets and within Spheres, which are the least profitable and show a negative market growth.

Another board member asks how we chose the spread between different sales channels, and the answer is that it is mostly ad hoc. This sets off a long chain of questions and statements directed to the Arrow participants including: *Where should we sell? How do we become top-of-mind? What* *should we focus on?* The board member continues by asking how they could recruit a sales force without first knowing where to focus. The CEO, Sales Director, and Sales Consultant look weak; the Chair proposes a break.

After the break, the discussion concerning profitability per market flares up again. Demands are proposed for a more thorough analysis with an EBITDA/hour perspective rather than volumes or price per ton since different sizes and density of the Widgets leads to different productivity and different prices. A question is raised about whether a market perspective might be to blunt compared to a customer perspective.

The Sales Consultant adds that they are missing the fundamental systems in order to conduct the requested analysis, but informs the board that they met with two market peers, although not competitors, to learn from their approach and systems. One of the board members asks how they calculate prices today without any system whereby the Sales Director replies:

> "…I make a control calculation when I become suspicious."

This statement is met with silence. One of the board members asks the Arrow participants with what EBITDA level they would be satisfied. He adds: "But you have said that you are satisfied if we are satisfied." He admits that perhaps was a bit cruelly worded. "We do not want that; we want you to stretch yourselves and think outside-the-box to achieve the unimaginable." The union representative swiftly adds that it is a pedagogical challenge to explain to employees how it can be sometimes more profitable to have the machines standing rather than produce Widgets.

After a few seconds of silence, the board member who is the most annoyed with the bonuses, commissions, and rebates starts up this discussion once again. He argues that there are no inducements for merchants to sell since they do not have any incentives. The Chair adds:

> "Everything is cemented in a routine fashion."

One of the most passive board members adds that they should sidestep the merchants and focus themselves upon direct-customers in order to circumvent these merchant costs: “Hence, we need to terminate all contracts and start over.” The most senior board member asks why all bonuses are volume-driven when our whole existence is dependent upon contribution. The Sales Director simply explains it by tradition. The CEO adds that all these annoying questions are really good to since this is a new way of thinking. The Sales Consultant agrees, but says that they must not act too hastily since “one of the board members and I tried that a decade ago and we all got fired.”

One board member stresses again “the ship for price increases is sailing away as we speak.” It becomes obvious that the CEO is about to mention something unwanted on this theme. He starts: “In accordance with the last board meeting, we were asked/requested to increase the prices in one of our biggest markets and we did.” He becomes quiet and looks at all participants and says: “Our largest customer representing more than 60 % in that market has threatened to throw us out and demands retroactive price decreases to keep us in his portfolio.” The Chair adds that this makes it even more important to become top-of-mind with all merchants “especially now when several of our competitor reduce capacity within our segments”. The Chair also adds: “We should investigate whether we can easily rebuild one or our Widget machines to produce Cylinders instead of Spheres.” Even though the CEO looks very skeptical, he promises to look into this.

A board member finalizes this market discussion by asking how the recruitment of the new Sales Managers is progressing. The respons is that Arrow has found good candidates; however, since Goliath currently employs them, the issue could be quite sensitive. The Chair responds by stating that Goliath is not allowed to restrict the labor market for its employees in any way. He also adds that all of this has to be done before the next board meeting and “it is your damn responsibility to match these Sales Managers’ competence and experience with the focus we want for the firm, that is the segments and application areas we will target.”

At this point, an Arrow manager is invited to the meeting to discuss future energy solutions. While the discussion is long and intense, the board's message is that maximum degree of flexibility should be sought and that the board does not care what kind of investments Arrow does or its costs. The only thing the board is interested in is that every unit of energy should be cheaper than it is today.

Before the meeting ends, one of the board members reformulates the investment policy that was decided upon during the last board meeting.

> "If the payback period is <1 year, then go for it; if it's 1-3 years, then evaluate it; and if it's >3 years, then fuck it!

The Chair adds that, since the market, sales and financial issues take so much time, they should postpone the business plan. While the other participants agree, one of the board members explains the difference between goals and means: "Before we acquired you, investments were one of your overriding goals. This has changed. Your only overriding goal is the performance and profitability; hence, investments might be a means to attain that goal."

### The Board Meeting's Aftermath: Exchanging the Sales Director

The CEO, Sales Consultant, and Bay Lake partners stay after the board meeting for a more private session. The main topic of the meeting is that the Sales Director will have to leave the firm and the Sales Consultant will serve as Acting Director until someone new is hired. The Chair asks the Sales Consultant if he is up for the job and he says that he needs to think about it over the weekend. "However, you already accepted the job last week" the Chair adds. This somewhat surprises the CEO. The other Bay Lake partners try to persuade the CFO that she really should contract a consulting firm to support her with the more complex financial issues; however, she is reluctant and explains that they need to drive these kinds of important projects from the inside.

## Analytical Summary: Doing What you are Told Regardless…

### There's no Time for Passivity; We Must Change Now!

The board is very explicit and flexible in its ideas and approaches of handling upcoming situations. The fact that it wants the management team to analyze the consequences of dissolving the badwill quicker indicates that it either foresees a covenant problem due to the weak performance or a higher tempo in Arrow's turn-around. The latter argument parallels their idea of swiftness when it comes to firm changes. In fact, the board, in all of its communication with the management team emphasizes that all large changes need to be immediately accomplished. In response to the CEO and CFO's statement that the situation is really tough, they only say that it always is tough and that there is a negative correlation between price and the firm's challenges during an acquisition process (i.e. that is why you were so cheap).

They infuse the CEO and CFO with ideas that were unattainable earlier. The management team finds it novel that everything should be measured in relation to its most finite resource: time. However, this will prove to be one of the most important control and governance mechanisms in this changeover process.

The board also criticizes the management team for being too passive: "We have provide an opportunity for you to take control of your life and your future, but still you want guidance from us in all questions and you are being way too loyal to your former employer."

### Focusing on What you Know Even Though it's not the Solution

The management team still emphasizes its success with factors such as production, quality, and complaint levels; however, it slowly yet steadily directs increasing attention toward the top-line of the profit and loss statement. This behavior annoys the board since, in contrast to outcomes, it sees the means that management deploys as marginal, if not irrelevant (i.e. the cash-flow and the EBITDA).

The most senior board member complements the CFO for being in control of her responsibilities since all financial material is already complete on the $10^{th}$ day of each month. The management team seems to possess very strong control over the factors they deem to be controllable, while it ignores the rest. However, we will see that the board's "nagging" will change the management team's view on what is truly controllable.

In contrast, it is highly appreciated when the cost focus is packaged in parallel to the board's normal modus operandi. The measureable and quantified cost-savings program that the HR Director presents reflects the structure, language, and unambiguity that the board craves. This will work as a control mechanism that the board can follow. The HR Director is quite new in the management team and is using a language less governed by production; this goes over well with the board.

## Nothing is More Important Than the Topline

The Chair labels the sales and market questions the most important topic of the day; this indicates the board's focus on the topline. While the board's view is that Arrow is much niched, the Sales Director presents the segment that Arrow is present in along with those that are adjacent. Hence, he educates the board on Arrow's non-niche position in a non-appreciated way since the board disagrees. Instead, the team lectures him on his presentation setup: that his data fails to give a correct account of the reality. In fact, it argues that it is much worse than he indicates. One reason for this is that the board wants to establish a sense of urgency: in other words, a crisis attitude. The board asks questions such as: Where should we sell? How do we become top-of-mind? Upon what should we focus? However, the board realizes that the management team and sales management has not formed a sales strategy or an idea of what its wishes to accomplish.

One of the board member's proposals to sidestep the merchant and strengthen the net revenues; this is met with resistance by the management team. This strategy would actually be in line with Bay Lake's investment heuristic (i.e. close to the end-customer); however, the Sales

Director deems it to be impossible due to tradition. Hence, if this side-stepping strategy is a bad idea, the management team lacks rational arguments in support of it. The Sales Consultant further demonstrates his personal relationship with the Chair in front of the CEO and the other management team participants.

Lastly the CEO presents the results of the board's trial-and-error strategy requested/deployed during the last board meeting. He explains that the largest customer on that market threatened to throw them out and now demands retroactive price decreases to keep Arrow in his portfolio. The Chair, who feels unwilling to embrace that information, continues to advocate the price increase idea.

### The Paradox of Short Versus Far-Sightedness

The board's view on the management team's investment autonomy gives an interesting view on the alleged short-sightedness. In fact, it seems that the board's investment horizon can be long term if the effects are immediate and included in the firm's valuation at exit. Thus, investments that generate a positive EBITDA effect will be included in the valuation of Arrow at exit and, hence, the board can advocate a long-sighted view of investments.

# The CEO Perspective: Going Against the Principals' Wishes

## Sales Director Presents Action Plan: Decreased Prices

The CEO, Sales Director, and Sales Consultant meet to discuss the sales action plan that the Sales Director and the HR Director have compounded over the last few weeks. The Sales Director hands out a printed copy of the plan and adds that they should not get upset with the fact that his name is next to all primary activities. Since both participants are so absorbed by the plan, they do not react to the Sales Director's comment. It is obvious that neither expected the plan to be as profound and comprehensive as it is. Without lifting his eyes from the plan, the CEO says he is pleased that the owner's pressure to increase the prices has finally decreased. Both participants bombard the Sales Director with questions about the plan's assumptions, timeline, and expected outcome.

After the discussion, the three agree that the most important objective right now is to secure orders for the summer (the summer the low-season of the industry): "Hence, we must decrease the prices on some of our important markets. After agreeing on this, the CEO receives an email from Arrow's most important customer who is active in the market in which the board has decided to increase prices. The CEO, who now looks somewhat pale, does not show the email to the two other participants, yet he does show it to me; the email states that, under no circumstances, will the customer accept the price increase.

While the CEO chooses to keep this information to himself for the time being, it is obvious that he is becoming more eager to find new business leads. He asks the Sales Director and Sales Consultant whether they should try to produce and sell U-Widgets. He also says that, even though he feels very reluctant to split the production capability into two parts, there might be no other choice. The other participants acknowledge that there might be a market for this; the CEO calls the most senior Production Manager and requests him to investigate the possibility as soon as possible. Before the end of the meeting, the CEO asks the Sales Director several control questions concerning the sales action plan; these are satisfactorily answered.

## Meeting with Brand Consultants: Is it Really That Important?

The CEO, Sales Director, Sales Consultant, and the HR Director meet with one of the largest brand management consulting firms in the Nordics. The most senior consultant introduces the company as a management consulting firm focusing on how one is acknowledged in the market. He continues: “We focus on sales, organization, culture, and branding. After my discussions with your Chair, I have concluded that you probably need help with establishing a market and customer-oriented organization, establishing self-confidence and energy within the organization, and finding better and stronger sales argument. All participants reluctantly agree, and he continues to say that they must formulate the following:

Table 6.14: Focus Areas

| *Focus Areas:* |
|---|
| Vision, mission (business idea), values, and brand position |
| Internal and external implementation plan |
| Establish tools to involve the employees |
| Package and present the competence |
| Toolbox for Sales Managers |

After the presentation of these five focus areas, a discussion between the CEO and the Sales Consultant emerges where the former argues that emphasis should be on the external perspective; the latter holds the opposite view. However, they both agree upon the value of having one consistent and continuous message, and approach toward the customers. The CEO informs the consultants in a very serious voice that Arrow is renowned for being extremely customer-oriented. After a lengthy discussion concerning the focus areas, a heated discussion once again materializes between the participants since they have a different view on the internal project leader who the consultants want to appoint. While the CEO wants to choose someone from the lower echelons, the Sales Consultant demands that someone from the management team govern this. The meeting is adjourned following a long and intense discussion without any decisions being made. Upon leaving the room, the CEO states that one of his greatest fears right now is that the owner wants to widen the product portfolio. He says:

> "We are currently looking into three new products due to Bay Lake's requests, but I'm sure I'll terminate them all!"

## CEO Debriefing: I Finally Have the Breathing Space I Need… Right?

On my way to Arrow's headquarters, I meet with one of its most senior market coordinators. She cheerfully informs me that she and her colleagues feel very excited about this in-house sales organization. She continues: "We really like the thought of handling all sales activities ourselves and assume a greater responsibility. I guess the only annoying thing is that we have to read about these changes in the newspaper rather than be directly informed by our manager.

Upon my arrival at the headquarters, the CEO invites me to his office to update me on the current situation. I notice, for the first time, upon entering his room that a vision is written on his whiteboard: *Produce 300,000 tons in 2010.* He informs me that he will meet two students that day to discuss whether they should write a Master's thesis on improving Arrow's logistics capability. He explains that the average price for Arrow's products has intentionally decreased by approximately 2.5 % and that Bay Lake has finally eased down on its questions, particularly on increasing the price. He continues:

> "They've either understood that I need some work peace to accomplish something or they are planning on firing me."

He continues to say that, fortunately, they have been able to obtain the internal Beta price list from one of the largest Beta producers in the Nordic market. Unfortunately, this is not pleasant reading since the market forecast of lowered Beta prices has been altered to the opposite.

The CEO also informs me that, since the holding firm that owns Arrow needs to be operating in order to handle VAT transactions, he has been requested to move his employment from Arrow AB to Arrow Holding AB. He adds that this worries him and that he needs to consult his lawyer before agreeing to such a construction. He concludes the meeting by cheerfully informing me that the new Nordic Sales Manager has signed his contract and will start in a few months.

## Analytical Summary: Taking a Deep Breath Before the Plunge

### It Seldom Pays off to go Against Your Principal's Wishes

The CEO expresses his relief that the board has finally stopped pressuring him about price increases. The truth is the board has realized the CEO is not receptive to its ideas, so it continues to simultaneously search for a new solution instead, as it processes the Sales Consultant on the same ideas.

The CEO agrees with the both the Sales Consultant and the Sales Director that following the board's instructions of raising the price will harm Arrow during the summer since the demand is too low. Hence, it plans to lower the price for the summer.

The quote "crisis is the mother of all ingenuity" comes to mind when the CEO, demands that the most senior Production Manager evaluate a new product only minutes after he receives an email from a main customer. This is combined with the necessity to lower the prices: an idea that, only months ago, was impossible. However, he admits after the meeting with the two sales representatives that the new product evaluation is probably not very viable for Arrow due to its fundamental single product strategy.

He also explains that the board wants to reallocate his employment from the operating firm to the holding firm. This is a fairly normal procedure to make the holding firm operative and, hence, increase its ability to reclaim VAT. His concern about this leads him to consult a lawyer indicates the status of the relationship between the board and the Chair, and the CEO.

Lastly, a paradox discrepancy in views between the Sales Consultant and the CEO is observed at the meeting with the consultants. In contrast to the CEO, the fact that the Sales Consultant advocate internal communication at the expense of the external team, indicates that the Sales consultant (who is new in the organization) perceives an absence of information and participation among Arrow employees. This is an idea that might parallel common sense; however, here it reflects the board's idea of empowerment and participation.

## The Board's Increasing Executiveness

At the meeting with the sales consultants, it became apparent that the Chair had informed them where there to focus, in terms of Arrow. Hence, the board's operational focus becomes increasingly evident: a reality that neither the CEO (nor the rest of the management team) appreciates. The CEO agrees with their focus areas (i.e. primarily market-oriented ones), yet he argues that Arrow is renowned for being extremely customer-oriented. The board doesn't disagree with this; rather, it believes that the customers will pay for services they appreciate (e.g. flexibility, small deliveries, and customer adaptation). There is a discrepancy between the Sales Consultant and the CEO yet again. While the CEO wants to place the responsibility of the project in the lower parts of the organization; the Sales Consultant argues this must be a top-management issue.

Lastly, from a statement on the CEO's whiteboard, it is evident that the board's and the CEO's view on the overriding objective of Arrow (i.e. its vision) is diametrically opposed. One supports autonomy, profits, and cash flow; the other propagates volumes. While these ideas are not that fundamentally separate, one speaks of means and the other of ends.

# The Management Arena: I Finally Roared!

The management team meets in the large conference room at Arrow's headquarters a few minutes past 2:00 pm. Before the management meeting starts, the CEO informs the participants that this particular management team composition has not yet been finalized: "We are currently, with the support of an external firm, evaluating three internal candidates for the Production Director position and this will to be finalized within a short while."

## Management Meeting: We are leaking on the top-line, but at Least we are Better Than Goliath

The CEO starts the meeting by asking the participants to inform him if he is spending too much time on unimportant issues. He continues to say that, since he is so exhausted with the board's numerous and continuous questions, he finally yelled at the owner. He adds:

> "I constantly have a bad conscious for not having answers to all of their questions. But, more annoyingly, after having disturbed the organization in order to find the answer, the owners seem uninterested in the response."

He continued: "I also want to stress that you should consider and reconsider whether you want to become shareholders in Arrow. I genuinely think this is a good investment in the long term. But due to the current performance, one can wonder whether this is a good investment or not. Luckily, the board has come to its senses regarding several issues. They have, for example, realized that we cannot create a business plan for the board meeting on June 29th and one of the board members has successfully convinced the others that price increases are more or less impossible. It would have been really good if he were present at the first board meeting, then my life would have been much easier."

The acting production representative informs the rest of the team that the employees are asking him a lot of questions about the last board meeting. The participants agree that the monthly newsletter that has been distributed for years should re-emerge. This communication has been on hold since the acquisition, due to heavy workload.

The CEO continues to inform the participants that the board is really worried about the financial performance and that all capacity investments are out of question. Investments that increase flexibility and decrease costs are highly interesting, however. The financing question of any flexibility or cost investment will be a challenge though since it should be off the balance sheet.

The CEO concludes this discussion by saying that surviving the upcoming summer and fall is their most important goal right now: "Since it would not surprise me if we started to earn an EBITDA of SEK 20 million per month after that."

## Looking Through the Financials

The CFO starts the financial presentation by stating that they have to widen their financial perspective to include the full profit and loss statement as well as the full balance sheet: "Thus, we have to stretch our view below the EBITDA on the profit and loss statement (P&L) and include non-operational items on the balance sheet due to the new financial construction in Arrow." The CFO stressed that the fundamental problem is that Arrow is leaking on the top of the P&L: "We are strong and competitive on both variable and fixed costs, but weak on revenues and gross margins. Hence, it is exactly as the CEO has said so many times before; we need to save and be cost-efficient to survive but the biggest-bang-for-the-buck is on the sales and marketing side." While the CEO agrees, he asks the CFO to change the layout of the P&L so that it becomes more obvious that they are doped with the Beta subsidy. He adds: "I do not want our employees to think that the performance is better than it actually is." He asks the CFO how they should work with forecasting, whereby she answers that a rolling quarterly forecasting approach will decrease the volatility in the board presentations: "More importantly, it will perhaps also help us to learn more due to a more continuous analysis and follow-up."

The CFO explains that the cash flow situation has worsened due to increase days of sales outstanding (DSO). After a brief discussion on cash flow, which seems rather distant to many of the management team members, the CEO explains the emerged badwill to the participants. He says that badwill emerged since Bay Lake acquired Arrow below visible substance: that is, below book value. The board has decided to dissolve this badwill over three years, which indicates that it expects "it will take approximately three years to turn us around. The badwill dissolvement will strengthen our EBITDA and, hence, our possibility to fulfill the bank covenants. The HR Director addresses the participants by saying: "Given the information we have been presented, what should we do?" The CEO quickly responds:

> "Redirect our attention to sales!"

## The Marketing and Sales Situation

The Sales Director starts off by informing the participants that a lot of orders have been lost during the last month. He continues to present order values and prices in different markets as well as the industry development. He stresses that Goliath's development is worse than that of Arrow. The CEO abruptly interrupts him by stating "we should not compare ourselves to Goliath since we must be much better." He criticizes how the data is presented since this does not reveal the severity of the situation. The CEO, who is quite irritated, lectures the Sales Director on how the data should be presented in the future so that they do not deceive themselves. While he tries to defend himself by arguing that this is the way it has always been done, the other participants look very bothered by this and passively stare down the table.

This discussion follows a long but scattered discussion on how to increase the environmental profile of the products and the large impact of the exchange rate volatility. Logistic opportunities in the form of new transportation and packaging were also discussed. The Sales Director and Purchasing Director informed the others during the logistics discussion that the delivery capability has to be reorganized in order to attain the discussed cost-decrease. This leads the CEO to exclaim: "This is insane! We cannot jump back and forth between alternatives all the time. We have to take one decision and live with it for a while." While leaving the discussion on the logistic opportunities, a discussion on product development emerges. The Development Director informs the rest that they have performed rather extensive tests on their two Widget products to see if one of them can be refined to work in the new high-growth segment called the D segment. The conclusion from the tests is that both the M-Widget and S-Widget suits the D segment perfectly. While one of the participants cheerfully states that a new product is unnecessary; the Development Director takes another standpoint: "Let us market this as a new product specially developed for the D segment and label it D-Widget." The discussion is concluded by a coffee break.

### Communicating With the Customers and Revealing the Sales Action Plan

After the break, one of the participants mentions that a lot of customers are starting to pose questions about Arrow's new sales organization. The HR Director adds that it is about time that they start to inform stakeholders about their plans and how they will be affected. The Sales Director disagrees and asserts that he wants to be more confident about the plans before anything is communicated externally. "But we do not want any rumors in the market," the HR Director responds. While the Sales Director agrees, he is persistent that the plans should be more explicit before anything is communicated. He continues to say that he and the HR Director have compounded a sales activity plan, which builds on a few key pillars: "We have formulated several activities addressing the following criteria: (i) our profitability, (ii) market focus and geographical position, (iii) merchant relationships, (iv) position towards some specific competitors that are closing down capacity, and (v) a few workshop sessions with our Sales Managers." The HR Director adds that, while this is important, it has to be a part of the business plan. "Hence, we need to address all of this on the upcoming planning day." The CEO adds that a consulting firm will accompany them and help with something really blurry. Browsing through the agenda of the planning day concludes the meeting.

## Analytical Summary: Loosening the Taken-for-Grantedness

### Adapting to the New World Order

The financial focus on the management team progressively becomes more prevalent. In fact, it has taken the pull position on the agenda from the production and investment questions. The profit and loss statement has become the point of departure for many of the production and investment-oriented issues. In fact, the CFO's statement that Arrow is strong and competitive on both variable and fixed costs yet weak on revenues and gross margins, is an unambiguous and explicit problem formulation and a vast leap from blaming the weak performance on lack of investments.

The agreement to change the layout of the financial reports to show how fragile the situation really is indicates the CEO's and CFO's desire to establish a sense of urgency on the management team as well as in the rest of the organization. Their agreement to establish a rolling quarterly forecasting approach is a means to mitigate the board's pressure, and the volatility in the reported figures further emphasize how the profit and loss statement is used to fulfill the goals. A huge difference in attitude could also be perceived in the CEO's response to the HR Director's question: "Redirect our attention to sales!"

The board's implicit focus on controllable issues such as costs and financing is a direct consequence of its worries about Arrow's financial performance. Hence, volume-increasing investments are disqualified (since their outcomes are hard to predict, thus, less controllable). Flexibility-increasing and cost-decreasing investments are advocated (since their effects are more predictable) as long as they do not affect the firm's financing situation (i.e. balance sheet). The CEO's use of a financial terminology also increases as a consequence of the board's focus. The changed timeframe of the badwill dissolvement might be an expression of the board's worries or an ambition to accelerate Arrow's turn-around.

## Partially Embodying the Board's View

The CEO assumes the board's view that the firm should not compare itself to Goliath, but to its most successful peers instead. He also criticizes the Sale Director in plenary for presenting the sales and market data in a way that marginalizes the severity of the situation.

Whether this is his actual belief or just a projection of the board's sentiment is unknown at this time. However, he implicitly criticized the board's industrial insights and experience when stating that its idea to raise the price would have been discarded right of the bat if one of the board members would not have missed the first board meeting. The fact that he was absent and that the price increase idea consequently was decided upon might have affected the creativeness and sense of urgency on the management team, thus, making them find other solutions to rectify Arrow's current performance. This creativeness and sense of urgency manifests itself through environmental profile issues as a way to grow the top line, mitigation plans for the exchange rate volatility as a way to minimize the board's critique, and cutting costs through reinventing the logistics and delivery capability.

All these change initiatives, and by the CEO experienced scatteredness, makes the CEO furious. He demands a more profound stability and consistency within the organization, which might indicate his level of change proneness.

Lastly, a discussion on products, product development, and product positioning takes place within the management team. The fact that the Development Director educates the rest of the management team that product development does not have to be physical development is a large mental leap for the team. In fact, packaging and positioning of the products could fulfill the board's requirement of new products as a means to increase the price premium, approach new segments, and create a niche.

### On Personalities and Persona Non Grata to the New System

During the meeting, the CEO mentions that he has a genuine belief in Arrow's long-term viability. In fact, he believes that if they survive the summer and fall, Arrow might start earning 40 million SEK per month after that. However, he also asks his colleagues, in a rather personal tone, whether he is focusing on secondary issues since the board and Chair constantly ask him questions that he finds irrelevant.

# The CEO Perspective: Price-Setting Creates an Internal Disagreement

The CEO has several rendez-vous with internal and external stakeholders on the day after the last management meeting.

## CEO Debriefing: What am I Doing to my Former Employer?

When I met the CEO in the morning, I walked with him from the main office to one of the production buildings. He explained to me that the Chair and the Sales Consultant do not realize that recruiting from Goliath can lead to a legal process: "Goliath can complicate our situation severely if we aggravate them. As it looks right now, all our Sales Managers will be recruited from Goliath even though this gives Goliath a reason to initiate a legal process against us."

## Anchoring the Sales Activity Plan With the Production Team

The CEO arrives at the production team's main conference room were the production management team and some key employees are waiting. The Sales Director has not yet arrived, and the CEO opens the meeting by saying that the Sales Director owns this meeting. When he finally arrives, he looks very stressed. He explains that he and the HR Director have compounded an action plan in order to regain control of Arrow's sales and marketing activities. He starts off by presenting the competitive situation in terms of competing firms and their products as well as the development of individual markets. By the end of this 45-minute presentation, he starts to appoint owners to the different activities. On one occasion where the Sales Director appoints two owners to the same activity, the CEO responds that he is against dividing responsibility between two persons, and requests the Sales Director choose one or the other.

After all activities have been distributed and everyone seems to understand what is expected of them, the CEO mentions his view on the owner's preconception of Arrow's market position. Bay Lake still seems to think that Arrow is unique and that there are "bulletproof walls between our competitors and us. But there are no walls, which is why we have to be flexible in our price setting." One of the most senior Production Managers questions whether lowering prices to keep market share really is the right way to go. While the CEO and Sales Director seem to think that it is, the majority of the other participants seem to disagree. The CEO ends this meeting by emphasizing that everyone in this room needs to update him on their progress within 18 days. This is really important.

## CEO Debriefing: Why Can't People do What They are Told?

When I met the CEO a few days later, he explains that two of the most important markets currently have an unfavorable development, and that they are currently setting up in-house sales offices on those markets to mitigate the situation: "The new Sales Manager for the Nordic market is currently being interviewed by Bay Lake today so I really hope I will have him onboard soon." The CEO explains that he is a bit annoyed the Sales Director is interviewing the new market coordinators instead of the Sales Consultant, as they agreed.

## Analytical Summary: Sliding Doors

The discrepancy between the CEO and Sales Director, and the board grows increasingly wider; a fracture between the organizational participants seems to emerge as well. How to go about and save the volumes and, hence, the market share seems to be the issue that divides the members on the management team.

# The Management Arena: the Short/Long-Term Conflict

## The Planning Day: Extending Your Horizons and Consolidating the Authorities

This meeting, which is expected to take 13.5 hours, starts at 8:00 am at a conference center close to Arrow. The number of participants, including the management team and the product management team exceeds twenty. The HR Director initiates the meeting by presenting the agenda and the underlying purpose of the meeting. After only a few seconds, the CEO interrupts him and completely changes the agenda. The meeting transcends from being a discussion meeting aimed at planning Arrow's long-term goals and activities to becoming a short-term action-oriented meeting. The CEO says that the idea for the meeting emerged when they presented the catastrophic result in April: "We have come to realize that, while currency losses are not okay, they are manageable. But when we lose money on our fundamental business, we need to adapt quickly." He also adds that Bay Lake has finally given up hope to change him or they are covertly planning to get rid of him. He continues: "After I criticized the communication between us, they have begun to give me some breathing space."

"We have an additional problem," the CEO adds. Our sales volumes are so low that one of our Widget machines has been standing still for four days now. This is very demoralizing for our employees and we need to fix it immediately. After having discussed this sales shortage for a few minutes, the CEO turns his head towards the HR Director, the initiator of this planning day, and says:

> "Since I stand so deep in the mud, I have a really hard time speaking in terms of visions."

More or less all of the participants laugh at this comment. The HR Director says: "Thirty minutes for discussing our future is not sufficient." He once again presents his purpose slide and says: "We are here today to initiate our strategy process. Hence, the main raison is to have a profound dialogue in this forum on how we can move forward." One participant asks him whether this is the kick-off for the business plan work; the HR Director explains that the idea for the day emerged when the board requested the management team present a long-term business plan at the board meeting on June 29$^{th}$. The CEO quickly interrupts again by saying: "Of course we can formulate a business plan, but first we have to focus upon sales and our finances. My principals will hang me if I spend valuable time on this." The HR Director and the Sales Consultant simultaneously say that the two things are not mutually exclusive, but fundamentally intertwined. In quite a harsh tone, the CEO says:

> "We need to focus on the short-term first! Thus, I want to postpone the business plan."

The CEO continues to say that he wants a three to four months' perspective and "I want us to speak very openly during this meeting." A participant asks the CEO to summarize the former board meeting: "We know nothing about the meeting's outcome, but we have heard a rumor that the business plan deadline is postponed." This has become really important in the organization. The CEO explains that the board meeting's focus is primarily directed toward marketing and sales questions, but it has recently changed characteristics. Their aggressive approach has transcended into a more understanding tone. One of the board members has educated the rest of them on the pricing mechanisms in the industry. The CEO continues to explain the necessity of having knowledgeable board members: "One problem has been that we augmented our niche position a bit too much during the acquisition process and the reprisal is hitting us hard right know in the form of a disappointed and irritated owner. Bay Lake still believes that the M-Widget and S-Widget are pure niche products."

The CFO then starts reading from the former board protocol. They discussed:

Table 6.15: Board Protocol Headlines

| *Board Protocol Headlines:* |
|---|
| CEO procedures |
| Savings program |
| Sales and market outlook |
| Beta and energy situation |
| Future energy alternatives |
| Investment routines |
| The list of open issues (i.e. the surveillance list): |
| (i) Financial policy |
| (ii) Currencies |
| (iii) Beta |
| (iv) Key value drivers |
| (v) Business plan |
| (vi) Bonuses |
| (vii) Product calculation system |

The CEO also explains that the union representatives could be perceived as hostages now since one of the board members asked them if the savings were, in fact, not quite easy to accomplish. They answered that it will work out fine due to the good cooperation climate between the union and the management team. This statement makes some of the participants look quite uncomfortable.

The CEO and CFO mutually express the need to simultaneously focus upon cost-savings and revenue-boosts. "There is a wide-spread notion among private equity firms," the CEO says, "that all changes need to be initiated and accomplished within 90 days after the acquisition. They have been telling me over and over again that the opportunity is right now and we have to seize it immediately. This is why they wanted us to increase the price on Widgets instantly." He continues:

> "The problem is that they found our false teeth in the bathroom on the wedding night, but I am confident that we will pursue our marriage anyway."

They are just in a learning process and I am confident that we will find a mutual foundation.

## Strong on Costs but Weak on Revenues

Shortly after a coffee break, the participants gather again for the CFO's presentation of the financial situation: "We have received a template from Bay Lake on how we should develop a monthly report, but I actually think that the one we are developing is more thorough and elaborate" the CFO says. "I furthermore see a dual value from the report. It is a good educational tool for the board but it also makes us more congruent." The CFO continues to present the profit and loss statement starting with revenues, commissions, and logistics. This is actually the first time the revenue-side has been presented before the cost-side. She concludes that the price still diminishes and the top of the P&L is where they should direct their efforts. More or less all variable and fixed costs have decreased except for energy costs. Before elaborating on the cash flow, she states that Arrow's strength is on the cost side; now they have to strengthen the revenue side: "We are, hence, very good at producing effectively, but we lack selling skills." She continues to educate the participants on the badwill and its effects for the upcoming three years: "This badwill supports us so that we do not violate our covenants so much, but I have invited the bank to discuss the likely future covenant breaches to be on the safe side." The CEO interrupts the CFO on several occasions during her presentation and the tension between them is obvious to the participants. One of the Production Managers ask if they should change the financial communication to the employees as to fit the one to the board whereby the CEO says: "We should not confuse our employees, hence, keep the original layout." While the Production Manager informs the participants that the employees are asking a lot of questions concerning the new direction, the CEO says that this will be communicated when they are ready.

## A Mutual Interest has Emerged

After a short break, the Sales Director takes over in order to present the market outlook. He presents a wide set of market data from different industry organizations and explains that price increases are very unlikely in the current climate. The Sales Consultant asks him if he sees any price increase in the upcoming months, to which he responds negatively. "I did not think so either," says the Sales Consultant. The Sales Director explains that there is an echo in the order books right now and that Goliath's sales organization, which still handles Arrow's sales, is quite unreasonable: "We have support from the grass roots, but not from head office." It is obvious that the Sales Director receives more questions from the participants than anyone else. In fact, he has not received so many questions since I arrived at Arrow. It is as though everyone is suddenly very interested in sales and marketing activities. The Sales Consultant adds that the customers are craving for information concerning Arrow's new sales organization. The CEO then says:

> "There is so much we ought to do in the market, but there just isn't enough time."

The CEO requests a meeting with the Sales Director and the Sales Consultant later in the afternoon, which the two gently postpone to the following day.

## Savings and Intentions in Different Functional Areas

The Purchasing Director takes over and explains to the participants that, in order to save money on purchasing, they have to work very proactively and be long-term oriented. Savings are not only found in the purchasing price per sé, but also in the mix they use, the amount they use, and the supplier they use. This leads to a discussion on the risk of currently only using one Beta supplier. After a 20-minute discussion, the participants once again split for a short break. It has also become obvious that the mutual two-way discussion on Arrow and the long-term ambitions have degenerated in to a one-way presentation from the different functional managers without any long-term context.

After a break, the HR Director starts to present the vision and strategy for the HR department that includes the primary success factors. He also adds that several individuals have resigned recently, which does not feel good. The Sales Consultant asks if a common denominator can be found between the resignations, whereby the HR Directors explain that they have not found any common denominators but that it is very dangerous if they were to quit due to a lack of belief in Arrow's future. Another participant adds that these resignations simplify the implementation of the savings program. He stresses that they have to become better at communicating the management team's ambitions and better explain where they are headed. The CEO states his belief that the employees have a good overview, but more or less all other participants disagree. The CFO continues to say that they have to establish involvement and explicitly communicate the way forward. After a rather intense discussion on the need of communication and information, the HR Director continues to present the savings-program. We have the largest opportunity to trim the fixed and variable costs by various creative solutions. We will, hence, reduce the number of consultants, make vacancies permanent, decrease purchase prices and the acquired volumes, as well as focus on decreasing the usage of the most expensive input factors. During the discussion on fixed and variable costs, the newly appointed Production Director presents the production management team's saving proposals. Based upon a combination of headcount reductions, investment postponements and adjustments in input factors, they estimate a cost-level decrease of 28.55 SEK million per annum. While the CEO looks satisfied with, this he states that it once again becomes evident that Arrow is outstanding on cost-decreases and efficiency increases, but lousy on revenue boosts and gross margin expansion: "In fact, every cost saving we accomplish is mitigated by a revenue loss." The participants leave the meeting for a mutual lunch after this rather positive discussion.

The brand management consultants arrive directly after lunch to do a one-hour workshop with the participants to identify the foundation for the vision, mission, and core values.

This workshop is followed by a two-hour discussion on the different preparation committees that Arrow has. After scrutinizing all the committees, one participant says that this hierarchical structure is worse than that of the Kremlin. A long discussion on the value and position of these committees takes place with the consequence being that more than 50 % of them are closed. While the participants seem to agree, two issues create a rather heated discussion. First, the Sales Consultant asks for a product development committee. One participant explains that this is handled bi-monthly by the production committee. This answer makes the Sales Consultant furious: "Product development should be market-driven and not production-driven. You have to realize that we are supposed to be an innovative autonomous firm now." While the participants agree to his line of logic, the HR Director asks how they feed market information and business intelligence into the firm. The Sales Consultant continues to argue for the product development committee. There are currently only six individuals at Arrow that actually meet customers, so what happens if two of them die in a car crash? The Development Director advocates the importance to strengthening the relationship between production and the market organization. The Sales Consultant adds that each and every one of the Production Managers needs to meet customers on a weekly basis. "How can you otherwise know their challenges and what kind of products and services they want? What is the overall objective of the customer service function that we have?" One participant states that this function handles all customer complaints. By this time, the Sales Consultant has become really furious: "Are you really telling me that a customer service function should work reactively and handle complaints rather than working proactively with the customers to develop world-class products and services?" By now, the participants are starting to realize that they have been working in a very introvert way. Several small discussions among participants emerge on this subject.

The CEO interrupts these small talks after a few minutes and asks whether they should postpone the brand management consulting project to the fall instead of starting right away. Even though the participants have been somewhat reluctant to this project, all but two intensely argue that they should start the project immediately. The CEO says: "Okay, but stress that the business plan will still be postponed to the fall. This project will be a really good input to the business plan." Before the meeting has ended, the CEO brings up the issue of product calculations. He states that he is not a fanatic of product calculations since they often become overly complex. One participant disagrees and says that they must have it in order to understand where and what they should sell. The Sales Director ends the discussion by saying "We know that anyway."

## Analytical Summary: Sales are the New Messiahs

While the strength of the discrepancy within the management team has vastly grown, the view on short versus long term is one of the more explicit issues that set some of the participants apart. The HR Director and the CFO see the need to focus on the long-term vision and strategic intent, whereas the CEO requires the management team and the rest of the organization to direct their attention to the immediate threat of weak sales. He elaborated on his priority and explains that there is such a huge pressure from the board to solve the immediate crises and that this is extensively affecting his decisions.

During the planning or strategy day, the position of financial and revenue questions have climbed in importance compared to earlier. Whether this is a consequence of the weak sales performance or an influence from the board's financially-oriented language is still ambiguous; however, it has attained a predominant role in the discussion and the CFO educates the participants on how the financial vocabulary can be interconnected to the board's ambitions and objectives. The interest in sales-oriented matters has also grown and no participant receives as many questions and comments as the Sales Director. Hence, the other participants' interest in financial and sales-related questions has exploded, probably as a consequence of their impact on Arrow's currently weak performance and, consequently, on the firm's possibility to survive. However, while the discussion centers on sales-oriented matters, almost all actions discussed and decided upon at the meeting concerns cost savings.

The latter part of the meeting further elucidates the incongruity between the participants' view on customer service and product development. All incumbents view these functions or services from a production outlook, while the Sales Consultant assumes the customer outlook, which stands in direct contrast to the established view.

## The CEO Perspective: I Have Never Questioned my Sales Director for Failing the Sales Budget

### Extraordinary Sales Meeting: We Must Progress Faster With More Orderliness and Structure

A few days after the planning day, the CEO called the Sales Director, the Sales Consultant, and the CFO to a very early extraordinary sales meeting. He explains to me right before the meeting that its purpose is to strengthen the progress of building the sales organization. He argues that he is unsatisfied and worried about its progress. When the other participants enter the meeting room at 7:15 am, the CEO explains that he wants to feel pleased after this meeting. He continues: "I want to discuss three primary issues today: the employment of Sales Manager and Market Coordinators, preparing for the meeting with Goliath's sales organization, and scrutinizing the sales plan."

The meeting starts off by the CEO reading the contract proposals for the new Sales Managers when he states: "We do not have any margins or cushions in our setup, which worries me." The Sales Consultant looks unsympathetic, but does not answer the comment. After a few quiet minutes, the CEO sketches a 14-bullet action list on the whiteboard and requests that the meeting will be about these bullets. The CEO argues that we are too weak on the first three bullets, which correspond to the three most important Sales Managers. He argues that it is a weakness that they only have one candidate for each position. The Sales Consultant disagrees and asserts that they have received an oral acceptance from all three candidates. "Do you have a signed agreement with them?" asks the CEO. This leads to a heated discussion between the two. The Sales Consultant argues that the CEO has to explain how he wants it done since all he does is complain.

After a short break the participants continue through the 14-bullet list by discussing issues such as the Market Coordinators, how to approach Eastern Europe, and the set-up of the customer service function. The CEO states that he is worried that all key employees they currently are employing are 55+ and that he knows that he is boorish, but that he only wants some orderliness and structure. He stresses that the staffing of the new sales organization is really parsimonious and that it is strongly associated with risks. The participants then settle the rest of the fourteen bullets, and the CEO says:

> "You see how much we can accomplish if we just spend some time together and talk."

The next objective is to secure the plan for the summer-tons, the Sales Consultant adds. He continues to state that Goliath's sales organization is key in achieving this, but argues that Arrow has been too gentle with them. The CEO's standpoint, which differs from the Sales Consultant's, is that the relationship with Goliath should be strengthened since Arrow is not only dependent upon Goliath, but they have a long history together.

At the end of the meeting, the CEO mentions in a confession kind of tone that no Sales Director has ever been yelled at for missing his budget: "I have, in fact, never questioned my Sales Director and have never been questioned myself. Our culture is pathetic, which is why I really appreciate your input." This is the last thing the CEO says to the Sales Consultant before they leave the meeting.

## CEO Debriefing: Relieving Your Worries

At 9 am on a Tuesday at the beginning of the summer, the CEO called me to explain that he had so much new information that he needs to call me to soothe his bad conscious. The new Sales Director is finally employed (i.e. the one that was intended for the Nordic market) and he will start in September or October: "Due to this, I have to inform the current Sales Director that he will have to leave the firm. I will do this on Friday with the support of the most senior Bay Lake partner."

He continued: "While we also start tests to produce U-Widgets on one of our Widget machines, it is too early to evaluate the tests. We have also contacted our Beta supplier and informed them that they have delivered 4 % less Beta than they have invoiced. While I am sure that this has been unintentional, the EBITDA impact has been considerable.

I have also on numerous occasions stressed my inconvenience with the fact that we are recruiting Sales Managers from Goliath. Bay Lake and the Sales Consultant are completely insensitive to this issue, since they argue that Goliath does not have any legal rights to restrict the labor market for their employees.

Lastly, I want to stress that the EBITDA forecast has vanished behind the horizon, which feels really detrimental."

## CEO Debriefing: Now we Must pay for the Board's Mistakes…

The CEO and I met in his office a few hours before Bay Lake arrives at Arrow to discuss the financial forecast. He explains that the order intake has decreased with 40 % the last week.

> "This is truly chaos."

He says: "While the market is doing well, we are moving in the opposite direction." The CEO continues to explain that the reason for this is that the market price has decreased while they have tried to uphold or increase the price level as a response to the board's requirements. "We have been too insensitive. The Sales Director has spent too much time on the new sales organization and too little time on the important day-to-day activities, which is to secure the short-term sales."

## Sales Preparation Meeting: Substituting the Long-Term for the Short-Term

The CEO and the Sales Director meet an hour before Bay Lake arrives to discuss price flexibility and the need for a short-term perspective. The CEO starts the meeting by stating that they need to be more flexible in their pricing strategy: "We have to be able to quickly adapt to new market conditions." He continues to stress that the long-term (i.e. the next three years) is irrelevant right now: "Instead, we have to focus on the upcoming days, weeks, and months. There are rumors in some markets in Southern Europe that Arrow is about to default."

## Analytical Summary: We Must not Forget our Origin

Even though the CEO explicitly argues that their culture is neither performance oriented nor competitive, he still believes that the former owner should be treated with more respect. He argues that the board's unintelligent instruction to raise Arrow's prices in its largest market has placed Arrow in a very shaky position. This has forced him to focus on the day-to-day business rather than the long-term view of the firm and its strategic intent.

# The Management and Board Arena: Establishing a Sense-of-Urgency

Two of the three Bay Lake partners arrive at Arrow to conduct an in-depth discussion on the financial forecast, set the overall short-term EBITDA ambitions, as well as deploy the financial reporting package.

## Bay Lake Meets Management to Deploy Financial Forecast

A few days before Midsummer 2006, two of the Bay Lake partners arrive at Arrow to meet with the full management team. The more senior of the two presents an agenda, which looked as follows:

Table 6.16: The Agenda

| *Agenda:* |
|---|
| EBITDA and cash flow goals |
| Where are we headed with the EBITDA? |
| How should we reach the right EBITDA level |
| Liquidity |
| Currencies |
| Monthly financial reporting |

He continues on to say that they have been thinking about what a reasonable EBITDA goal for Arrow should be: “As you know, we acquired the firm below visible substance, which gives us some leeway in the short and medium-term. By performing a back-casting exercise, we arrived at an EBITDA goal of 280 million SEK, which we feel is reasonable. As you also know, the firm is currently doped by a both a Beta subsidy and a badwill. I believe that it has not escaped anyone that the situation looks very unfavorable right now and that it has to be mitigated if we want to survive. The budget or forecast you presented to us when we were about to acquire you has failed on each and every point. Thus, more or less every assumption we have made has gone wrong, such as the share of sales overseas, the raw material and energy prices, as well the share of cubicles. These aforementioned factors are the reason we are here today.”

The partner continues to explain to the participants that they are no longer a part of a group, yet have to finance their investments through internally generated earnings. He explains the different factors they can affect to increase their investment frame. He continues: “I argue that we should remove the badwill from the financial reports since this is only a temporary dope and we should not be deceived by it. He becomes quiet for a moment and looks each and every participant in the eyes while asking how they think it is going. No one directly responds to this. They decide to take a short break.

After the break, the partner mentions that he has heard that Goliath's sales offices are being troublesome in some markets. The CEO verifies this and explains that it has come to their understanding that the increased sales commission from 1.8 % to 3 % only reaches the head office and not the local sales satellites that need the extra incentive. The partner responds by saying that they must become tougher toward Goliath and that it seems as though it always goes in Goliath's favor when something happens. "I get really pissed off when this happens! Even the account receivables have increased." The CFO explains that Goliath has a crisis meeting regarding this and that she is confident that the company is not doing this intentionally since it lacks control of its financial flows. The partner responds that there are so many problems with Goliath that it has to be intentional to some extent: "I have sold so many firms that I have seen jealousy on numerous occasions. I think that we should withhold money from Goliath from our Beta payments until they have settled our account receivables. Money talks!"

## The Birth of the P200 Program

The partner continues to explain how they arrived at the EBITDA target of 280 million SEK and asserts that Arrow is missing approximately 200 million SEK given the current performance reduced for the two dopes. "My colleagues and I argue that we should start a continuous project focusing on cost-savings and revenue-boosts to strengthen the EBITDA with 200 million SEK. Let us call it Profit 200 million or P200. We would furthermore like to utilize the DuPont model that we supplied you earlier to be a financial backbone of the program", the partner says. He continues to scrutinize the DuPont model/formula and state that the yank is to involve the whole firm.

After yet another short break, he explicates different areas that the management team needs to focus upon: lowering the required capital of Arrow through decreases in stock as well as account receivables, and increase the level of account payables. You have to decrease your intended investments and release capital assets through leasing and other smart financial solutions. The partner shifts the focus from the balance sheet to the profit and loss statement. The CFO interrupts the partner when he argues that the overseas market share needs to be diminished. She argues that using overseas as a measurement is too blunt; she says it is better to discuss actual markets or customers. While the partner agrees, he moves along to the cost side: "You have to spend a lot of time and energy on the Beta cost and Beta consumption and remember that this is a continuous program." The partner continues:

> "To be honest, you can do whatever you want as long as you reach an EBITDA of 280 million SEK."

The idea is that the HR Director will head this program. The CEO adds that the 10 % head count reduction has been already initiated.

## On the Current Financials

The CFO states that the current EBITDA forecast for 2006 is approximately 136 million SEK, and the senior partner asks whether the Beta subsidy is included. Since the CFO answers positively to this question, the partner says that 136 million SEK minus the Beta subsidy equals 76 million SEK: "Hence, we are missing the 200 million SEK that the P200 address." He adds: "It is damn lucky that we have the badwill." The CEO quickly responds that it is not luck. The CEO adds that they will stop selling the S-Widgets with the lowest density since the contribution margin is too low. The partner responds that it is a really stupid idea to stop selling it; they should increase the price so that "we either earn money on them or the customers stop buying." The CEO replies: "That is really smart." He continues to explain that the depreciated USD severely deteriorates the contribution levels, but that it has a positive effect on the logistic costs.

## On the Current Situation

After a shorter coffee break, the CEO states that even if it looks really bad right now, numerous projects have been initiated to mitigate the situation. He also adds that the summer period will be really tough due to few summer-tons. The other Bay Lake partner stresses that they have to go and visit each and every important current and future customer to secure the order intake.

The more senior Bay Lake partner assumes a very serious facial expression and addresses the rest of the participants: "As you know, your Sales Director is an incredibly excellent individual. However, the phase Arrow currently is entering is calling for an individual with a more extensive network and with more international experience. Through our experience, we have seen that this is a necessity for success. Due to this, we have recruited a younger and more international Sales Director (i.e. the one intended to be the Nordic Sales Manager). He is a very experienced and skilled Sales Director whose family has been in the business for four generations. My intention is to inform the current Sales Director within two hours when he comes back from the dentist. All participants are very quiet whereby the partner asks if this comes as a surprise. Everyone says yes.

One of the participants argues that they need continuity on the management team and that exchanging one individual will only have a marginal effect. He adds that "we need to supersize the whole sales and marketing department." The CEO responds by saying that this Sales Director will be more strategy-oriented and less focused upon personnel responsibility since a mid-manager position will be established. Another participant asks if the new Sales Director has any experience from Arrow's kind of Widgets; the CEO responds that this exact competence is redundant: "Instead, he has wide Widget experience from both sales and business development." After this discussion about the management team's newest member, the meeting is concluded.

## On Financial Reporting

After the former meeting, one of the Bay Lake partners, the CFO, and the financial controller meet to discuss the financial reporting. The partner stresses that sales, EBITDA, cash flow, and net debt are the four most important factors. He also emphasizes that he will coordinate everything with the other partner since he is very experienced in this area.

After a long discussion on how the monthly financial report should look, a small argument between the CFO and the financial controller develops on the issue of change. While the controller argues that the financial report should be as similar as possible to the current one due to comparability and tradition, the CFO says:

> "It doesn't have to be good just because we have used it for ages."

After this discussion, the partner adds that the key value drivers that Bay Lake developed during the acquisition process and presented (to you) two weeks before signing should be included in the report as a means for the board and management to follow the development. "Lastly," the partner says, "the covenants need to be clearly explicated in the report, so that we know where we stand right now and so that we receive early warnings if we are about to breach them."

## Analytical Summary: Tilting the Power Toward Newcomers

For this meeting, it is obvious that the intentions of the board representatives (in this case the Bay Lake partners) are purely financial and performance oriented. They have arrived at Arrow to promote and implement the idea of deploying a program to align the views of the management team, the organization and, consequently, the board; they also want to create a sense of urgency at Arrow. While the board members shove the responsibility into the hands of the management team with arguments that management is responsible for this uncertain situation; they also try to establish a "us against them" feeling to undermine the team's supposed loyalty toward Goliath.

This program is complemented with the tools they believe to be sufficient and accessible to the management team and give very explicit instructions on how to create value in terms of balance sheet adaptations, etc. Moreover, they argue that Arrow's weakness in general and the management team's in particular is the absence of international sales experience, which is why the current Sales Director needs to be exchanged. This is done to re-adjust the power-balance on the management team from production orientation to a sales and marketing orientation; it will also strengthen the position of the newer members on the management team.

## The Board Arena: in War the Workforce can be Cut With 25 %

### Third Board Meeting: Establishing a Tangible Sense of Urgency

The CEO, Sales Consultant (i.e. now the Acting Sales Director), and the owner representatives meet to discuss some difficulties one-and-a-half hours before the board meeting. The CEO explains that they currently have three problems with the Goliath relationship: "Firstly, we have found a flaw in our contract with Goliath, which has led to the loss of 600 thousand SEK due to its sales office in Spain. Furthermore, Goliath has delivered 4 % less Beta than they invoiced us for. Lastly, we have a dispute with Goliath's sales office in the market where we unsuccessfully increased the prices.

"But perhaps most importantly, the doubled commissions we paid to Goliath to give their sales offices' a strengthened incentive to sell our products, have never reached the sales offices. But, they have stayed instead on Goliath's corporate level, which has negatively affected our sales level.

The owner representatives assert that they have to gather all these outstanding issues and find a counterpart for their lawyers at Goliath. The CEO mentions that the reason for Goliath to be so hostile right now is that management is so disappointed with the sales price for Arrow and especially the Beta subsidy they had to agree upon in the twelfth hour of negotiations.

## CEO Report: Sorting out the Cash Flow Problems

After the Chair had ticked off the usual formalities, the CEO and CFO present the EBITDA, EBIT, and cash flow levels for the month. Even though the EBITDA and EBIT level was not a pleasant read, the board was very satisfied that the balance between account receivables and account payables had evened out. The reason for this imbalance was that Goliath had been slow to forward money from Arrow's customers.

The CEO continues to explain that he is really worried about the sales level and order intake: "First and foremost, we do not have any good data anymore since Goliath has supplied this to us before. Secondly, we can see an unexpected price pressure in our segments. On the bright side, a new Sales Director will join us within a few months, which feels really satisfying and all new Sales Managers have been hired. We will also cut off Goliath's sales network in the Nordic countries from August 1$^{st}$ and the rest of the world on October 1$^{st}$.

"Based upon Bay Lake's initiative we have also initiated the P200 program: a program to annually strengthen our EBITDA result with 200 million SEK. The Chair adds that, since the spread between Widget prices and the Beta costs is continually decreasing, the P200 program is the plan for our survival. The CEO continues to explain that the energy costs for the first time have blown the 1 billion-SEK interval. This steep increase in energy costs has put two of their most important competitors on the verge of bankruptcy. The Chair adds:

> "We have a really tough time right now with the dual efforts of building a sales organization and becoming cost-superior, but nothing is impossible… right?"

## The Financial Situation: Cash Flow Becomes Stronger, but Not From any Operational Success

Some of the financial issues have been discussed. To the board's delight, the CFO goes through the financial statements in detail, especially the strengthened cash flows: "The top line on the profit and loss statement is weaker than expected since we have not been successful in reallocating volumes to Europe and the exchange rates have hit us hard yet again. The less profitable Spheres (in contrast to Cubicles) have also dominated the sales. One board member questions why the logistic costs have increased with 17 % (i.e. 65 million SEK). The CEO explains: "This is a large problem and a person is currently being hired to look into this, but I think it is due to the increased energy costs." By this time, the Sales Consultant enters the meeting and immediately states that the reason for the high logistic cost is that they have perceived customer satisfaction as a goal and not as an means, hence, been giving express shipments etc. for free."

One board member wants the CFO to make the financial statements more detailed for the next board meeting so that "we can see the components that make up the costs". She refuses since this will lose the overview advantage of having one page per financial statement. The CFO also presents that Arrow is currently on the verge of breaching two out of the three bank covenants: (i) interest coverage ratio, (ii) debt/equity ratio, and (iii) equity ratio in %. A board member adds that, while this of course is negative, banks seldom react to this.

## Savings Program Transcends Into a Profitability Program, Namely P200

The HR Director who runs the P200 program is on vacation, so the CFO presents the framework and the forecast for 2006. While the board is very pleased with the framework and the explicitness of the targets, one of the board members asks how comfortable the management team is with these forecasts. The CEO responds by saying that they have good control over the cost side but not the revenue side. The Chair mentions that, at every board meeting, they are told that the prices are decreasing and the overseas sales share (i.e. outside of Europe) is increasing and, hence, the P200 program is fundamental.

> "It's do or die for Arrow!"

The CFO continues to explain that, together with Bay Lake, they identified the gap between the current EBITDA level and the owner's expectations, and realized that the value of the gap was approximately 200 million SEK. Hence, the P200 or Profit 200 program was invented: "The ambition has been to strengthen the savings program that were in place before Bay Lake acquired us and complement it with revenue generating activities. Hence, it is not a savings program anymore, but a profitability program. It is for the first time that we have been allowed to set Arrow's needs in the front seat and start nurturing our creative side on other areas than just production. Bay Lake has supplemented an advanced tool based upon the DuPont formula that we use as the backbone of this program." One board member adds that the payback on revenue activities surpasses the ones on the cost side, but "we have to be the best at everything". The CFO adds that a large contemporary project is to define the current status of Arrow's operations. In terms of cost reductions, one of the board members add:

> "In war the workforce can be diminished with 25 %."

The union quickly responds that, while this is true, it has already been done. They supplement that it is very productive to have a hypothesis like the P200 program to work with and discuss. The CFO stresses the P200 program should not be perceived as a program, but rather as a continuous process. All participants agree. The Chair concludes this discussion by adding that one big advantage of this model is that it initiates a thinking process. But today's discussion also makes it obvious that there is no room for investments in a crisis situation and that it should be communicated to all employees.

### Market Outlook: We Need to Change the Product Name

The Sales Consultant starts the market discussion by saying that the board should not expect price increases on specific markets: "Instead, our objective is to increase the average price on our aggregated sales mostly due to market reallocation. The price announcements made last month by some actors have only driven down sales prices now since our customers increase their purchase volumes and build stock before the price increase is assumed to take place." One of the board members adds:

> "This announcement of a price increase has a similar chance of survival as an ice-cream in hell. This will only lead to a somewhat increased activity in market during the months preceding the alleged price increase."

Another board member who works as a consultant in the Beta industry explains that the Beta prices are climbing now, "which is why we have to reallocate volumes to Europe before everyone else does." The Sales Consultant adds that they will change the name on the product S-Widget since they realized that customers searching for another product actually disregarded the S-Widget due to its name.

The Sales Consultant continues to inform the board that the new Sales Director, who is currently employed at Goliath, will start in September: "So I will be a parenthesis until then." The Sales Consultant continues: "In fact, all Sales Managers except one that we have recruited, come from Goliath."

A board member reminds everyone that a customer profitability analysis was going to be presented today. The CFO responds that time has been inadequate, but that they compiled a few Excel sheets. The board member says gently but firmly that he expects to have this presentation during the next board meeting. He also asks how the project with the brand-consultants is developing: "It is an important project, you know, to raise the confidence of the whole organization." The CEO informs the board that the project will be finalized in October; it includes three distinct parts: (i) to entrench the new Arrow with the employees, (ii) to build a Widget lab for customer demonstrations, and (iii) to identify and produce sales material for the new sales force. Another board member states that producing the material is not enough: "We have to learn and understand the customer." During the following coffee break, one of the board members expresses his irritation towards the CEO. He says:

> "How can you ask us for comments and advise when you haven't presented an analysis?"

The meeting ends with a discussion about the energy investment that still is pending. The CEO informs the board that several potential suppliers want to meet with the owner to assure Arrow's survival.

## Owner Debriefing: Exchanging the Role Model

When I met with most senior Bay Lake partner at the headquarters, he informed me that Arrow's current CEO will be exchanged. According to him, he is no CEO. He continues to explain that becoming CEO after 45 years of age is more or less impossible. I would argue that the current CEOs largest deficiency is his lack of business acumen and commercialism.

> "He just doesn't want to take advantage of the fact that Arrow now owns it own future."

"He is also much too loyal to his former employer Goliath and he should have reacted much earlier to the problems we have encountered with Goliath, such as the account receivables. Due to this, we have initiated a search process and have already interviewed one candidate who is the CEO of a competing firm", the senior Bay Lake partner explains.

## Analytical Summary: Shifting Views

As the management team's loyalty towards Goliath begins to waver, they simultaneously start to focus upon the aspects the board finds most important. However, the management team still projects some of these aspects (e.g. the prices) as being largely external and, hence, uncontrollable. The management team is also becoming increasingly aware that, while it is rather successful in terms of controlling the cost side of the profit and loss statement, the revenue side is still remote. Hence, the board has come to perceive the P200 program as Arrow's one and only means of survival – at least rhetorically. This program is beginning to transcend from a savings program to a profitability ditto and from being perceived as a program to a continuous process. This change in view also affects how the management team perceives certain aspects: for example, its view on Widget prices versus aggregated Widget prices, where the latter includes other factors that had not been earlier considered.

# The CEO Perspective: They Seem to Love the New Sales Director

## CEO Debriefing: Our new Sales Organization is Spectacular

The CEO sounded quite bothered when I talked to him a week before the first board meeting after the summer. He explained that the July result would be probably worse than expected, but that the Sales Consultant is doing a very good job finding new orders. Our largest and most important market is currently performing so badly that I cannot describe it in words. That, in combination with the Beta, energy and Widget prices, makes nothing but red figures seem utopian: “In fact, our energy costs have climbed with 140 million SEK in one year. During my years here at Arrow, I have decreased the headcount by approximately 90 full time equivalents and, in the scope of the P200 alone, I will be forced to make even larger cutbacks.“

“On the other hand, I have received very good news a few days ago. Through our union representatives, I have heard that one of our strongest competitors presented a huge loss and Arrow will profit tremendously if they default. Their owner was, in fact, one of the bidders on Arrow.” The CEO explained to me that the two firms were more or less identical ten years ago, but that Goliath had invested in Arrow as to grow from 160 000 tons per annum to 260 000. The other firm had remained at their original volume level due to omitted investments. “These huge investments in Arrow have been the reason for our survival.”

The CEO continues to state that he speaks once a week with the Chair and that they contact each other to the same extent. Hence, even though the pressure from the Chair has decreased, the CEO still thinks that he is drawing his conclusions way too fast. He also lacks confidence in the current board composition. The CEO is very satisfied with the recruitment of the new Sales Director who will start within six weeks.

The CEO continues to discuss the new sales organization. “I have to be honest;” he says, “our new sales organization is spectacular. It is, in fact, revolutionary. The organization is approximately one fourth in size compared to our competitors. More importantly, all recruitments but one are already accomplished and the Sales Consultant has been an important part of this. I have tried to inform the Chair how small the sales organization really is, but he just responds that it is okay. Something I find very strange is the complete and utter trust between the Chair and the Sales Consultant.”

By the end of the update, the CEO explains to me that the primary focus areas right now are the P200 program and the currency situation.

He states that he is really satisfied with three things: (i) the recruitment of the new Sales Director, (ii) the separation of the former management team, and (iii) how he handled the former Sales Director. He says: "On the more negative side, it is my firm belief that Bay Lake's yield on this investment will be postponed a few years. It depends on how successful the new Sales Director will be. I have, in fact, decreased the fixed costs with 11 % since last year, so the focus must be external now. And if I have to describe the primary weaknesses or risks, they have to be the external (i.e. uncontrollable, factors such as Beta, energy, and Widget prices).

# The board Arena: It is Important to See the Reality as It Is

## The Fourth Board Meeting: No Sense of Urgency

The meeting started according to normal modus operandi with the formalities; the CEO's new remuneration package was also presented.

### CEO Report: Skyrocketing Costs Lead to Unorthodox Ideas

The CEO starts the presentation by informing the board that the average Widget price has decreased by 454 SEK per ton. The Beta prices have increased by 90 SEK per ton, and the energy cost has increased with 118 SEK per ton this month leading to an annual negative effect of approximately 165 million SEK, thus, erasing more than the forecasted EBITDA for Arrow. He continues by stating that the P200 program is the only thing that could counterbalance this since it will deliver 200 million SEK per annum with full effect from the end of 2008.

The investment in a new energy source is expected to decrease the costs by approximately 20 million SEK per annum and the announced capacity decreases have now grown to 250 thousand tons. He adds that the Beta subsidy will come to an end by the end of this year, which leads one of the board members to argue that they have to establish financial statements that indicate how it would look without the subsidy since this only is a temporary dope. While this is agreed upon, the CEO adds that the board should be aware of how small the new sales organization actually is. Instead of using Goliath sales organization at a commission of 1.8 %, hence, approximately at 65 million SEK per annum, "we only employ eight Sales Managers and a few market coordinators, which decrease our sales costs with numerous million SEK. This solution is very creative, but there are some inherent risks in the setup."

The board continues to discuss the actual capacity closures that have been announced and the capacity growth outside of Europe. Due to the lack of information and the feeling of only possessing a fragmented view of the market, the board proposes that a market report be acquired to guide the right decisions and build a knowledge bank.

The board member with the most extensive experience from the Widget industry also adds that they should consider rebuilding one of the Widget machines so that they can produce L-Widgets as well. The proposal to change the current setup of Arrow's production capability really stresses the CEO who quickly adds that Arrow was built on the assumption of being a one-product plant (S-Widget and M-Widget has the same production procedure): "If this strategy is wrong, we really have to question it now." The CEO's reluctance is obvious, and the issue is postponed.

The Production Director enters the meeting to give the participants an overview of the production plant. The conclusion is that the production capability is in a very good shape, and there is an over-capacity in converting (i.e. converting Spheres into Cubicles). The board participants ask whether this over-capacity can be sold on the market place, but are informed that the geographical location of Arrow makes this compelling. The Chair adds:

> "Remember that the objective is to be the last one to die. A consequence of the decreasing spread between Widget prices and Beta prices has led to a caravan of Widget producers heading for the cemetery!"

## Financial Situation: The Beta Situation Ruins all Chances of Profitability

The CFO continues with the next point on the agenda by presenting the weak results for the month. The volumes have been good; however, the prices have decreased in combination with the fact that they have conducted a lot of maintenance according to plan. The currencies have negatively hit the result. The Chair adds:

> "Due to the Beta subsidy, we have a window-of-opportunity compared to our competitors and we have to use it now! "

The CFO continues by informing that they have now breached one of the bank covenants, but the bank has not yet commented upon it. She continues by explaining that the volumes are fairly strong, however, the prices have deceased again. The CEO adds that they are really worried about the sales level in Europe, which led to an unproductive meeting with Goliath's sales office that still handles all of Arrow's sales. The CFO continues to present the forecast for the rest of the year and the assumptions behind it. One of the board members questions the validity of the forecast since they assume a Beta price lower than today even though prices currently are rising. The CEO adds:

> "It's time that we decide on what we want to do with this Beta situation. Should we do the necessary investments to open up the possibility to use Gamma or not?"

The Chair quickly responds that this is obviously a viable option, but you have to deliver a structured report on the consequences of this investment: "Moreover, we will never become profitable by only focusing on the production side; instead, we have to think how we can differentiate ourselves. It is all about the product characteristics and how we chose to position the products." After a long discussion on this theme, the CFO mentions that she has one reaming question. She wants to postpone the budget for a few months. One of the board members states that the time when the budget is finished is absolutely irrelevant; instead, the quality should be in focus and that you have a strategic plan to underpin it. The union adds that it is important that it allow this process to take time since the budget is not falling down from the sky anymore.

## Market Outlook: Instead of Raising Prices, we did the Opposite

As the Sales Consultant enters the meeting, he is asked how he felt with the position as the Acting Sales Director. He replies:

> "I assumed this assignment with some skepticism."

He describes the market situation as okay, but not satisfactory and that he does not believe in any price increase this year: "It seems as we became unable to increase prices after we stopped working in cartels a few decades ago. The order situation looks okay since we found out the price level of one of our worst competitors and, thus, could steal some of their business." With a notably irritated voice, one of the board members asks if they are driving down the prices to which the Sales Consultant replied positively. This makes the board member yell:

> "This is outrageous!"

The Sales Consultant asks quite calmly if the board member has a better proposal. Another board member supported the Sales Consultant by saying that it is more profitable to lower the prices on tons in Europe than selling overseas. The first board member replies that there is a hell of a difference when comparing non-prioritized outlet markets to the strategic home market. He continues to say: "We have to make the market understand that we have to increase the prices even though market share still is important. We have to make the big dragons (i.e. Goliath and its peers) understand that it might be more profitable to them to close down capacity than to lower the prices and ruin the market. The management team must furthermore present a customer analysis to us, so we understand the structure, the outcome from the large bonuses and rebates, and the profitability on our largest customers. I am sure we lose money on a large fraction of our current customers. Last, but not least, we have stop talking about prices and start talking about contribution. I know this takes time, but we need an analysis and a plan."

Another board member asks what the cost is of having one machine standing. This statement paralyzes both the CEO and the CFO for a few seconds, when the board member continued by saying that this must be a part of the business plan and strategy. Another board member added:

> "It's important to see the reality as it is – it looks like hell!"

The same board member asks how active the sales organization is at approaching the customers who are currently using products from the Widget producers that are closing. The CEO says that they are waiting until September out of respect to their former colleagues, which makes those on the board roll their eyes. The Chair concludes the discussion by asking how the branding project is proceeding; the Sales Consultant answers that he and the new Sales Director who starts in September are developing a brand strategy where the firm's name, Arrow, will be used as a family name for the products: Arrow M-Widget and Arrow S-Widget.

## P200: Bridging the Beta Dope With the P200 Program

The HR Director, also called the P200 General, is invited in. He presents the current status of the P200 program and adds that all involved participants have started their work: "We will have a P200 workshop soon and intertwine the program with the budget process." He continues by stating that the program is a process, which will be updated quarterly and will continuously roll forward 12 months. The Chair says that this process approach is very good since it creates a dynamic process, but he also stresses:

> "…We have now been separated from Goliath for 4.5 months which means that our comparative competitive advantage (i.e. Beta dope) ends in 4.5 month;, thus, our window-of-opportunity is now half-closed. The tempo must be damn high right now!"

Two other board members simultaneously mention that they must have a fighting spirit, so "if any whiners want to leave the firm, then so be it." The HR Director adds: "Information is fundamental right now and the brand management consultants we use remind us that we still are too introvert even though I argue that the internal information to our employees is paramount." Lastly, he adds that the upcoming Sales Director is already mentally involved in all marketing and sales questions of strategic character.

The CEO takes over and asks the board what they think they should do with the exchange rate problem, which leads to the outburst of one of the board members:

> "You cannot ask us questions of this dignity without presenting an analysis!"

The CEO responds that they need the help of a magician. The CFO adds that a financial policy will be verified with some board members and will be presented during the next board meeting. The meeting is concluded with a brief presentation by the Purchasing Director who the board has perceived as being too wimpy. Right after the board meeting, the toughest and perhaps most aggressive board member approaches the CEO and says that there is way too little sense of urgency or crisis awareness within Arrow.

## The Board Meeting's Aftermath: CEO's True Belief Becomes a Reality

The Bay Lake partners, the CEO, and CFO met with the house bank of Arrow after the board meeting. The CEO makes a very frank and genuine presentation to the bank about Arrow's current bad earnings capacity. The Chair adds that the overall objective is to transform Arrow from being a cost center to being an autonomous firm who is cost-superior in all that it does. Another Bay Lake partner describes the success of Bay Lake in terms of IRR and CGM and all prominent investors it has on board. While the bank seems pleased, the CFO asks whether they should submit monthly instead of quarterly reports to the bank since they are breaching one of the covenants. The bank thinks that quarterly reports are just fine.

## Analytical Summary: Patience is Needed When Attempting to Influence People

Changes in the currently uncontrollable factors (i.e. the Widget prices, Beta price, and energy costs) during the last two months have completely erased all potential effects of the P200 program and, hence, Arrow's going concern; the board is unexpectedly calm. On top of that, Arrow has breached one of its bank covenants; this does not seem to aggravate bank representatives. Instead, the board continues to attempt to influence the management team's taken-for-granted assumptions, such as extending the Arrow's production capability to two products by introducing the more profitable L-Widget. They demand the management team to become increasingly proactive and start to assume the formulator role in addition to their historical implementer role. They also initiate discussions on product positioning and other intangible things, which is unchartered territory for the management team.

The strength of the Sales Consultant's role grows to a larger extent than the CEO and CFO are able to pose and argue for a view that differs to the board. His new position (that of Sales Director) has increased the interpretive dominance of the management team, which irritates some of the external board members. The board members have a firm conception that the sense of urgency or crisis awareness on the management team is underdeveloped and is, hence, detrimental to Arrow's continued development. Interestingly, this is something that could be also said about the bank since it seems completely unaware of the global financial turmoil that lurks around the corner.

# The Management Arena: the Management Team Needs to Assume a Greater Collective Responsibility

## Preparing Internal Sales for the Big Bang

The Sales Consultant initiates a meeting with the internal sales organization: all Market Coordinators and order handlers, excluding the Sales Managers. He starts the meeting by informing the participants that they have to prepare for the big bang on October 1st when they assume all the sales responsibility with which Goliath has helped for the last six months and for decades before that. He asks the participants if they believe the distribution between them is fair from a workload perspective; they inform him that they will not know until they have tried. One of the participants stresses the fact that the Goliath sales team was more than double the size - just to handle Arrow. The Sales Consultant responds that they employ more people if they need it.

After a lengthy discussion on customer service, they agree to invite the logistics department to a meeting later that afternoon to ensure efficient deliveries. The Sales Consultant stresses that the overall objective is to give outstanding commercial service and not be afraid to charge for extra services. The team asks him which customers they should perceive as strategic, whereby he responds that all customers are equally important right now. Even the team stresses that it must be tough when it comes to additional services, such as express deliveries: "We cannot afford to give things away for free." However, there is a large discrepancy between the newly employed and the others. Those that have been with

Arrow longer seem more reluctant to charge the customers extra for additional features.

The last question that is posed during this meeting is whether they are allowed under special circumstances to deviate from the price list. The Sales Consultant responds that the new Sales Director will have to make this decision, and they are naturally allowed to increase the prices.

## Chair Informs Management Team About CEO's Dismissal

Later that same day, the Chair arrives at Arrow's headquarters. He asks the CEO's secretary to gather all members of both the management and the production management in the large conference room right away. When everyone is present, he explains that Arrow has begun its journey from being a cost center to becoming a fully autonomous commercial firm, and that it requires a new set of leadership skills: "We have to increase the speed of the transition to become a commercial firm and we do not have time to wait for the CEO to develop his commercial set of skills. Due to this, the board has agreed to dismiss him. As you know, production expertise and technical skills are important, but this is not where we need to be strengthened; instead, it is on the commercial side. I also want to stress that the CEO has done nothing wrong, but different phases need different leadership.

"The HR Director will be Acting CEO until we find a new one. More importantly, all of you on the management team will have to become more involved and assume a greater scope of responsibility so that we do not lose any momentum. You will have to become more active and involved in the decision-making. We have several CEO candidates, but we are looking for someone who is very coaching oriented. The CEO will support a successful transition to the Acting CEO and he will be at Arrow's disposal." He continues:

> "The CEO actually said from the get-go that he might not be the right man for the job, but he wanted to try."

The Chair continues to explain that he will be present at the headquarters once per week as well as support the budget and business plan processes until they have employed a new CEO.

One of the participants asks how the CEO is feeling. The Chair explains that the CEO is a fighter. Another participant asks whether they can propose a CEO to which the Chair responds positively. Yet another question concerns the new CEO's requested traits. The Chair says that a coaching individual who has great experience and interest in the business side, the market, and logistics is the aspiration. The Chair also adds that anyone is free to call him if they have any questions.

The Chair continues to state that there is an incredible inefficiency within the Widget industry and they have to leverage on that immediately. Unfortunately, the CEO did not possess a gut feeling for the discrepancy between primary and secondary issues. He says: "Since this became mostly apparent during the board meetings, all of the board members have called me to recommend that the CEO should be exchanged." The Chair concludes the meeting by stating: "This will give each and every one of you an opportunity to grow as individuals and mutually, as a firm."

## Chair Informs Union on CEO's Dismissal

Just minutes after the meeting ends, the Chair informs the union representatives of the same. The Chair starts by saying that each time requires its leadership and "we currently have entered a new phase that requires a new kind of leadership. We need someone focusing on and being experienced from the market dynamics and logistics. Our current CEO was aware of this from the start, but we have now concluded that we need someone with the aforementioned skill set as well as someone who is more coaching oriented. We really need to increase the outspokenness and commitment of the management team. Your HR Director will be acting until we find a new CEO and I will be here once a week." The Chair asks the union representatives whether this was a surprise whereby they respond that it was expected, but that it happened perhaps a bit sooner than anticipated. One participant asks how easy it is to find a new CEO whereby the Chair responds that it is quite easy and that they both are looking within and outside of the industry. He adds that a larger responsibility will fall upon the management team and the employees: "I will also inform the press within the hour."

The Chair emphasizes that the CEO has done nothing wrong and the only motive for this is the need for a new kind of leadership and that it is too risky to wait any longer. One of the union representatives states that there are inherent risks with a CEO without a production focus: "We cannot lose focus on our production and a lot of people need a role model." The Chair ends this meeting by stating that a lack of production experience will not be a problem since he will have very experienced production-oriented co-workers at Arrow.

## Analytical Summary: Loss of Power for Production-Oriented Individuals

The Chair makes it clear that Arrow's transcendence from a cost center to an autonomous firm needs to accelerate when he informs the management team as well as the production management team and the union about the CEO's dismissal. He explicates that this acceleration can only be achieved if the commercialism of the management team is heightened; hence, a new CEO is a necessity for Arrow's survival. He also informs the participants that one of the individuals most aligned with the board in terms of language, models, and concepts (i.e. the HR Director) will be Acting CEO until a new one is recruited. The fact that the Chair will be present at the office once per week will strengthen or at least facilitate the relationship building and interaction between the management team and the board.

According to the Chair, the remaining management team members and other key employees (i.e. participants of the production management team) will also need to assume greater responsibility since the board has historically made numerous remarks on the top-down control of Arrow.

Furthermore, it is interesting how the potential CEO's background and orientation (i.e. not production) creates an anxiety in the organization since the role model (i.e. the CEO) and the rest of the organization will be diametric opposed in terms of experience, competence, and orientation. Hence, there is anxiety that there will be a reduction in the historical and vast power of production-related individuals at Arrow.

## The CEO Perspective: In the Aftermath of the Dismissal

### Handing Over to Friend and Acting CEO

The CEO, Acting CEO, and the Chair enter a meeting to secure the handover less than an hour later. During that time, the CEO has the Chair inform the management team; the CEO made a list of issues that the HR Director, who is now the Acting CEO, needs to address.

Table 6.17: Issues to Address

| *Issues to Address:* |
|---|
| Secure the new finance system |
| Negotiate the raw material agreement with the bank |
| End the telephone compensation for the employees |
| Finalize the agreements with the North America agents |
| Hire the logistics expert |
| Set up a meeting with Arrow's logistics partner |
| Finalize the agreement with the Nordic agents |
| Plan the kickoff for the agents |
| Redevelop the technical data sheets |
| Inform the new Sales Director that he needs to travel to Asia |
| Conclude the currency issue once and for all |
| Finalize the intended product calculations |
| Secure the future energy project |
| Secure the environmentally friendly sourcing material |
| Change the contribution margin used in the production which currently is wrong |
| Implement a less ambiguous rebate structure toward the merchants |
| Secure the long-term supply of Beta |

The CEO, who looks quite comfortable given the situation, says to his HR Director that he will help as much as he can. He then wishes him good luck. It is also obvious that he does not hold any grudge toward him.

## CEO's Initial Reflections

I had an opportunity to sit down with the now former CEO directly after his meeting with the Chair and the Acting CEO. He explains to me that he should have expected this since the board's communication had decreased so dramatically the last weeks and since the new Sales Director was employed in the holding firm. He continues: "Why did they not fire me one month ago since then I would have received two annual salaries from Goliath?"

He continues to question the board's composition and the hostile environment. He really hopes that the line of communication between the board and the Acting CEO will be less hostile and more supportive.

## Sales Consultants' Initial Reflections

I bumped into the Sales Consultant in the afternoon that same day, a few hours after everyone was informed. He explains to me that he had spoken to several employees and that the feelings were mixed. He continues to state that it is sad that it had to come to this, but that it is probably for the best. He says: "There are so many truths that we must challenge. I have just been to a quality meeting where the participants informed me that we never could use another kind of Beta than the one we currently are using." He continues to explain that he asked them why, to which they explained that they always used that Beta.

## Analytical Summary: He Probably Already Knew…

The CEO accepted the information from the Chair in a remarkably calm and peaceful manner, and he expressed his sincere support in choosing the HR Director as his temporary successor. He expressed a wish that the relationship and communication between the HR Director and Chair would be different and better than the one he had experienced. The Sales Consultant's reflection was that this probably would have a positive impact on his and the board's ambition to eliminate some of the preconceptions that are prevalent within Arrow and that are not aligned with the board's view.

# The Management Arena: the Post-CEO Era

## First Management Meeting Post-CEO: Shifting Perspectives and Cognitions

The management team gathered to have their first management meeting without their CEO on the morning of a beautiful late-summer day at the end of August 2006. The HR Director (hereafter referred to as the Acting CEO) starts off by welcoming everyone and stresses that one of its key members (i.e. the Sales Consultant) is stuck at an airport and will be missing this meeting.

### Agenda Suddenly Becomes More Strategic

The Acting CEO continues to present the agenda of the meeting and argues that it is his firm belief that these meetings will start off by browsing through the last meeting's protocol followed by a short update from each participant on the current situation. This latter participant presentation should include both an overview of the current and a forecast of the closest future.

The Acting CEO continues to define the focus according to three different time-horizons:

Table 6.18: Planning Horizon

| *Planning Horizon:* |
|---|
| Immediate activities: 2006/2007 |
| Short-term activities: up until 2008 |
| Long-term activities: up until 2010 |

He argues that the focus should be on performance enhancements through developing sales, as well as maintaining and developing the production. He presents a slide on the kinds of activities they should focus upon in the short and long term:

Table 6.19: Short and Long Term Activities

| *Short-Term Activities:* | *Long-Term Activities:* |
|---|---|
| Managerial control and realizing the strategy proactively through a well elaborated business plan with clear short and long-term objectives | Define and deploy value creating and profitability promoting activities |
| Formalize the profit/result enhancement program – P200 | Investigate and explicate other potential energy investments |
| Analyze and rebuild the energy sourcing | Deploy a product development capability |
| Deploy the in-house sales organization | |

The Acting CEO looks at the other participants and asks whether anyone has a different opinion on the activities. Everyone responds no. “Okay, then”, he says, “let us move on with the agenda.” The participants thoroughly scrutinize the former protocol. The Acting CEO says that he wants to add one thing to the agenda: namely, the surveillance list, which represents the outstanding issue on the board protocol that the board is monitoring closely.

The CFO asks the Acting CEO if he knows anything about the closest time ahead. The response is that he currently lacks information about that, but that he counts on being informed during the planning day with two of the Bay Lake partners next week. The CFO mentions that she read in the newspaper that Bay Lake believes it will take three to four weeks to identify a new CEO. I wonder if he will be here then or whether he has a resignation period. She continues to say that this will vastly affect the decision-making possibilities. Another participant reflects on the risk that Bay Lake employs someone the management team knows is unsuitable. She says: "It is important that we have the courage to share our reflections on this."

## No One-Man-Show Anymore

The Acting CEO acknowledges that this is an important issue. The CFO adds that everyone must understand that, while they have a new Acting CEO, everyone on the management team must assume a larger responsibility than before. The Acting CEO adds that the fact that we have such a strong relationship with the Chair is important since it gives us the opportunity to be more explicit, structured, and honest. Another participant agrees, yet adds that it must be of fundamental importance that they do not initiate too many new activities until the new CEO arrives since he must be involved in all important decisions. The Acting CEO agrees, but stresses that they must have a tempo shift: "We will deliver all the things we have promised before including a business plan and a market plan. Yet another participant argues that they should meet more than twice a month since information and experience sharing is fundamental during a period like this. The Acting CEO agrees by saying that it is only natural in a strategic change like this. The CFO adds that this increased communication and information should permeate the whole organization: "Hence, we should start to communicate weekly through our intranet as we did before the acquisition. This information must be very stringent since there are a lot of worried souls in the organization. Another participant adds that the content per sé is not as important as the fact that they are actually communicating something.

## Widening the Financial Perspective

For the very first the time, the CFO starts to present the financial outlook from the holding firm's perspective rather than from its daughter (i.e. the operating firm). She explains to the participants that the primary discrepancies between the two is that the financial costs and badwill are included in the holding firm. This is also the legal entity that the bank observes for potential covenant breaches.

The CFO presents a Widget price analysis model for the first time, which initiates intense discussions on the management team. For the first time, she has broken down the components of the Widget price so as to see the cause of price increases or decreases. This transcends the Widget price from being perceived as an uncontrollable factor to a semi-controllable ditto, without mentioning the controllability. The average Widget price for Arrow is actually compounded of four factors:

Table 6.20: Components of Widget Price

| *Components of Widget Price:* |
| --- |
| Market mix (controllable) |
| Share of Cubicle (controllable) |
| Currency effect (controllable) |
| Market price (uncontrollable) |

The CFO continues to give an overview of the holding firm's balance sheet, profit and loss statement, as well as the cash flow situation. She continues: "We have very low fixed costs for the period, but I cannot see any trend changes. Unfortunately, the overseas and Sphere share of sale is increasing." One of the participants quickly states that Spheres are not bad per sé, but that their contribution on some markets is too low. While the participants agree, the CFO adds that they have been paying their Beta deliveries after 30 days even though the payment terms clearly state 60 days.

The Purchasing Director scrutinizes all major cost areas such as Beta, raw materials, and energy. This concludes this section of the meeting.

## Narrowing the Bridge Between Board and Management

After a short coffee break, the CFO presents the major discussions and conclusions from the last board meeting by reading from the board protocol. She explains that the board meeting was fairly unstructured since everyone is trying to learn. She continues to say that she informed the board on the progress of the P200 program, on the bank's interest to finance the new energy solution, and the fact that only one position in the new sales organization is vacant. It was also discussed whether the sales organization is too skinny to fit its purpose, but no conclusions were drawn from the discussion. The Production Director presented the key ratios for the production capability; it was agreed that Arrow should try to identify all of its customers' special needs so that they can be exploited. "We also informed the board that we have increased the efficiency in our logistics capability", she continues.

The CFO explains that the board showed a great interest in the new environmentally friendly energy solution that is being investigated. The Acting CEO proposes that the Development Director should present her work, so that they can educate the board on this. One of the participants adds that this is a really good idea since "we do so many good things that they are totally unaware of." The CFO says: "We also agreed with the board to have the budget ready by December since it prefers quality to speed.

"The board once again stressed the importance of the market plan, which we really have to initiate soon." One of the participants asks if they should not deploy a Nordic market plan first and then transcend it to Europe, followed by the rest of the world. While this discussion does not lead to any explicit conclusions, the participants decide to start working immediately with the marketing plan and include a brand strategy in it.

The CFO continues to explain that the board continuously emphasized the P200 program and that they should be aware that the Beta subsidy gave them a nine month window-of-opportunity (i.e. the Beta subsidy decreased the costs of the operation over a three-quarter period) whereof 50 % has elapsed. Lastly, the board meeting added a few issues on its surveillance list, including the project with the brand management consultants, currencies in our Beta agreement, and that the business plan work will be initiated on August 24th.

## Giving an Overview of Your Area

The Development Director presents a short status of her department and continues to say that Arrow has been overly complex: "I believe everything should as simple as possible. For example, I think we should establish an external operations policy so that we can centralize all our policies in one place and decrease the level of detail. Furthermore, I suggest that all our handbooks should be merged and simplified." While all participants agree, she also proposes that an easy overview should be presented on the intranet. The Acting CEO asks her to present a proposal so the management team can decide upon it during the next management meeting.

The Production Director takes over to present the production capability. He argues that everything is under control except of the fact that "we sell too few Cubicles, that the order stock is too short, and that the long-term sick leave is increasing."

Both the Purchasing Director and the Development Director argue that purchasing and product development are, respectively, under control. Also the Acting CEO, hence the HR Director, argues that the HR department is developing according to plan, but that he really wants to start working with the business plan, so that the HR strategy can be developed.

The Acting CEO concludes this part of the meeting by presenting slides on the P200 program's organization and responsibilities, time plan, start-times, follow-up procedures, and decision points. He adds: "This is what we have agreed upon and this is what we will achieve." The CFO adds that, while the P200 program should generate a result improvement of 200 million SEK, "it will only concern those factors that we can achieve ourselves, which are controllable." The Acting CEO adds that they will also establish a communication/information committee that will continuously supply the firm and its employees with information on the contemporary activities at Arrow.

## Planning the Work Ahead

The participants discuss the purpose of the management meetings before the end of this first management meeting without the incumbent CEO. The Acting CEO states:

> "…the management team should operatively plan and coordinate Arrow and its departments given the strategic decisions we and the board mutually take."

He adds that since they are so deep into the daily operational work, they seem to miss the long-term view and strategic decisions: "Hence, we must become much better at delegation of information and power, become more structured and efficient when it comes to follow-ups, and increase the possibility of discussing various issues." He concludes by proposing that the meetings be bi-weekly. Another participant argues that the meetings should be weekly to start, since there is such a large demand for information exchange right now.

After all participants have agreed upon this intention formulation of the management team's work, the Acting CEO presents a slide on the purpose of the business plan. The Sales Consultant quickly adds that the most strategic question for Arrow is whether they should be a one-product or a multi-product firm. While the participants look somewhat uncomfortable with this question, another participant quickly asks how they should involve the board and tap their competence and experience into the business plan. One of the participants adds that, while the board members' Widget knowledge is okay, their governance, management, and negotiation competence is excellent. The CFO also adds: "They expect us to be more proactive and develop proposals to present to them instead of forcing them to become operational. We own our own opportunities and future, which is why we should be more proactive and creative." Almost all participants fully agree. The meeting is adjourned in a very cheerful mood.

After the participants part ways, I asked one of the production-oriented participants how he interpreted the dismissal of the CEO. He explains that it was not unexpected at all; however, he is impressed that Bay Lake did it so fast. He explains that he thinks the CEO's low receptivity lead to the board decision. Arrow's slow turn-around and the slow pace in establishing the sales organization were probably also important factors for the board's decision. A few minutes later, I bumped into another individual who participated in the management meeting. He argued that the reactions to the dismissal were more negative the further down the organization you look, and that it probably has to do with the lower echelon's information shortage.

## Analytical Summary: Shifting Individualism to Collectivism

The Sales Consultant role within the management team quickly strengthened when the HR Director became Acting CEO, and the Acting CEO promptly shifted the management team's views concerning the time horizon. The short term quickly swelled into an 18-month perspective rather than the monthly ditto. Through the Acting CEO, the management team had quickly redirected its focus towards both short and long term strategic activities in addition to the day-to-day dittos. The Acting CEO tried to further reduce the distance between the board and management team through thoroughly scrutinizing and discussing the board protocol with the rest of the management team. Another step to bridging the gap between the management team and the board came in the form of the Acting CEO presenting his and the CFO's intention that management must become increasingly involved in board interaction and assume a greater personal responsibility. Hence , this was no longer a one-man show. The CFO advocated how the management team needs to educate the board in order to diminish the gap between the two actors and simultaneously tap into the board's vast competence pool. He went on to say the full management team should be up to date on the discussions taking place during the board meetings.

The management team argued persuasively that they must establish a more transparent and beneficial relationship with the Chair and, subsequently, the board. The participants also agree that a tempo shift needs to be implemented so that they can deliver upon all the board's requirements, as well as increase the internal communication and information to the employees.

Lastly, while financial matters were quickly promoted on the agenda at the expense of production-related matters, the CFO presented a new view of Arrow's unicorn (i.e. the Widget prices). She presented a deconstruction of Arrows aggregated price and demonstrated the majority of its components were, in fact, controllable or quasi-controllable; hence, the team had a larger governance leeway than they expected.

# The CEO perspective: I think the board is Incredibly Naïve

I met with the former CEO at Arrow's headquarters two days after the new management team had its first meeting.

## Sure we Need New Ideas, but…

When I sit down with the former CEO, he explains to me that he is worried that the board's strategy is extremely naïve and that he is worried for his former colleagues' employment: "If they will try to make Arrow into a multi-product firm, they will crash and burn. They further only see the advantages by substituting the current Beta for other Beta variants or Gamma, and neglect all the potential risks. He goes on to explain that the industrial knowledge in the board has been too shallow: "Sure, we should try new ideas and be creative. But, there is a boundary we cannot cross."

### Analytical Summary: What is Really a New Product?

The former CEO's perspective is explicit – Arrow is a one-product firm completely adapted to a specific kind of Beta from one specific supplier. The difference in perception lies in the outlook. The board's view of a new product includes a repositioning of the same product (with the same technical traits and characteristics) into a new application area. The CEO perceives a new product as something that is tangibly new.

## The Board and Management Arena: the Planning Day

Two of the Bay Lake partners, Arrow's board members, and its management team meet on the morning of August 24th, 2006 to discuss the P200 program, the business plan, and the budget process. This meeting will be intense, long-term oriented, strategic, and last the entire day.

### Reinitiating the Strategic Change

When the Chair and his partner enter the meeting room, the atmosphere is filled with anticipation and cheer. The Chair starts of the meeting by saying: "We have an autonomous firm with a focus on segmentation, sales, cost-structure, as well as transportation and logistics in front of us. For the first time we own our complete value-chain." The Acting CEO adds:

> "All our boundaries have been demolished and a whole new set of opportunities has been opened."

The Chair agrees, but emphasizes that there are some boundaries left in the form of profitability and yield goals. The Acting CEO presents a slide describing how he has interpreted the board's instructions:

Table 6.21: The Acting CEO's Assignment

| *The Acting CEO's assignment:* |
|---|
| Achieve a result improvement: |
| (i) Yield/profitability demands |
| (ii) Depreciations |
| (iii) Keep the production intact |
| Volume development |
| Guidelines: |
| (i) No limits |
| Resources: |
| (i) Internally generated |

The Acting CEO continues: "My mission is hence to fulfill this by making sure that the management team and the whole firm paddle in the same direction. There will be an open and forgiving climate were we are allowed to do wrong, were we dare to be creative, and were we support each other." He continues to present a goal slide indicating that the short-term goals are to formulate the overall goals, craft a strategy, develop a budget process, and embody everything in a business plan: "We have to explicate our prerequisites and assumptions."

The Chair adds that he has heard from the brand management consultants that the employees at Arrow do not know so much about Bay Lake. "Hence, we have to present some information about ourselves" he says.

The Acting CEO continues to present a bullet stating that the sales strategy needs to be crafted quickly, whereby the Chair adds that they need to focus on: the market mix, the channel mix, the product mix, as well as distribution and logistics. The Chair also adds that maintaining quality and increasing efficiency must be the paramount goal of the production capability. The Acting CEO continues to state that they cannot wait with the business plan anymore since it governs all Arrow's activities and "we have to immediately depict the prerequisites for our investments." The Chair adds that they have never been closer to the market and the customer than they are today."

The Acting CEO presents a slide stating the EBITDA goal of 280 million SEK. He asks the other participants what they need to do to accomplish this. The acting CEO says: "I argue that if we do not believe that we are able to sell as many Cubicles as we assume we need to adapt the organization to fit the new prerequisites. I furthermore want to state that we cannot wait for the business plan to be finished before we act!" The Chair adds: "If you find lucrative short-term actions then just do it!" The Acting CEO continues to present the major activities from the P200 program including the in-house sales organization that will save Arrow 40 million SEK per annum, the new data system that will save 12 million SEK per annum, and the head count reduction, which will save 38 million SEK per annum. The Chair says: "This is the first time you are autonomous on deciding what you need to do. You must benchmark yourself continuously."

After this rather lengthy discussion, the Acting CEO presents a slide stating the word: *business plan*. He stresses the importance of the plan not becoming a paper tiger and that the process is more important than the actual document: "We have not had the need for a business plan before; we do need it now and the ambition is to have it done by the end of the year." The Production Director adds that they must strengthen the business intelligence operations since Goliath supplied those services to them. One of the Bay Lake partners adds that they must not forget to include the logistics in their business plan. The Acting CEO, who is an old lieutenant colonel, mentions that he has a good friend who was responsible for shipping people out of Lebanon. "This guy," he says, "will definitely apply a new perspective on our logistical challenges."

## Differentiating Between the Controllable and Uncontrollable Factors

After a coffee break, the participants gather once again in the meeting room whereby the CFO starts to present the financial assumptions: "I have a set of three external demands that governs our financial work and our upcoming budget process including the yield demands from our owner, the P200 program, and the bank covenants. The internal demand is long-term survival, which is compounded of: (i) a solid foundation to stand on, (ii) reinvestment needs, and (iii) our strategic goals. Hence, how do we look today and how do we want to look in the future? Concerning the yield requirements, they are fully aligned with the EBITDA goal of 280 million SEK." The CFO continues to stress that this goal should only include factors over which they have control; hence, an increase in the Widget's market prices will only be perceived as a bonus and not as a part of their 280 million SEK.

The Chair agrees, yet adds that they should implement a capital rationalization program as well in order to reduce the current operating capital of 1.5 billion SEK. He continues say that Goliath was really angry concerning the price for Arrow, however, "if we should be honest with ourselves, the emerged badwill has been a necessity for our survival." The Sales Consultant adds that this feels very motivating and not as an impossible mission. Another participant agrees, but stresses that when the badwill is fully dissolved, 2009 will be a really tough year. The Chair adds: "The large difference is that we have a strong competitive advantage compared to our competitors due to our unsinkable financial construction. The CFO also mentions that the board has been generous enough to let them have the budget ready by February, however, he argues this is such an important governance tool that we have to have it done by late November. We also have to remember that the budget process will be much less dramatic when we have the business plan fully developed, since it will govern our activities and assumptions." The Chair goes on to say:

> "We are currently transcending Arrow from a plan-economy to a market-economy: a process that took Russia several years."

## We Must Transcend our Blunt Outlooks to Something More Accurate

The Sales Consultant (now Acting Sales Director) starts off the market outlook presentation by stating that the volumes are actually increasing and that there has been a real drop in the market prices of Widgets. He asks the other participants whether the assumption really holds true that Cubicles are more profitable than Spheres. Without receiving an explicit response he adds:

> "There are so many truths in Arrow that we must start to question them."

The Sales Consultant adds that Spheres might be much more profitable on market X than Cubicles are on market Y. This statement follows an intense discussion among the participants. They unanimously decide that they need to understand the market dynamics on each and every geographical market and not just on an aggregated market cluster level. The Sales Consultant adds that they have been using average prices on Cubicles and Spheres, which is exceptionally bad.

Another participant says that they also need to scrutinize the branding strategy: "We have to understand how much we do sell and how much we want to sell under our own brand and private label, respectively. While the Sales Consultant agrees, he argues that the new CEO has to be involved in this, A Bay Lake partner then says that the customers should supply the primary guidance. He then asks when they will be presented with a market profitability overview. The CFO responds that they have it, but need to refine it somewhat before presenting it.

After a shorter coffee break, the Sales Consultant states that he will present some facts that might upset the Bay Lake partners: "You have argued that our product is niched and that we should direct it to different application areas. But after testing the product, it could be described as an "ein mädchen für alles" (Eng. allround traits). Hence, in contrast to the board's belief, the product is not niched toward any specific application area(s), but is fairly strong in all application areas. The question is whether product differentiation is necessary or desirable and if Arrow should be a one-product firm. Arrow has a contra-intuitive strategy since it is quite small, but still focuses on a large-scale strategy of economies-of-scale and volume products. I would argue, however, that we have to differentiate ourselves if we want to survive and be profitable. I would also argue that our product quality is too high compared to what we are able to charge our customers." The Chair responds that he agrees, yet "our products are probably niched, but not from a technical standpoint." All participants agree, and the Sales Consultant asks whether he can investigate Arrow's potential to produce the profitable B-Widgets. The Chair quickly responds: "This is exactly what we should do since the B-Widget is a very niched product for a specific application area."

After a few minutes of intense discussions, the Sales Consultant adds that they will make a full investigation of how Arrow can charge the customers extra for product and service additions, payment terms, and logistic alternatives.

### Defining and Agreeing Upon Budget Assumptions

The CFO presents the assumptions that they will use for the upcoming budget process. He says: "We will assume no new products, no vast changes in the market mix, and no changes in the Cubicle/Sphere mix. We will assume small volume increases." The Acting CEO replies that it is an important psychological question whether the market or production capability should govern the sold volumes. The Sales Consultant states that he sees opportunities to increase the volumes with 8 % next year.

Directly after the Production Director presents how much they can produce of the different products (i.e. product variants) and their inherent contribution, the Chair adds that they must stop talking about contribution per ton since it is irrelevant. "Contribution per hour," he says, "is the only relevant term since time is the thinnest sector and it differs to such a large extent depending on what we are producing."

The participants leave the meeting to eat lunch together.

## Deciding Upon What is Believed to be Arrow's Most Strategic Issue

The Production Director starts by presenting their new investment heuristics. He says they are prioritizing our investments according to the following criteria:

Table 6.22: Investment Criteria

| *Investment Area:* | *Focus Area or Decision Heuristic:* |
|---|---|
| Quality investments | Market governed |
| Volume investments | Market governed |
| Productivity | Cost governed |
| Cost reductions | Raw material, energy, personnel, and maintenance |
| Reinvestments | Retain current production ability |
| Environment | Authorities and system requirements |
| Work environment | Authorities and own priorities |

"We have decided to make a full stop regarding more aggressive investments since we are awaiting the market plan in order to know where we are headed. However, I want to stress that the risks in the current production capability are increasing the longer we wait with reinvestments", the Production Directors continues.

## Please, Don't Pee Your Pants

After yet another coffee break, the participants initiate their last session of the day. One of the Bay Lake partners argues that it becomes too dangerous to include too much wishful thinking in the budget: "Instead, I think you should include today's market prices of Widgets in the budget." The Chair adds that if the prices were to increase, they should perceive that as a bonus. While the participants agree on this point, the Bay Lake partner also adds that it is important they calculate the uncontrollable costs quite high, so they do not receive any surprises. The Chair concludes by saying:

> "Don't sugar coat the budget."

The Chair acknowledges the participants' strong control of the internal issues, however, argues that the time has come to assume control of the external issues as well: especially logistics, sales, segmentation, and margin control. The Acting CEO also adds that the production calculation system should be moved immediately to the to-do-list. One of the Bay Lake partners also points out that Arrow lacks a product development function.  The CFO agrees and argues that they must become better at feeding in market information into the firm.

## What Have We Decided Upon is How We Should Move Forward

The Acting CEO summarizes the decisions of the day by stating the business plan should be finalized by the end of the year and that the budget process will be continuous, hence, rolling twelve months (RTM). Arrow should focus upon market mix, product mix, channel mix, and logistics. He says: "We should also use today's prices on the revenue side in our budget assumptions since positive speculations about the future are seldom fulfilled."

"I think it is really good that you are here from Bay Lake, since we need to understand how you think and perceive things." The CFO adds that she thinks the board should be present when the management team discusses its goals and strategies. The planning day is concluded with the CFO stressing the need to tap into the former Sales Director's experience and information since he really can help.

## Analytical Summary: Re-Instigating the Strategic Change With Allies

While the budget, the P200 program, and the business plan are at the top of the board's and management team's agenda, it has become obvious the Acting CEO and Chair perceive this day as the re-instigation of the strategic change. The Chair further specifies sales, segmentation, cost-structure, as well as logistics as the primary means to fulfill the yield requirements of the board. The Acting CEO convincingly argued that these areas compiled in to a business plan have become increasingly important and need to be instantly addressed. The Chair agreed he advocated that this is the first time Arrow is autonomous and actually free to do whatever is necessary.

The participants continued to define the strategic underpinnings of Arrow and what the primary building blocks of the business plan and P200 program were and should be, The atmosphere is very positive and engaging. The management team further argued that it needed to become increasingly discriminating and separately analyze each and every application area, geography, and customer, instead of continuing with their aggregated approach toward market evaluation.

While the perceived alignment between the board and management had never been so strong, the Sales Consultant addressed the eternal question of Arrow's niche position when he described their products as very generic and allround. Interestingly, a product within this line of business with all-round capabilities or traits is a very niched and interesting product for Arrow's primary customers (i.e. merchandisers and not direct customers) even though this was never discussed until much later.

## The Management Arena: Shifting the Short-Term For the Long-Term

### The P200 Workshop

On the morning of one of the last days of August 2006, the full management team, the production management team, and nine of Arrow's key employees meet for a full day off-site workshop on the P200 program. The Acting CEO opens the meeting by stating the reason for the workshop: the P200 program. Contrary to common belief, this program is a result-enhancement program and not a pure cost-reduction program. The Acting CEO continues to explain that the first hour of the day will be spent on establishing a mutual foundation, in terms of views on the present and the future, as well as the purpose of the program: "The P200 mission is to fulfill the owner's yield requirements, honor our interest payments, handle depreciations, and keep the firm intact, hence, attain result enhancement." The Acting CEO continues to explain that the guidelines of the day are simple:

> "There are no guidelines."

The acting CEO continues to say: "I furthermore believe that we receive a lot of support from both the board and from Bay Lake's other portfolio firms." The Acting CEO presents a slide saying: *involvement*. He says: "All of us must be personally committed and each and every individual at the firm is important for achieving success." A slide describing the strategy's components is then presented. The Acting CEO stresses that the two focus areas are market and production: the former should address sales and logistics; the latter should address production quality, production efficiency, cost efficiency, and a continuous strive for improvement. He also presents a slide that states: *Arrow 2010*, which indicates that the first step is to formulate a vision for Arrow along with the brand management consultants that will have impact on our overall short and long-term goals.

The CFO adds that they have been looking to several product calculation systems to support the goal formulations, yet they have come to a point were they have to stop evaluating and just chose one of the alternatives. She also says that the somewhat abstract P200 figure has been back-casted via the DuPont formula. This means that they have to strengthen the current EBITDA level with 200 million SEK and, hence, achieve a result of 280 million SEK: "We will focus on controllable factors and not uncontrollable ones such as market prices, currencies, and complaints when doing this. Hence, we should direct a large fraction of our attention to the revenue and gross margin side. The Acting CEO adds if they find good and risk-free activities, then they should just go for it!

## The Pedagogical Dilemma

The CFO explains to the participants that the budget will change name to *forecast*. She adds: "If we already achieve 320 million SEK in the third quarter, we will not stop as we have done under Goliath's ownership. If we only have achieved 160 million SEK in the third quarter, we will strengthen the P200 program. I also want you to remember that the 280 million SEK only represents factors that we can affect. Hence, if the market prices on Widgets are increasing, that effect will not count since we deem it to be uncontrollable. We cannot include these factors since they change continuously - both in the short-term and in the long-term - with the business cycle." She adds that she sincerely believes this to be a pedagogical dilemma when speaking to the organization. She continues: "We must also decide what we deem to be controllable and uncontrollable." A participant asks whether this goes both ways, thus, if their result improving activities takes them to 280 million SEK; however, the market prices have decreased to such an extent that they only reach 190 million SEK. Then, would that be okay? The CFO responds that this is another part of the pedagogical dilemma since 280 million SEK is the minimum regardless of the development of uncontrollable factors. One of the most senior participants in terms of year of employment at Arrow adds that if the business cycle turns, they have to reconsider whether they are comfortable with all the risks they are taking in the P200 program, such as absent reinvestments.

## Framing the Demands of the Owner and the Bank

After a shorter coffee break, the CFO explains that the only boundaries they have are the owner's yield requirements and the bank's covenants. She continues to explain the implications of the badwill that emerged when Bay Lake acquired Arrow. The perhaps most important implication is that the badwill reflects Bay Lake's assumption. Thus, it will take approximately three years to turn Arrow around, hence, the same period as it will take to dissolve the badwill. She says: "As I have mentioned numerous times before, we have to direct our focus towards the revenues and gross margins in order to fulfill the thresholds of the owner and the bank."

She continues to state that Arrow depicted a whole other scenario during the acquisition and due diligence process, however, the development has been a disappointment to all stakeholders. Normally one is capital investing in downturns in the Widget industry, so that one can leverage when everything turns around: "But Bay Lake will never agree upon any volume investments until we show a strong performance. This is also one of the reasons that we have to start to think more strategically." One of the participants adds that this is the first time in the last 30 years that Arrow's volume growth is leveling off. Another participant says that Widget firms that have neglected to invest in volumes with less than 5 % per annum have defaulted. The Sales Consultant says, while it is correct that the volumes need to grow, the last 50 thousand tons of production capacity in which we have invested has been allocated to overseas markets where our contribution margin has been very low or negative. These last volume investments should be perceived as a failure. This is also the prime rationale for why we are reallocating our volumes to European markets." The CFO says:

"It's not about volumes; it's about the right volumes."

She goes on to say: "And I want to stress once again that the P200 is a result-improvement program and not a cost-slashing program." The CFO concludes this part of the meeting by stating: "We will have a coffee break then we start with today's teamwork activities."

## Working Across Intra-Organizational Borders

The Acting CEO and the CFO explain after the break that they have divided the participants into six different teams that will spend a few hours identifying revenue-increasing and cost-decreasing controllable factors to strengthen Arrow's performance. The Acting CEO adds that he will summarize all the identified activities in a GANT-schema and present it to the participants within a few days. Shortly later, the participants split up to join their assigned groups. The fact that Arrow's key employees are gathered to discuss Arrow's future is very novel; the fact that the teams are compounded of participants from several different organizational functions is revolutionary for Arrow. Since the teams split into different meeting rooms, I choose to join the team focusing on sales and marketing. The team is compounded of five diverging individuals including the Sales Consultant (now the Acting Sales Director). The team had an one-hour brainstorming session guided by the five areas the Chair had mentioned before: the channel mix, market mix, product mix, amendments, and payment terms. The team identified fourteen areas with an average of three activities in each area. An example of this can be found in the following table:

Table 6.23: Focus Areas and Proposed Activities

| *Focus Area:* | *Proposed Activities:* |
|---|---|
| Payment terms | Standardization<br>Form<br>Cash rebates<br>Number of payment days |
| Rebates and bonuses | Five identified activities |
| Freights | Three identified activities |
| Warehouse costs | Three identified activities |
| Amendments | Five identified activities |
| Product mix | Three identified activities |
| Market mix | Two identified activities |
| Decreasing product quality | Three identified activities |
| New product/applications | Seven identified activities |
| Order size | Two identified activities |
| Freight optimization | Two identified activities |
| Logistics system | Two identified activities |
| Better planning | Two identified activities |
| Reclamation handling | Three identified activities |

After a long in-depth discussion on these activities, their direct and indirect outcomes as well as their implications on other organizational functions, the teams met for a short presentation followed by lunch. The different groups had identified a wide set of traditional and original activities. For example, the production-oriented team had identified a large set of invisible tons. Participants had started to evaluate how much production capacity the production capability looses as a consequence of the employees showering at the end of their shift. The HR team had identified an organizational change that could decrease the head count with up to 40 full time equivalents. After this two-hour presentation from all the teams, everyone breaks for lunch.

### Summarizing the Monetary Effects

The teams continued to discuss their areas for a few hours. They once again met to present their conclusions and summarizing the financial effects. The sales and marketing group presented its conclusions, and it became obvious to the other participants that the realization and success of this team's activities alone would secure the P200 program. The financial team, which had focused upon capital efficiency, found very promising activities in terms of: decreasing the fixed assets, decreasing the finished goods warehouse, decreasing the account receivables, and increasing the account payables. The tentative effects from this group could lead to a decreased operating capital in the area of 160 million SEK.

The fixed costs team and HR team found savings of 9 million SEK and 56-58 million SEK, respectively. The team focusing on variable costs had identified 16 areas, which could result in an annual savings of 45-50 million SEK.

After all teams had presented their conclusions and the small talk became attenuated, the Acting CEO concluded that numerous good ideas and initiatives had been developed during the day and that he was very satisfied. He ended the meeting by informing the other participants that he would post something about the exercise on the intranet tomorrow morning and distribute the GANT-schema of all activities by end of this week.

## Management Meeting: Less Than Two Weeks Until the Big-Bang

The management team met for its bi-monthly management meeting about two weeks after the P200 workshop. Before everyone has joined the meeting, a few of the participants discuss whether they should continue with the self-assessment program they have used in the past. They all agree on the fact that it creates participation and commitment in the organization; they also agree that it never leads to any direct activities.

One of the participants believes that they postpone or reject all activities that are non-critical since the workload is excruciating right now. The participants agree a few minutes later that they should not initiate any new projects or pursue any activities that are not value creating. By this time, the management team has been gathered and everyone accepts the decision.

## Help to Reflect on Your own Situation

The Acting CEO informs the participants that Bay Lake will come to Arrow's headquarters within four weeks to introduce themselves to the employees and answer any questions they might have. The brand management-consulting firm identified the employees' curiosity about Bay Lake in the interviews consultants had conducted with the employees. The Acting CEO presented those conclusions from firm's preliminary report, whereby one of the participants adds that their conclusions are so painfully correct. Another participant asks why pay for this project if the consultants only "state things we already know". The CFO responds by saying that it is really hard to look at yourself and your current situation with the outside view that they can supply.

After a shorter break, the CFO starts off by describing the current financial situation. She explains that both the revenue and EBITDA level surpass the forecast. The volume and average price has increased but the Cubicle share and market mix are quite unfavorable. She continues to explain that the logistical costs have decreased; this is great, however, they are clueless about the reasons why. She adds:

> "This is just another example of our lack of control."

She continues to scrutinize the balance sheet and explains that the stock level has decreased and the account payables have increased: "However, something I am really worried about right now are our bank covenants. We are currently breaching the equity ratio covenant and, if we do not decrease the balance sheet with 10 million SEK this month, we will breach our covenant. She concludes her presentation by explaining that Bay Lake has handled the recruitment of the new Sales Director and that it has employed him in the holding firm, which she feels is quite strange.

One of the participant states after a coffee break that they should not compare the financials to the former month, however, compare to the same month last year instead. One reason for this is seasonality. "More importantly," he says, "we trick ourselves that the situation looks better than it actually is." The other participants agree, while one of them mentions that the market controller possesses so much valuable market information that never reaches the management team.

## Re-Evaluating Your Former Fears

The Production Director presents a report that the production management team has compiled on the topic of outsourcing. He explains that the team has studied one of its industry peers that have outsourced a large fraction of its maintenance department without any success. He continues to explain that there seems to exist a presumption that outsourcing leads to lower costs, while the firms they have contacted report higher costs. This leads to a rather lengthy discussion, yet no conclusions are drawn. He also asks how long they dare to postpone important investment and costs, in terms of maintenance and so on. The CFO asks the other participants if they should take all these costs during the fall and winter and perceive 2006 as a lost year: "Perhaps this will strengthen our journey." The Production Director asks who is responsible for this, and the Acting CEO asks whom he proposes. The participants agree on a manager in the production management team.

## On the Market, Development, and Procurement Front

After a shorter coffee break, the Sales Consultant introduces the other participants to the status on the market front. He says: "We have been able to increase our prices in several markets and the newly employed Sales Managers do an excellent job." He continues to explain that, when comparing to the industry organization's data, Arrow is currently gaining market shares.

"Furthermore, instead of using a call center solution for our new sales organization, we are currently educating our staff in the three major European languages and setting up an 800-number so that we can assume all sales responsibility on October 1st without interference from any external party. I guess if we managed to survive the tough summer without a sales force, we will probably do great now."

The Development Director continues the meeting by explaining that the savings program is going ahead as usual with a monthly savings of 5 million SEK: "We are also looking at new Beta variants to find additional savings. In fact, we are going to initiate some tests later this fall."

While still on the Beta issue, the Purchasing Director adds that he has ordered Beta from two different suppliers in order to supply the production team with different variants to test. He explains that they also currently experiment heavily with other raw materials in order to increase the flexibility and cost-efficiency of the production capability. He explains that they have initiated contacts with other firms to start up benchmarking activities in combination with these tests of new materials. The Sales Consultant also adds that he and the former Sales Director met with one of the most successful Widget producers in the Nordic region and that they have discussed a mutual logistics solution. While all participants acknowledge this as a good idea, the sentiment is that they should wait for the new CEO so that he or she can be a part of the decision.

## On the P200 and the Long-Term Direction

The Acting CEO starts of the last part of this meeting after returning from another short break with a 30-minute presentation on the P200 program. Following his presentation, the CFO adds that the overriding goals have been divided into a large set of sub-goals, but that the associated activities are still on a theoretical stage: "We have to identify the practical activities today," the Acting CEO adds. He then gives an example from the sales department.

Table 6.24: Example From the Sales Department.

| *Department:* | *Overriding Goal* | *Sub-Goals* | *Activity* |
|---|---|---|---|
| Sales and market | Increase gross margin and gross profit to SEK X/ton | Change the market mix | Increase sold tons in Western Europe with X p.a. |
| | | | Increase sold tons in Eastern Europe with X p.a. |

The Acting CEO continues to present a slide from the planning day describing all the goals and sub-goals, the person who is responsible for each area, where in the organization the goals and sub-goals are positioned, a illustration of the timeline, and how the participants should develop the activities and the financial impact. He continues to present an overview of the goals pertaining to the revenue side. While the overriding goal of this area is to secure additional revenue of 100 million SEK, the sub-goals include issues such as market mix. He goes on to explain that the Sales Consultant is responsible for this area and that he should note in a predefined table all activities pertaining to this goal.

All participants seem to agree that this is a good modus operandi to identify all activities. The CFO adds that they need to prioritize the activities through a cost-benefit analysis. A heated discussion between the Sales Consultant and the Acting CEO and Development Director emerges on the issue of product development. While the Sales Consultant wants to break the notions of what is possible and what is not, the other two seem to believe that the best strategy is to "stick-to-your-knitting"; hence, to continue doing what they have always done instead of trying to do something they know little about. In order to break up this heated discussion, the Acting CEO presents an Excel sheet that describes all theoretical activities that were identified during the planning day. The maximum theoretical financial impact from these activities amounts to 478 million SEK, of which 300 million SEK is market and sales related. The Production Director quickly adds that, since the activities are so disparate, the management team must stay fully aligned in its ambitions.

The meeting is concluded with one of the Production Managers presenting a tentative solution to the energy sourcing investment. After a lengthy discussion on this sourcing solution, the participants agree that this is a strategic decision of such magnitude that the board needs to be more heavily involved in the discussions.

## Analytical Summary: Crisis and Success Welds Together Even the Most Disparate Group

The acting CEO for the first time presented the P200 program to a wide array of employees and depicted its rationale as Arrow's strategic underpinnings that will support the fulfillment of the board's requirements. Another component of his communication was that a large share of personal commitment from all employees is a prerequisite in achieving this success.

The CFO explained that the budget would be relabeled and remodeled into a forecasting process. The relabeling of the budget makes it more controllable and personal. The budget was something that was historically compounded and controlled by Goliath; this is in contrast to the new forecasting process, which Arrow masters itself. This way of working makes it more affectable, more adjustable to changing environments, and something detached from the heritage as a cost-center. The CFO continued to underscore that the only requirement from the board is yield target fulfillment; everything else is up to Arrow.

As aforementioned, the fact that Arrow's key employees gathered to discuss Arrow's future is very novel; the fact the discussion included participants from several different organizational functions was revolutionary for Arrow and the processes breathed democracy and engagement. In terms of financial implications, focusing upon outcomes rather than outputs from the identified activities was also novel for Arrow. However, the participants were worried since they had come to understand that the board never would accept any volume investments. However, the Sales Consultant argued swiftly and seemingly successfully against the preconception that Widget firms in general and Arrow in particular would default unless the firm invested in volumes during downturns. The idea of exploring new Beta variants and trying new Beta suppliers was an idea that had grown increasingly in strength and was now led by its two strongest opponents: the Development and Purchase Director.

All of these aforementioned processes and mutual views had further welded the management team to such an extent that the delegation had become more recilient than ever. Moreover, a mutual view on the tough workload had emerged among the management team participants; this made them decide to postpone all activities and process that were not crucial for the P200 program or Arrow's performance.

## The CEO Perspective: Our Top Quartile Position Justify Inertia

A few weeks after the CEO had been fired from Arrow, I met with him at his home not far from the Arrow headquarters in Sweden.

### Meeting with the Fired CEO: They Cannot Alter One-Product Strategy in the Short-Term

Upon entering the former CEO's home, I asked how he was feeling. He responded that he was really disappointed. He added in what I believe to be a strictly professionally way, that Bay Lake has made some foolish decisions: "I was somewhat prepared for this since Private Equity firms are not known for their silk gloves. One of the board members actually called me this summer and informed me that this was a potential scenario. I also have to add that, while my communication with the Chair was really tenuous, I thought we had a good relationship.

"But why did they not fire me in July? This would have strengthened my chances of receiving a new job at Goliath and it would have strengthened my compensation package with one full year salary plus provisions for pension. Except for that informal phone call from one of the Bay Lake partners, they never informed me that I was not right fit for the job or that I was sitting in a shaky position."

> "I think it's legio to mention when ones position is shaky."

The former CEO continues to explain that he could have helped Arrow with so many things, but that Bay Lake never asked. "I was actually thinking of stepping down from the CEO position," he said, "and leave room for someone else since I was longing to be a Development Director again. I have a gut feeling that the Sales Consultant is one of the reasons for my fall. He was constantly communicating with the Chair behind my back and leaking information. The Sales Director was extremely questioned when he argued that Arrow would lose on third of its customers if the prices were to increase by 5 %. I think this was the reason they fired him. The annoying thing is that the Sales Consultant later on agreed upon the same fact. I did not see them communicate anymore after I questioned their covert contact, but I am sure that the Sales Consultant and the Chair continued to interact frequently."

"I do not want to criticize the Sales Consultant since he is a really good Sales Director but how can the board listen more to him than to me concerning technical issues? How can they turn to him when it comes to my area of expertise? When the Chair and one of the external board members came to Arrow's headquarters, they always entered the Sales Consultant's room and closed the door."

## I Cannot See a Successful Future When They Make the Very Foundation of our Production Capability Tremble

The former CEO continues to explain that they sold the firm as one-product firm and that he could not see a future for Arrow as anything, but a one-product firm: "They tried to produce the U-Widget as the board and the Sales Consultant requested, but it went to hell. The situation looks really bad right now with 40-50 Widget machines currently searching for niche products. Since Arrow belongs to the top quartile we should continue with our strategy (i.e. sticking-to-your-knitting strategy) until a fraction of the other firms either have closed down or reallocated to a niche segment. One of my biggest mistakes was that I did not more explicitly communicate all the cost-saving activities we initiated."

"One of Bay 's partners spent the entire dinner trying to persuade me that we should increase the prices on the M-Widget at a meeting we had together in June. The worst was when the Chair called me in the middle of May to say":

> "Hello, this is [Chair]. Hello [Chair]. You know that M-Widget is a niche product, right? Yes I do. So raise the damn prices then [phone hang-up]. "

"I sincerely believe that we should have new products in the long term, but not now. I guess there is a possibility that the Sales Consultant is trying to identify as many new ideas (including new products) as possible to redirect the attention from him, since he is the one that recommended Bay Lake investment in Arrow, which has been all but fortunate thus far. His idea to run the production capability on several different Beta sorts is outrageous."

At the end of our three-hour meeting over dinner at the home of the former CEO he explained that, when he met Bay Lake for the first time the company emphasized to him that it never meddles in the firm's operational issues since its role through the board function was one of following up. I realized already this from the inception: that one of the board members had opinions about everything.

> "The board quickly transcended from being a support and follow-up mechanism to becoming a demand-machine. "

## Analytical Summary: It's Hard to Grasp What you Never Thought of…

The CEO was sincerely disappointed over his dismissal and that his communication with the Chair had become so fragile. Furthermore, it has been both stressful and disappointing that the Sales Director had direct communication with the Chair. However, in his opinion, the board's desire to introduce new Beta variants and make Arrow a multi-product producer was the most disappointing of all since these decision were going to decompose Arrow's competitiveness.

# The Management Arena: Involving the People

The management team with the CFO in the lead started of its first autonomous budget process at the end of September 2006. The CFO had invited around 50 mid-managers and managers to this budget kick-off meeting; however, less than 50 % joined.

## Presenting Budget Directives for Management and Mid-Management

The CFO started of the meeting by positioning it like a kick-off meeting for their first autonomous budget process. She said: "We will discuss the budget in terms of the following":

Table 6.25: Areas of the Budget

| *Area* | *Owner* |
|---|---|
| Planning and follow-up | CFO |
| Budget assumptions | CFO |
| Timeline | CFO |
| Budget process | Financial controller |
| Instructions | Other financial employee |

The CFO explains to the participants that they control the assumptions and the ambitions of the budget for the first time: "Our own assessment of the market and price development will govern the outcome of the process. While we also have new external demands from our owner and from the P200 program, Goliath is neither helping nor overturning us anymore. We must remember that long-term survival and an EBITDA of 280 million SEK are our paramount goals. Secondly, investments and reinvestments will govern what we should focus upon and how we should do it." She continues:

> "We have to start to look in the crystal ball ourselves since no one will do it for us."

She then presents the areas that need to be scrutinized and evaluated, such as the sales budget and its inherent components: volumes, market-mix, product-mix, prices, freights, commissions, annual bonuses, rebates, and cash rebates. She also stresses that it will be a challenge to introduce all the employees to what she calls the P200-mindset. The CFO continues to present all the important components for each and every one of Arrow's functional areas.

## Establishing a Better Platform Next Year

The CFO starts the discussion after a short break by asking the participants how much investing and maintenance are they willing to postpone.

After a lengthy and somewhat heated discussion, the participants agree that they should not postpone any of the investing or maintenance activities; they should execute them during this year instead so that they have a good platform for 2007.

The CFO also adds that she wants to increase the middle managers' and managers' insight by influencing their own budgeting. All participants but one agree since this will increase the strength of the control mechanism and vastly increase employee commitment as well.

This discussion is followed by an in-depth scrutiny of the profit and loss statement, the balance sheet, and the cash flow. Everyone accepts the HR Director's proposal that, given changes in the environment, they should have quarterly meetings to follow-up, revise, and amend the budget. This concludes the meeting.

### Analytical Summary: One for All and All for One

While the new keywords *delegation, involvement,* and *personal commitment* began to permeate the organizational processes; the budget process became a concern for all employees.

## The Board and Management Arena: Introducing the Missing Competence

By the end of September 2006, approximately six months after Bay Lake acquired Arrow, the owners were convinced that they had found an individual that would make up for the missing business acumen at Arrow.

## Informing Union Representatives About the New CEO

On the early morning of September 25th, two of the three Bay Lake partners represented on Arrow's board and the Acting CEO gathered Arrow's five union representatives for a closed meeting. The Chair started the meeting by stating that they had been looking for an individual with some specific traits for the position of CEO. These traits included business acumen, sales and marketing orientation, as well as distribution and logistical knowledge. He continued to say that the new Sales Director who was going to start later this month had also indicated his interest in this position. After numerous test and evaluations, it was decided to make him the new CEO instead of the new Sales Director: "One good thing with this is that he can start today instead of us having to wait for 8-12 months for a new CEO" said the Chair.

The Chair continued to present the new CEO as someone with a solid background in the industry: "In fact, he is the fourth generation of Widget professional in his family. He is 43 years old and has been working as Vice President for a large Widget producer in Southern Europe. He is married with two children and he is actually born here in our municipality. Since we have the Sales Consultant as Acting Sales Director, he can continue on until we find a new Sales Director.

Thus, the new CEO will start today. The Chair went on: "Since we have a strong pool of technical competence, we strongly value that he has a business degree instead of one in engineering. Furthermore, he has worked for many years at one of our most important merchant customers and, thus, has extensive insight into their way of thinking. He has worked for our Sales Consultant earlier and he receives good recommendations from everyone to whom we have spoken. The most senior union representative states that he never heard anything negative about him, but that he is very anonymous." He also stresses the importance of the new CEO walking around the firm already this week to meet all employees.

> "Our former Director (the former CEO's manager) only visited us twice: once in the late 80s and once a week after Goliath had sold us."

The Chair concludes the meeting by explaining that the management team and the production managers will be informed about the new CEO within 15 minutes and the rest of the firm directly after that.

## Informing Management Team and Production Managers About the New CEO

The management team and the production managers (i.e. the former production management team) are invited in the conference room directly after the meeting with the union representatives. The Chair starts off the meeting by saying that they all know that there is a vacancy here at Arrow: "Hence, in order to increase the business acumen, we have now hired a new CEO." The Chair introduces the new CEO who presents himself by explaining his university degree, his professional background, and the fact that he has worked for several years for one of Arrow's most important customers.

He continues to stress the importance of not losing any customers when Arrow assumes control over all customer relationships from Goliath on October 1st, which is in a week. He also adds that his former workplace, a Widget firm in Southern Europe, was a disaster compared to Arrow.

One of the union representatives ask if he still will work with marketing and sales related questions even though he has become the CEO instead of the Sales Director. The new CEO answers that, due to the strong technical and production-oriented competence and experience that already exists within Arrow, his time will be best spent on the marketing and sales side: "I think my leadership skills and enthusiasm will be most valuable." He also points to sales, marketing, and procurement as important focus areas, as well as leveraging on Arrow's strong brand: M-Widget. The information meeting ends with the Sales Consultant stressing the importance of approaching the customers of the Widget firms that are currently decreasing their capacity. The new CEO adds that the product practically sells itself.

## Informing Employees About the New CEO

Directly after the meeting more than 160 employees are invited into the room; this represents approximately one sixth of the firm's employees. The Chair opens the meeting by introducing himself as one of the owner representatives as well as the Chair of the Board. He continues: "I am really grateful that you have all taken the time to attend this information meeting. Today's presentation will be three-fold: I will present Bay Lake; the Acting CEO (i.e. the HR Director) will present the goals and future direction; and, the Sales Consultant will present the sales and marketing organization.

The Chair states the long-term objective of any firm is to survive. I also want to paraphrase a magazine's headline when it was communicated that Goliath sold Arrow:

> "The occupation at Arrow is over!"

The Chair continued: "We have consequently been given the opportunity to develop Arrow according to our own wishes and, hence, leverage upon Arrow's specific traits and advantages. The Chair continues to explain that Bay Lake consists of approximately 15 investment professionals, of which some are more senior and have more operational experience than others. He continues to present some of their current portfolio firms and compared Arrow with one of them since both were treated as thought they were step-daugthers of the big group. He explains that they do not have a common denominator in their investments. Instead, "the expertise is located in our portfolio firms and we support them with organizational and leadership experience and skills. Our investment horizon is generally five years."

The Chair continues to present a new slide questioning why Goliath sold Arrow in the first place. He explains this by stating that Goliath was extremely pressured by the business cycle and the shareholders in combination with a new strategic intent to exclusively focus upon volume products. The Chair also adds that, in contrast to Goliath's new strategy, the firms that are usually most successful in downturns are the ones focusing on niche areas.

He then presents a slide that describes the major conclusions from Bay Lake's analysis of Arrow, which includes good and strong products, a good production capability, and a strong brand name. He says: "The areas we have to complement Arrow on include finance, sales, marketing, IT, logistics, and product development." He also mentions that one of Arrow's currently most important competitive advantages is the Beta subsidy, which gives them some leeway in these turbulent times.

The Chair indicates what makes a firm successful by presenting another slide. The major building blocks include customer-orientation, cost-superiority, and firm-wide participation, hence, mutual values and goals among the employees. He also adds that we must shorten the time-to-market on all our activities.

The Chair continues to present a slide indicating that Arrow finally stands on its own again and the majority of the transition activities have already been accomplished:

Table 6.26: Transition Activities

| *Area* | *Status* |
|---|---|
| Administrative transition | Accomplished |
| Financial transition | Accomplished |
| Commercial transition | Initiated |
| Strategic turnaround | Initiated |
| Goals and vision | Not initiated yet |
| New business plan | Not initiated yet |

The ambition is to transcend Arrow from being a cost center to a customer and results-oriented autonomous firm; in other words, from being a small fraction of an industry giant to becoming an explicit leader within its niche. The Chair concludes his part of the presentation by reminding the participants that they are not only building a new sales organization, have launched the P200 program, initiated tests with different Beta variants, tried new products, and started to focus on the 400 million SEK they spend on logistics; they have also initiated the recruitment of a new CEO. Directly after this, the Chair hands over the word to the new CEO.

The new CEO introduces himself by stating:

> "I was born with a Widget in my mouth, I have experience from four generations of Widget professionals, and I believe that my business experience will be highly valuable to Arrow."

He continues to say: "I have worked for many firms in the Widget industry and adjacent industries. More importantly, I have worked for one of your most important customers for several years. I really look forward to working with you to show Goliath how a firm like this should really be developed."

One of the participants asks what the vision for the firm will be and whether they will invest. The Chair quickly responds that they will scrutinize all opportunities; however, they will have to understand the current position first. The Acting CEO who now steps down to his ordinary role as HR Director presents a slide with the headline: *Strategy*. He explains to the participants that the two most important areas to focus upon are the development of sales and logistics, as well as retaining the product quality and strengthening Arrow's efficiency and cost-superiority. The primary activities to increase Arrow's performance will include:

Table 6.27: Primary Activities

| *Activity Areas* |
|---|
| P200 program |
| Business plan |
| Internal operational sales organization |
| Logistics development |
| Product development |

He continues to explain that these are the short-term activities the whole firm will focus upon (i.e. during 2007 and 2008): "And you should all remember that the P200 program is not a cost-savings program, but rather a results-enhancement program." The Sales Consultant reinforces the HR Director's message by stressing how large Arrow's opportunity actually is right now. He also adds that his primary objective is to find more new customers since he is certain that, with its strong production capability, Arrow can produce more given its condition and skilled workforce. "No firm has ever starved themselves to success," he says. One of the participants asks whether the S-Widget and M-Widget could be used in any other application areas. Both the Chair and the Sales Consultant simultaneously say that this is an excellent question, which probably holds the answer to Arrow's future success.

The meeting is adjourned following a short informal discussion and Q&A with the new CEO.

## Analytical Summary: The Right Person and a Common Outlook in Place

The Chair restated what Arrow's competence pool was missing and, hence, what they looked for in a new CEO. While the production experience and competence is vast at Arrow, sales and marketing skills as well as distribution and logistics knowledge was the missing piece to the puzzle. Both the Chair and the Sales Consultant, whose word has become increasingly powerful, proudly stated that they had found the right person for the job. The Chair told Arrow's employees that the occupation was over and an increased focus upon finance, sales, marketing, IT, logistics, and product development would make Arrow a highly successful firm. The Chair and the Acting CEO also explicated what were the focus areas needed to accomplish this, including the P200 program and the business plan. Hence, the new CEO was in place; a common view on the focus areas ahead was communicated to the employees and indirectly to the management team.

## The Management Arena: Contrasting Views

The management team and the brand management consultants have a mid-term meeting at the beginning of October with the consultants who will present their preliminary findings. This is also the first time that the new CEO meets with the consultants.

### Presentation of the Brand-Management Consultants: Out-of-Date and too Traditional

One of the consultants explains to the participants that, while the purpose of this meeting is to present the preliminary findings, the more important purpose is to present ideas concerning the business idea, vision, position for the brand name, and the strengths of Arrow's product(s). The next step is to develop an implementation plan for these fundamental formulations followed by building the necessary tools to persuade the employees about these formulations. He concludes by saying: "We will finally conceptualize the ideas and create a toolbox for the sales force to carry out the message to the market."

The most senior consultant explains that there are three fundamental steps in their process: the overview of the current situation, the platform or strategy, and the realization or implementation plan. He says: "The first of these steps will be presented to you today."

The HR Director quickly interrupts the consultant and asks if they should really formulate Arrow's business idea and vision: "I thought that was our job." The new CEO (hereafter referred to as the CEO) reflected the same thought. He added: "We cannot be fed with some formulations; we have to do it ourselves with our colleagues instead. This comment leads to a lengthy discussion between the management team and the consultants where the latter argue that it will be a more fruitful outcome if they have some tentative formulations that they can discuss, revise, and amend. The management team agrees to some extent; the HR Director argued that the formulations  are not the primary purpose per sé, but are instead the process of getting there.

After a rather rocky start, the consultants present the outcome of the interviews with Arrow's customers. The HR Director and the CEO once again criticize them since the interviews were made with primarily Swedish customers even though Arrow exports more than 90 % of its Widgets. A lengthy debate once again develops and the relationship between the management team and the consultants seems to deteriorate quite quickly. The participants split for a shorter coffee break.

## Are They Carrying Board Message or Right Message?

Following the break, the most senior consultant asks the participants what the most important factors are when a customer buys Widgets. Rather than waiting for a response, he says that their interviews indicate that the answer is three-fold. The customers want to experience the firm; they want to experience the competence and the relationship, and they want to experience the product or solution. After a long discussion on the effects of this and how this affects the Widget industry's value-chain in general and Arrow's in particular, the CEO emphasizes the need for Arrow to communicate more with its end-customers. He says: "The problem is that Widgets are becoming more and more commodity-like, which is why we have to establish a stronger position with our merchants." The rest of the management team agrees, and the consultants also stress the importance of selling directly to the end-customer and, hence, sidestepping the merchants. The consultants present an analysis of Arrow's three strongest competitors and explain how they have chosen to approach the market and the end-customers. They then contrast customer perception of Arrow to their view of their competitors; they conclude that Arrow is nice and personal, however, out-of-date and too traditional.

Arrow needs to strengthen its relationship with the end-customers and deploy a customer-segmentation approach.

## On the Relationship With Employees

Upon their return from a shorter break, the consultants continue to describe the outcome of the interviews with the employees. A large number of them neither feels appreciated nor trusted, nor believe there is enough information from the management team. The CEO argues that employees always crave more information; while the others on the management team seem to disagree. The HR Director emphasizes the importance of information and another participant argues that the employees want to know the direction of the new Arrow. On the good side, the consultants say, more than 75 % of the employees feel that being acquired by Bay Lake is a positive thing.

The consultants also explain that the employees emphasize quality awareness, knowledge, and reliability as the firm's most positive traits. While the consultants mention that this neatly matches the customers' perception, there is a need to formulate a clear and reachable vision, increase the sense of responsibility, and show to the organization that competence is valued. This discussion leads back to the issue of which type of customers' value which traits. The CEO states that it is more or less impossible to attain a price premium for Widgets, which is why they have to strengthen their relationship with the merchants and focus upon being the merchants and end-customers. While the Sales Consultant agrees, he adds that the Widget price only represents 15-20 % of the customers' total price, which is why we must transcend to a total-price approach. "Moreover, we must kill all old truths and everything that is taken for granted", the CEO continues.

The meeting is concluded in a somewhat hampered mode where the CEO and the Sales Consultant argue that Arrow is too small to spend resources on the end-customers.

## Analytical Summary: Mimicking Board Perception Rather Than Doing Objective Analysis

The management team along with the new CEO in the forefront argued in contrast to the consultants that even though the fundamental formulations of Arrow are extremely important – that is to say, the vision and business idea - it is the journey or process toward the formulations rather than the formulation per sé that is significant. The obvious discrepancy between the consultants, which the board had powerfully recommended and the management team continued to grow when the targeted customers were discussed. The board's idea of approaching end-customers directly rather than through merchandisers was recommended by the consultant; this was something that was based upon the consultants' scrutiny and interviews with three competitors and numerous of customers. What the consultants had missed was the fact that they had primarily interviewed Swedish customers; Arrow sold more than 90 % of their Widgets outside of Sweden and two out of the three analyzed competitors were on the verge of defaulting.

# The CEO Perspective: the CEO's First Insight in the Strategy Process

The brand management consultants the CEO, HR Director, and Sales Consultant meet in the CEO's room directly after the meeting.

## Could the Brand Management Consultant's Analysis be More Wrong?

"I have to admit that this meeting was a huge disappointment," the CEO says. "They made so many mistakes that I do not know where to start. First of all, the three competitors they compared us with were quite upsetting. They used them as examples of Widget firms' with great strategies even though two of them are on the verge of bankruptcy. Secondly, they should not formulate our vision and business idea; instead, it should come from us and from our employees. The formulations must emerge from our hearts and feelings. Lastly, they only interviewed our Swedish customers when more than 90 % of our sales come from abroad.

Both the HR Director and Sales Consultant agree with the CEO's statements. They have a short discussion on its consequences before leaving for their respective homes.

# The Management Arena: Starting to Take Control of Your Own Destiny

## Management has a Workshop About Vision, Business, and Goals

The CEO begins the meeting by stating that this is the start of our future: "After reflecting upon the brand management consultants' work, I have to say they have done a great job at describing our current situation. While we can question some of their results, we can learn a lot from them as well." The CEO continues to mention that the management team and the full organization have to take over the process and assume internal ownership of the process.

"We have a lot of information in the form of the due diligence material, material from the brand management consultants, input from the P200 program, all consultancy reports, and from the industry organization. We should, hence, be able to define our vision and business idea ourselves." The HR Director adds that it feels like everything is dependent upon their formulations of the vision and business idea. The CEO agrees and adds that formulations have to emerge from within the organization, so that they feel commitment and ownership and subsequently use them when crafting their business plan: "We must, furthermore, align these formulations with our M-Widget, so that the formulations reflect our reality."

After a rather lengthy discussion on the importance of these formulations, the CEO asks who constructs the agenda for the board meeting. The CFO responds that the Chair has done so before, along with support of the CEO. Hence, the CEO suggests that he and CFO construe the agenda and supply it to the Chair for potential amendments.

## On the Financial Outlook

After a shorter coffee break, the CFO summarizes Arrow's financial development for the last month. The result has not only dropped severely, however, the result for September was actually 0 SEK. The CEO adds: "We need to start deploying forecasts, so that we can better govern the firm." The CFO continues to explain that the reason for the terrible result is the development in weak sales: "We have not only decreased our sold volumes, but the market mix has further developed unfavorably." The CEO mentions numerous reasons why they should not look at one month's isolated results. The Sales Consultant adds that they should present quarterly results rather than monthly ones. The CFO continues to state that the currencies have also developed unfavorably and that they currently lack control over the volatility in Beta and other raw materials: "More importantly, we are in that last period of our Beta subsidy.

"The stock has also increased under the period and the account receivables have now surpassed 500 million SEK. Two of the three bank covenants are under control; the equity ratio covenant has been breached, which is why the bank has increased the overnight-credit by 1 %. While this is insignificant for Arrow, since we do not use the credit, Bay Lake became really enraged about this and wanted to instantly switch banks."

## Moving Back to the Meeting's Purpose

After a shorter break, the CEO presents a slide with four bullets: business plan, business idea, vision, and values. He asks the participants if they have spent any time thinking about these four areas or formulations. Without waiting for an answer, he says that they have a blank sheet and it is up to them to formulate want they want to be and what they want to accomplish. The Production Director adds that they have to define the actual customer needs they want to fulfill. The CFO requests a formulation of Arrow's reason-for-being. She also adds that they must understand the whole value-chain from development to manufacturing, marketing, and selling. The CEO asks what makes Arrow unique; the

CFO argues that, amongst other things, it focuses on some specific segments. The CEO adds:

> "We have a blank sheet, my friends, so this is where our future begins."

He also adds that everyone in the organization needs to understand the vision, business idea, and values. The HR Director states: "We produce and deliver Widgets, but so does everyone else. Thus, we need to emphasize our unique traits such as the right service, the right quality, and the right environmental profile."

One of the other participants adds that they have to move away from Goliath's "corporate bullshit and buzzwords", and formulate something that is sincere and genuine. The participants continue to discuss and define a large set of traits that constitutes the uniqueness of Arrow's products. The CEO widens the product perspective to include Arrow's traits, such as its small size and inherent flexibility. "I think this will be the key to our success" he says. While the participants seem to agree, the Production Directors adds that they should all remember that the flexibility of Arrows hinges upon the fact that they are a one-product firm. The Sales Consultant mentions that words such as reliability and service are keywords for the vision and business idea. He also asks the other participants if they should start calling their customers "partners" to stress the importance of a close relationship. The CEO agrees and adds that it is all about exceeding expectations and being able to profit from this, hence, to increase the price premium.

## Breaking With the Less Flattering Past

One of the participants adds that they have to break with some of the less flattering cultural traits of Arrow, such as the fact that extracts from the "taxeringskalendern" are posted on the factory floor each year. The Sales Consultant adds that his first encounter with the organization and the union was when one member of the management team explained to him that they have a former regular officer as HR Director in order to handle the union. The CEO adds that they have to stop all these perceptions and revolve their actions and thoughts around the customers and the customers' needs. A long discussion between the participants develops on all the things that need to be rejected such as the grandfather principle, and that they need to implement a new and modern leadership approach. The Sales Consultant adds that, if the employees are afraid to take responsibility, Arrow will sooner or later default. The participants continue to discuss that they must create awareness within the organization and express the need to discard the top-down control that has permeated the Arrow for many years.

## So, What are our Actual Goals?

The CEO leads the participants back to the discussion on the fundamental formulations: the vision and the business idea. He argues that the overriding goals should be measurable and short-term oriented; hence, they should focus on 2007: "I would argue that the EBITDA goal for next year should be 180 million SEK (excluding the badwill and Beta subsidy) and that we must reallocate volumes to Europe." The Production Director interrupts him and stresses that not all European orders are favorable since there are bad markets in Europe as well. The Sales Consultant concurs and states that it is about time that they analyze what European market they should address and which ones should be discarded.

"In terms of operational goals," the CEO adds, "I think that there should be a maximum of 4-6 goals for the entire firm (i.e. one per function), which will be subsequently broken down into numerous functional and departmental goals." While the Production Director emphasizes total efficiency in the production as an important goal, the CFO stresses the financial goals and the bank covenants. The Sales Director, however, stresses customer satisfaction and contribution margin per hour. Other goals that are mentioned include sick-leaves and reclamations.

## Bay Lake Does Not Care; It Only Wants Results

When the goal discussion comes to an end, the CEO asks the CFO to summarize the former board meeting to the other participants. The

CFO explains that a wide variety of subjects were discussed, however, she feels that the P200 program needs to be strengthened in the sense that they must show the board that they really do something. The CEO asks if there is anything in the P200 program that is already explicit and measureable today, thus, easy wins and low hanging fruits. The participants discuss this issue, however, no direct conclusions are drawn. The Production Director adds that they must show the board they are not only able to formulate good activities; they can also realize them. The CFO agrees and adds that everything must be reflected in the financial results:

> "To be honest, Bay Lake doesn't give a damn about our activities; they are interested in the results instead."

The CEO adds: "Hence, we have to focus on the discrepancy between our revenues and our costs. We can starve ourselves all we want, but that will never generate success unless the revenues are simultaneously boosted. I think our Chair has an important message when he says that we should achieve cost superiority, but also that we have to complement that with revenue and gross profit growth. We must also start to differentiate ourselves from our competitors." He continues:

> "Perhaps our overriding goal should be to die last."

A lengthy discussion takes place on their idea that less than 5 % of the firm's employees do 95 % of the work. The CFO soon ends the meeting by stating that their window-of-opportunity is closing since the Beta subsidy is coming to an end.

## Parts of Management Describe Dissatisfaction With Sales Progress

Some participants stay behind after the workshop and discuss the current situation. One mentions how obvious it is that the CFO is about to quit due to the heavy workload and high pressure. While the others agree, one states that it might not matter since their costs will increase by 100 million SEK annually from 2007 onwards, so they might not survive anyway.

They also agree that the HR Director should have continued being Acting CEO so the new CEO could spend 100 % of his time on sales and marketing, which is the most important area at this time. The participant continues to express his worry that the sales organization with the Sales Consultant is extremely indecisive. They have spent more than six months on a small change in the product for which the customers are screaming. “So how long will it take for them to take the tough decisions?” The participants who are discussing their disbelief in Arrow’s sales capacity conclude the small informal meeting.

## Distributing Control: New CEO’s First Management Meeting

All management team members except for the Sales Consultant meet in mid-October for the first regular management team meeting with the new CEO. The CEO starts by explaining to the participants how important it is that all decisions are noted in the protocol. He also states that the surveillance list that currently is drowning the protocol should be removed. In fact, you will be responsible to update the rest of the management team when something happens with the surveillance issues. The CEO also adds that he really looks forward to consolidating all the policies that Arrow currently is utilizing.

## All About Being Curious

The CEO continues to emphasize the importance of external contacts and that everyone really utilizes their external networks now that Arrow has become autonomous; it is enormously important to keep in touch with the environment.

The HR Director takes over and explains why he, the CEO, and Sales Consultant met with a logistics expert the previous week at Bay Lake's headquarter: "We all felt like schoolboys after the meeting since he posed such good and fundamental questions about our logistics setup that we were unable to answer." The CEO adds that the major conclusion was that they must initiate this project for the right reasons and from the right direction: "We have to work from the outside-in, in contrast to our old habits." The HR Director states that the logistics setup must be based upon their ambitions and intentions: hence, the CEO says: We have to start talking to our customers and decide what we want to accomplish. Put differently, we cannot start working with our logistics flows before we have decided what we want to accomplish and how we want to be positioned. The CEO states that they have to initiate a dialogue with the market, and concludes the discussion with the words:

> "It's all about being curious."

A shorter coffee break follows whereby the former protocol is scrutinized and added to the official documents. Having the covenant breach in mind that was discussed at a former meeting with the management, the Development Director asked the CFO how the meeting with the bank progressed. The CFO answers that the solidity limit is 16 % and that "we can be calm that they are calm. Bay Lake is more shortsighted than Arrow. When the bank increased the over-night credit by 1 %, Bay Lake became furious and wanted to switch banks immediately." The Development Director asks the CEO and the HR Director how the recruitments on the sales side is progressing whereby the CEO answers that they just recently rejected two candidates for the position of Sales Director ( the position that the Sales Consultant currently holds) and that finding a Customer Service Manager is even harder.

## On the Departmental Outlook

Before the CFO starts describing the financial outlook, the CEO suggests that all customers visiting Arrow should be posted on the intranet so that all employees know when they have visitors. Everyone agrees; however, the CFO explains that the revenues for the month are low and the sales department explaining this by stating that the month is shorter than normal.

The CEO takes over and explains that the new Sales Managers are really eager and have chosen to direct their primary focus to increase sales on our current customers. He also adds that they will have an exercise with all Sales Managers to address the sales pitches, the payment terms, and discussing Arrow's segment focus in the different geographical clusters. He says: "We will also continue to use the bonus and rebate structure for our merchants, but change it to become purely conditional. Moreover, I want to add that the Sales Consultant and I will take personal responsibility for our three largest customers in order to keep the control of our primary revenue flows. The CEO continues to explain that they have to investigate, understand, and construct incentives for the merchant sellers so as to boost the sales of their products. One participant poses the sensitive question of Arrow's brand(s): "How can we emphasize that we have such a strong brand that we should leverage upon it when we actually do not know how much of our volumes actually are being sold under our brand name in contrast to private label?" After a lengthy discussion on this issue, the participants decide that they have to find out how much of their volume is currently sold under Arrow's own brand.

The Production Director explains that everything is normal, while the Development Director informs the participants that the quality levels are satisfactory - if not good - and that they are currently trying one new product. She also informs them that they are running tests with several Beta variants and that some of them have already been approved.

The participants continue to go through the purchasing situation, the organizational development, and some environmental activities.

## There are Only Structural Remedies Left

The meeting concludes with a lengthy discussion about the P200 program's development. The HR Director who leads this program informs participants that the overall goals include an EBITDA goal of 280 million SEK, a specific EBITDA margin, and an EBIT return. These goals are further divided into the following sub-goals:

Table 6.28: Financial Goals

| *Sub-Goal* | *Annual Outcome (SEK)* |
|---|---|
| Revenues: | 300 million |
| Capital efficiency: | 36 million |
| Variable costs: | 90 million |
| Other fixed costs: | 10 million |
| Personnel costs: | 34 million |
| Total: | 470 million |

The HR Director reflects his deep concern for all goals, especially the revenues: "We really have to get started on the revenue side since we have only structural changes left on the cost side." The CFO adds that Bay Lake keeps calling her and asking if they really understand that Arrow will fall into a black whole by the end of the year due to the weak results in combination with the end of the Beta subsidy. The CEO states: "While we have the internal cost perspective under control, the revenue side is really shaky." And with that, the meeting ends.

## Extending Former Management Meeting

The CEO starts the meeting by asking participants what they thought of the previous day's meeting with all mid-managers and managers at Arrow. He also asks what actually is the purpose of this meeting. One of the participants answers that the purpose is to compensate for bad management; another explains that information dissemination and dialogue are the reasons. The Development Director adds that the large problem is that managers and mid-managers attending the meeting are afraid to ask questions, "which is why I received hundreds of questions the morning after", she continues. The CFO asks whether they are addressing the wrong issues if they receive so many questions. The CEO agrees with the CFO's question and adds that they must increase employee participation and the sense of belonging. "I have in fact received explicit feedback that the meeting was good but that the interaction was too low", the CEO adds.

### The Reason for Today's Meeting: The Budget and the P200 Program

The CEO says: "The reason for us being here today is that we did not have time to penetrate the budget and the P200 program during our last management meeting." He asks the CFO if she can present the assumptions and consequences of the raw budget for 2007.

The CFO starts by describing the assumptions in terms of Widget prices, freights and logistics, rebates and commissions, as well as the Cubicle and Beta share. The reason for doing a raw tentative budget is that they can use it as a foundation for our discussions. She further describes the most important factors that need to be discussed in the budget, including market shares and mixes, volume increases, Widget prices, personnel reductions, logistic costs, raw material prices, and shares. The CFO adds that they must also decide what they should do if they do not reach an EBITDA level of 180 million SEK. The Production Director amends that they need to remember that effects from uncontrollable factors are not suppose to be included in the 180 million SEK, such as Widget and Beta prices; only the Beta and other raw material costs have increased with 330 million SEK between 2005 and today. The CFO stresses that they should focus upon those activities that lead to the biggest "bang for the buck", hence, those affecting the top lines of the profit and loss statement (i.e. the gross profit). The Purchasing Director continues to give his view on the major raw material and energy components. After the elaboration on the Beta development and the effects from using different and cheaper Beta variants, the CEO adds that they need to use a total-cost approach and not only the purchase price. He also asks if they can use one of the really cheap Beta variants to which the Production and Development Directors answer positively, but say that this might also affect the product's traits.

### Extrapolating Historical Events and Assumptions of the Future

The Sales Consultant provides an account of his view that either the Widget prices will increase or the Beta prices will decrease: "It has always been like this; otherwise, this industry would have been dead a long time ago." The participants agreed on what they thought would be a realistic development of the Beta prices when the Sales Consultant adds that he wants to increase the Widget prices by 3 % next year (i.e. for 2007). The participants agree; while the CFO restates that they must remember that uncontrollable factors such as Widget prices are not to be included in the EBITDA of 180 million SEK. The CEO then adds: "Instead, we should focus on the market mix, service levels, and logistics." The Sales Consultant reflects his view that it is enough to present to the board the 56 million SEK from Beta costs and 104 million SEK from Widget prices, since it is too early to present more detailed activities. The Market Controller who is participating in this meeting mentions that reallocating 30 thousand tons from overseas markets to Europe will strengthen the EBITDA by approximately 48 million SEK; however, it would be unrealistic to accomplish this during one year since the reallocation is incremental.

The participants continue to discuss a wide variety of assumptions, including a volume increase of five thousand tons that will strengthen the

EBITDA by 15 million SEK and different bonus levels for the merchants. The CEO adds that the situation would be completely different if all their peers were earning money; however, this is not the case.

After discussing all assumptions, the Production Director says that he will unfortunately suppress the budget since he forecasts maintenance costs that exceed the assumptions in the raw budget by approximately 24 million SEK for 2007. There might be some room for interpretation, however, since a part of this might be perceived as investments rather than costs. While the CFO understands his perception, she wants to be as precautionary as possible and perceive it as costs. She also adds that they are not allowed to include the 56 million SEK from Beta since this an uncontrollable factor. The CEO quickly adds that, in that case, they probably cannot include the Widget prices either. The CFO agrees. This infuriates the CEO. He states that they must immediately position themselves to the board as though they are in the front seat and be more constructive. The Sales Consultants adopt a rather dejected tone and say, in that case, all their assumptions are redundant.

The participants continue to heatedly discuss the assumptions and conclude by saying that, while they are fully committed and agree upon their assumptions, they must convince the board that they need to include the Widget and Beta prices.

## First Meeting with Management, New Sales Managers, and Sales Coordinators: Trying to Establish Common Ground and Direction

The management team, all new Sales Managers, and Sales Coordinators meet at the end of October 2006 for the very first time. This 12-hour meeting takes place exactly one month after Arrow assumed full control from Goliath of all customer relationships. The Sales Consultant welcomes everyone and states that this is where it all will begins: “I really hope that today’s exercise will result in numerous plans and decisions. We will start by listening to the CFO who will present the financial assumptions for today's exercise." The CFO consumes almost two hours to present the profit and loss statement, balance sheet, and the tentative budget to the participants so that they understand the content and its implications. She stresses that the result looks too favorable due to the badwill.

The CFO continues to describe the following as Arrows largest problems: the Cubicle share, market mix, as well as Beta and energy prices. However, the good thing is that the fixed costs look really good. The CFO continues to explain that the management team has decided to take on a lot of maintenance costs during the year so to attain a fresh start in 2007. She continues to present the forecast for 2006 and Bay Lake's yield requirements. She says:

> "There are so many differences compared to when we Goliath owned us. We used to receive instructions on more or less everything before and now we have only ourselves to count on."

She asks the participants if they have heard about the P200 program that Bay Lake gave them. She explains that, when Bay Lake realized that Arrow would not deliver according to their expectations, they handed over a very structured program that bridges Arrow's former forecast with Bay Lake's expectations: "We have subsequently connected a large set of activities to this EBITDA bridge. If we do not achieve the 280 million SEK in EBITDA, we will breach our bank covenants and run into severe problems."

The CFO continues to present the forecast framework so that the participants can join in on the assumptions and plans. "I would actually argue," she says, "that the numbers per sé are uninteresting; instead, the assumptions behind the data in the forecast is what is of importance. As you might have understood, we do not have any tradition of budgeting here at Arrow since Goliath has always done that for us."

After discussing the assumptions in the forecast, one of the Sales Managers asks the management team, in terms of volume reallocation, what should they sell and where should they sell it in order to succeed with the volume reallocation of 30 thousand tons from overseas markets to Europe. Where do they earn the most? The Sales Consultant gives a vague response and quickly adds: “This is your job: the Sales Managers’. This is actually the first time since Bay Lake acquired us that we actually can decline sales orders; thus, we have the opportunity to identify where we earn the most money.”

The CFO adds that decreasing Arrow’s head count is their last option since there is not so much more they can do on the cost side: “From now on, it is all about the revenues.” The Sales Consultant adds:

> “We cannot starve ourselves to success.”

He goes on: “We know where we are and what our limitations are.” The Market Controller takes over the meeting and presents a snapshot of the current market development.

Table 6.29: Current Market Situation

| *Current Market Situation* |
|---|
| Widget prices are decreasing |
| Volumes are increasing |
| Spheres are increasing |
| Cubicles are decreasing |
| M-Widget is increasing somewhat |
| S-Widget is increasing |
| M-Widget is more profitable than S-Widget due to its European focus |
| Overseas market sales are increasing |

The CEO mentions that during Goliaths ownership (his former employer was actually Goliath), they discussed profitable market clusters and countries, "but that we need to transcend this view down to a customer level. Hence, there are profitable customers all over the world and not just in Europe." "The opposite is true as well," the HR Director adds.

The Sales Consultant asks the Sales Managers to present the outlook on their markets. This leads to a lengthy presentation and discussion. After a few hours, one of the Sales Managers explains to the management team that they really need some information about where they earn money. He continues: "You have to inform me about what I should sell and to whom or at least give me the break-even analysis, so that I can do the calculation myself." This comment is met with silence. One of the Sales Managers describes his situation as follow:

> "I feel like I'm a swan, calm and beautiful above the surface, but extremely frenetic below the surface."

The Sales Consultant restates the guidelines or market ambitions of the forecast and explains that 30 thousand tons should be reallocated from bad to good customers: "We should further restrict our sales of Widgets with a low density due to their low contribution." The CFO quickly adds that they really have to be realistic in their assumptions. While the CEO agrees, he also stresses the need to think outside the box. There are so many truths within Arrow and in the industry - such as that Cubicles are good while Spheres are bad - and we really have to question the legitimacy of these truths.

After a shorter coffee break, the participants enter another larger conference room where a marketing consultant presents business-to-business marketing issues as a way to motivate, inspire, and align the participants. After a two-hour marketing discussion, the participants are then split-up onto different teams to fulfill the assignment of defining Arrow's core values or spirit, and the factors that differentiate Arrow to its competitors. This 90-minute exercise is followed by an organized dinner for all.

The teams meet up following dinner to present their conclusions on the Arrow spirit and how they should differentiate themselves to their competitors.

Table 6.30: The Arrow Spirit

| *The Arrow Sprit* | *Differentiation Pillars* |
|---|---|
| Experience | Service and flexibility |
| Wisdom | Direct contact with the customers |
| Intelligence | Strong brand |
| Stability | Problem-free products |
| Reliability | Constant quality |
| Competence | |
| Sustainability | |
| Information/communication | |

The meeting concludes with the CEO stating that technical differentiation is important, yet perhaps not exclusive and "we need to have a coherent and continuous message to the market."

## Management Team Meets to Discuss Budget Assumptions

The management team meets in mid-November for a combined budget session and a presentation from the brand management consultants. The CEO states that they will start with the budget work while their heads are fresh and then continue with the consultants in the afternoon. He continues: "While we will stand for the creative effort to develop the content, the consultants will support us with the packaging. We have already paid them, so lets attain some yield from this money. What is important, however, is that we lead this process and not them. We must also anchor this throughout the organization."

### Short Discussion on Primary Assumptions in 2007 Budget

The CFO takes over the meeting and states that the budget per sé is not the primary objective; rather, it is the process of establishing a mutual outlook for the upcoming year. He explains: "Our current budget draft indicates an EBITDA level for 2007 of 193.4 million SEK. This result is based upon the assumption that we increase our volumes with five thousand tons and that the Beta price drops in the second half of 2007. Furthermore, it is assumed that we will be able to reallocate 30 thousand tons to more profitable customers and markets of which 70 % will be realized during 2007. It is also my firm belief that we have to produce a budget in which we sincerely believe."

She asks the other participants if the volume increase is really realistic. The Sales Consultant addresses the Production Director and says: "I guarantee that I sell everything you produce. While the participants seem to be amused by this statement, the Production Director responds that this sounds like a plan as long as the tons are sold to profitable customers.

The CEO adds that they should construct a budget that reaches the intended EBITDA of 180 million SEK (i.e. 280 million SEK minus the badwill) and not a penny more: "We really need to have some tricks up our sleeves for the future." Before the budget discussion is concluded, the CFO asks the other participants to contact her immediately if they have anything else that should be included in the P200 program.

## Analytical Summary: Liberate Yourself from Goliath Empire and its Inherent Characteristics

The new CEO and the management team increasingly assume control from the board, from the consultants, as well as from other external stakeholders. In fact, there is growing vexation on the management team that the board's position has grown too strong. The management team members are, in fact, the experts - and not the board members. Examples of where this has become increasingly visible include assuming control of the vision and business idea formulation processes, as well as the board meeting agendas and the P200 program. The vision and business idea formulations, the P200 program, and the business plan have also continued to emerge as the most central components of the management team's work.

The management team's quest to distance itself from the Goliath Empire and delve into the profound questions of their own uniqueness or reason for being consumes an increasing amount of time. An increased focus upon simplification and holism, in terms of focus and participation, is also progressively more prevalent as is the earlier delegation within the management team that has grown increasingly extensive since the new CEO's inception.

A mutual ambition on the team is to bridge the board and management arena. This also emerges, as does the increasing need to illustrate everything the management team and their organization accomplish, yet is never communicated to the board. However, there is a growing anxiousness that the new CEO will spend too much time on internal matters rather than where he is needed the most (i.e. in sales and marketing). This has become especially prevalent since many of the management team members feel that the sales organization, particularly the Sales Consultant, is advancing too slowly.

The financial language, the financial heuristics, and the financial objectives have grown more rapidly than anything else on the management team. All management meetings start with financial scrutiny, which often consumes a large part of the meeting. While this is diametrically opposed to the earlier modus operandi, there is an increasing pressure on the management team from Arrow's employees to distribute these financial objectives and explain their impact on the day-to-day activities of the different departments.

Lastly, the Beta and product development processes are also developing quicker and more successfully than the management team ever expected. Several new Beta suppliers have already been simultaneously certified as a new product undergoes experimentation.

## The Board Arena: the Bank Should Not Question Our Ability

Six weeks after the new CEO joined Arrow, he participates in his first board meeting on October $8^{th}$.

### Fifth Board Meeting: New CEO's First Board Meeting

Prior to the meeting, one of the board members (i.e. Bay Lake's CEO) informed the other participants that they just acquired another firm in the same area as Arrow. After ticking off the formalities, the Chair continues to welcome the markedly nervous new CEO to the firm. The union also welcomes the new CEO whereby they gently yet firmly ask the Chair to invite them the next time the board has a conference call. The Chair stating that it has mostly been formalities whereby one union representative states: "Recruiting a new CEO is a rather big issue in my book."

A board member asks why the logistics issue is missing on the agenda and whether they have hired the logistics expert, as they had communicated before. The CEO responds by saying that "it would be irresponsible of me to hire someone for such an important position without doing my homework first. We have a vague view of our current status and we have not yet defined our long-term direction." Since two of the board members are running a bit late, the agenda is reorganized in order to take the less important issues first.

Several areas are discussed regarding the tasks Goliath used to handle for Arrow such as customer credit policies and pensions, and which they now have to handle themselves. The Sales Consultant adds that so much is illogical: "For example, we have one unique payment contract construction per customer of which more than 50 % is totally incomprehensible. The CEO adds:

> "The only chance to fix this is now. In one year from now, we won't have a legitimate reason to change it."

The union raises the question on the personnel bonuses that have existed and been production-oriented for the last 35 years. The CEO responds that he thinks a bonus is a good incentive, however, he needs time to sort out the situation before any decisions are made since he is so new. After a long discussion and the conclusion that it should be results-driven and goal-related incentive, one of the board members says that the management team should include a personnel bonus in the 2008 budget. The union quickly responds that this should be for 2007 whereby the board member answers:

> "I just wanted to see if you were awake."

The board informed everyone that several banks have called them to persuade Arrow to change bank. The board members are obviously annoyed that the bank increased the overnight credit by 1 % due to the covenant breach. The CFO looks somewhat stressed after this announcement since changing bank requires a lot of time and energy on her part.

Right before the last of the board members arrive, a few minutes are spent on what was defined as the two largest risks: namely currencies and Beta. The board members pressed the CEO and CFO to accept that consultants should be contracted to support Arrow with this.

When the last two board members arrive and the board was gathered, the new CEO introduces himself by stating:

> "I was born with a Widget in my mouth, I have experience from four generations of Widget professionals, and I believe that my experience is very important to Arrow in its current development phase. Last but not least, I

> believe it to be fundamental that all employees at Arrow understand our challenges and what we must do."

The CEO continues by presenting some organizational issues. He argues that, even though we have been very production-oriented, we are starting to become business-oriented as well; it is my job to refine that process. "From now on, the Finance and Purchasing Director will report directly to me and not to the HR Director. The HR Director will act on my behalf whenever I am out of the office. Since I will be traveling a lot to meet customers, I think my stand-in should be internally focused." The Chair suggested that they make the HR Director the Deputy CEO. Another board member (Bay Lake's CEO) adds that we now have a really good and open management team.

### The Financial Situation: Is the Board a Year Ahead of Management Team?

The CFO starts off by saying that September was not as good as they had expected, however, the next quarter looks very promising: "We have sold one more ton than the same month last year, although the revenue-side is a disappointment since the prices have not increased. On the other hand, the decrease in fixed costs and personnel costs has absorbed this to some extent. The CEO stresses that there would have been negative results were it not for the Beta subsidy. The board member who usually criticizes the bonuses and rebates continues to oppose this, as well as the vast decrease in the gross margin. He adds:

> "You really have to work to increase the gross margin. This is outrages, no firm can survive with these weak margins."

Another board member asks if the gross margin should not have increased due to lower logistical costs as a consequence of reallocating volumes from overseas to Europe. The CFO responds by saying that the volume reallocation will not be realized until next year, whereby the board member bursts out:

"Haven't you done this yet?"

The CEO continues with the financial presentation by saying that the account payables have increased dramatically since Goliath is late with its invoices. The most financially experienced board member quickly responds that they should not remind Goliath of this since they need all the cash flow they can get.

For the first time, the CFO presents a slide indicating the contribution per geographic market. This interests the board extensively. The CEO adds that, while this is interesting, it is a Widget industry phenomenon. The CEO continues: "I argue that look at aggregations of geographical markets is too blunt; we need to look customer-by-customer instead and perhaps also on different application areas." A board member adds that that they now have a dedicated sales force; therefore, they can directly govern and control the sales force toward the chosen customers and application areas.

The CFO continues by elaborating upon the October development by stating that the volumes as well as the production have been good: "We had some price increases in UK, but we also had some negative currency effects and the overseas sales have increased. This is also the last quarter with the Beta subsidy and, without it, the result would have been negative." One board member asks if the change in market mix had been intentional or not. I am interested in the actual control that the management team have. The Sales Consultant respond by saying that it has been the first month that they have actually been able to chose orders and even say no to a few. The CEO adds that this will become even better when a better information system is implemented.

Inviting the Development Director to a discussion on the Beta situation concludes the discussion. She informed the board that the production is currently running on 80 % Beta and 20 % Gamma. While the board is pleased with this, the board members stress that the cost level is very important; the increased flexibility in the production capability is even more important. The Development Director concludes the discussion by saying that they will run tests to increase the Gamma share even further.

## P200: Suddenly the Program is Only Referred to as a Profitability Program

The HR Director (now also Deputy CEO) starts off by explaining the gross and net effects of the program, and stresses that they have squeezed everything they can on the cost side. The CFO adds that they totally changed the perspective on this program. Instead of just focusing on cost activities, the revenue activities have received the paramount role. She adds:

> "It doesn't matter if we focus on costs or revenues; the only thing that matters instead is the bottom line."

A board member emphasizes that they should use the real Beta price level in the forecasts and not the subsidized price level. Another board member adds that the management team should be praised for its hard work, but that it is time to direct the energy and time to external issues. The CEO adds:

> "Yes, we have done an amazing job, but we will never starve ourselves off profitability."

He continues: "We have to start discussing Arrow's overall strategy since we currently just attack the fragments that are problematic instead of depicting an overall intention on what we want to accomplish. Following this discussion, the Development Director is re-invited to the board meeting. She starts by saying: "Since we are so slimmed right now, our keywords are efficiency and cooperation. Our development capability is equal today to cost savings and nothing else. Hence, our focus is directed to exchanging raw material to cheaper variants, reducing the use of raw material, finding alternative suppliers, and making the production process more efficient. This focus has given Arrow a cost base that is substantially stronger than its competitors', but all of them are currently in the process of starting the same journey."

A board member asks how the margin level looks within the three general Widget segments (where Arrow is active in one). The CEO admits that they have no idea, but the reason that S-Widget delivers such small margins is that the majority of its sales goes to markets overseas. A board member quickly asks: "So why do we sell S-Widget?" The CEO replies:

> "We ask ourselves the same question."

The Development Director continues to state: "Our development capability is very internally oriented; we only develop one new product per decade. However, we are very competitive within some sub-segments." A board member quickly asks: "Are we too good?" He continues to ask where is the future growth. The CEO gives an explicit response to this, yet he adds that this is where the strategy work begins.

The Chair concludes the discussion by giving a speech on the increased importance of a strong environmental profile. This will be decisive when we circumvent merchants and directly approach end-customers. He continues to reflect upon Arrow's potential value chain reallocation by saying:

> "The closer to production you are, the more important the brand is and the closer to the end-customer you are, the more important the environmental issues become."

## On the Strategy Process: Starting a Continuous Journey

The CEO starts off with a slide that says "A vision without action is a daydream and action without a vision is a nightmare". He continues to describe that they have to identify the answer to some fundamental questions, such as how they should position themselves as well as how their customers and end-customers look. A board member adds that this is a journey and that it is fundamental to include the boards' competence and experience. The CEO continues by saying that it might feel a bit corny, but the soft values becomes more essential in an industry where you trade commodities. Even though the board members reacted negatively when the CEO called the products for commodities, they did not interrupt him. The Chair asks when the CEO thinks the business plan can be finalized and he responds that he hopes it will be done by the end of January. A board member states that he thinks the management team will need external support on the marketing side. The CEO mentions that they have to become tighter with the merchants and meeting the end-customer with them. He then concludes the discussion.

## Market—Taking Control Over Sales and Sales Conditions

The Sales Consultant is invited to the meeting, which he starts off by updating the board on the process of building the sales organization: "All external and internal sales employees are now hired. We have implemented a new information system, which supports us to understand our customer profitability. Furthermore, the transition to take over all customer relationships from Goliath on the 1st of October went very smoothly, but we have had a heavy workload since then." He also adds:

> "I've told the Production Director that I'll buy him some cake the day we have delivery delays."

He then continues: "We have also explicitly planed to move 30 thousand tons from bad customers to good customers. I would really lie if I said that I knew what application areas our products were used for since the merchants' transparency is non-existent. Furthermore, we are developing a standardized price list, we are defining standardized payment terms, and we are currently changing the bonus and rebate system. The Chair adds:

> "We have to perceive all these problems as a gift, compared to what we would have had to change otherwise in order to create value."

The Chair continues: "If we look at the contribution bars, we can see that the two worst and biggest markets are the ones that visited us at Bay Lake directly after the acquisition was announced in a press release and they stated that they really want to continue working with us. The Sales Consultant adds that they are "really robbing us which is why we will (i) meet with all key customers, (ii) establish a rolling forecast system, (iii) deploy profitability analysis on all customers, (iv) deploy a market analysis, (v) establish a technical sales function, (vi) deploy a new product calculation system, and (vii) scrutinize the possibility of developing new products.

A board member stresses in a rather descriptive way that they have to know more about the market; he wonders how they will govern the Sales Managers: by customer visits, by volume, by margins, or by contribution?

The Chair also reluctantly adds that he was really cocky at first when he joined the former CEO to raise the prices in their biggest market, but that he felt like a schoolboy after the meeting. The CEO concludes the discussion by stating the 2007 focus areas will be (i) volume focus, (ii) reallocate volumes, (iii) increase volumes compared to 2006, (iv) examine the bonus and rebate system, (vii) focus upon logistics, and (viii) realize the P200 program. Lastly, a board member says:

> "Remember, doing more of the same won't help!"

## Analytical summary: New CEO Might Have a Middle Way Toward Merchant Dispute

While this is the new CEO's first board meeting, the board is not showing him or the CFO any leeway. The CEO states that the CFO and Purchasing Director here will report to him directly from that point on, instead of to the HR Director (who is appointed the new Deputy CEO during this meeting). The CEO also states that the results for the period would have been negative if the Beta subsidy would have been absent.

This is a statement that has never originated from the management team side before, but has only come from the board in the past.

For the first time during the meeting, the CFO presents a geographic contribution analysis while she adds that geography as a variable is too blunt in contrast to a customer-by-customer perspective. She also presents the status of the P200 program and emphasizes that the program is not perceived as a cost improvement program, rather, as a profitability ditto.

Also the discussion on direct customer versus merchant focus flared up again were the new CEO showed a very explicit view of Arrow's Widgets as commodities while the Chair's environmental discussion revealed that he had his heart set on circumventing the merchants and directly approaching the end-customer with Arrow's niched products. While this did not grow into a dispute, there still seems to be a vast discrepancy in the views. in contrast to his predecessor, the new CEO has a view that Arrow should meet the end-customers together with the merchants in order to strengthen the merchants' sales power and, hence, Arrow's sales result. The Chair also admitted at the end of the board meeting that trying to increase Arrow's Widget prices based upon a niche assumption towards Arrow's largest customer had failed severely them even if he personally had participated at the customer meeting.

## The Board and Management Arena: Aligning Interests

Late afternoon in the middle of October 2007, the three Bay Lake partners arrived at Arrow with the purpose of presenting the shareholder program. This was also the first meeting after the HR Director had been appointed deputy CEO by the board.

## Creating Engagement Through Visible Ownership

One of the Bay Lake partners starts the meeting by excusing the time delay when it comes to the shareholder program. He says: “We should have presented this to you in April, but a few issues came in between. As you all know, buying stock is associated with some risks; however, it is our sincere belief that there is a huge upside. Bay Lake, vendor notes from Goliath, and an ordinary bank loan financed the acquisition of Arrow.

The partner continues to explain that a sweet equity program (see the explanation in the chapter describing Arrow as a portfolio firm) has been constructed for the management team, the former production management team, and the external board members. “You are, thus, given the opportunity to acquire 10 % of Bay Lake’s equity (i.e. the fund’s part). I want to emphasize that this is extremely exclusive, which is why we would prefer if you kept this information to yourselves.”

The Chair, a Bay Lake Partner, adds that they always use the model of sweet equity since it creates commitment, engagement, as well as a huge up-side potential if (you) deliver according to (our) expectations. He says: “We have also reserved some stock for two additional individuals, hence, the one that will take over after the Sales Consultant as Sales Director and the upcoming Customer Service Manager.

The most senior Bay Lake partner explains that their primary objective is value creation, thus, value created within Arrow (see the value generation chapter). He continues to explain that they are using a fairly simple; however, a conventional model was used when calculating value: multiple* (EBITDA – net debt) (cf. second formula on page 23). Their assumptions are the following for 2011 when they expect an exit:

Table 6.31: Goals for an Exit

| *Goal* | *Target Level* |
|---|---|
| EBITDA | 292 SEK million |
| Net debt | 45 million SEK |
| Position / multiple | 4.5x |
| Bay Lake capital gain | 3.7x |
| Management and board capital gain | 11.7x |

After a short discussion based upon the goals and the associated levels, one of the Bay Lake partners presents the share purchase agreement in extension. The Chair says:

> "Remember that it's a capital gains game!"

## Analytical Summary: Motivating While Imprisoning…

The primary means to establishing commitment, engagement, and personal dedication as well as a career change lockdown among key employees (particularly, the management team) is to have them invest their personal savings in combination to their blood, sweat, and tears. A thriving way of accomplishing this has been to construe so-called sweet equity programs (see the value generation chapter) by tempting (and often delivering) huge personal returns.

# The Management Arena: the Inherent Need for a Second Look

## Workshop on the P200 Program, Budget, and Business Plan

Less than one week after the meeting with the Bay Lake partners, the management team had a workshop to discuss the firm's most important active projects. Since the CEO and Sales Consultant were abroad to visit customers, the deputy CEO (i.e. the HR Director) leads the meeting. He states that the purpose is to provide with information from the former board meeting, to discuss the P200 program, budget, and business plan as well as go through the goals for 2007.

The deputy CEO asks the CFO if she can present the outcomes of the former board meeting whereby she explains that Arrow's new organization, although without any names, was presented to the board. The board perceived the organization as good, simple, and normal, however, stressed the need to recruit someone to the Sales Director and Customer Service Manager positions.

### Uncertainty Concerning Arrow's Actual Position

There was also a lengthy discussion on the budget and the P200 program. The board argued that today's Beta prices should keep in the budget and not include any potential price decreases since they are out of our control. The board members explained that they are really impressed by Arrow's internal accomplishments, however, the team must redirect its focus and energy externally. They also stressed that they wanted to be an integral part of the business plan process. The board had a lengthy discussion on some of the fundamental traits, which leads them to ask for a presentation concerning the competitive advantages within production and our products, positioning, product development, and why Arrow sells the S-Widget. The Chair stressed the need to assume a leading environmental profile within the industry.

"This discussion was followed by a discussion on our upcoming business plan," the CFO adds. "The board stressed that sales control and governance should be highly prioritized in our work since this probably is the key to our success." The CFO also explains that the board was very satisfied with the new products we are looking at. The other participants looked somewhat surprised by this comment since the products the CFO mentioned have not been mentioned before. The Deputy CEO adds: "The primary challenge right now is to identify the segments and application areas that we should focus upon."

The CFO continues to explain that the board discussed the investments in the future energy sourcing and the tentative budget that she and the CEO had presented. The deputy CEO had looked somewhat disturbed for the last five minutes. He quite annoyingly stated that they are missing two important strategic questions; hence, how should they handle the Beta and energy situation, respectively?

## We Need to Address the Tough Questions

The deputy CEO states that they cannot postpone the actions concerning the Beta and energy situation any longer. "We need to take care of this now! When it comes to the Beta situation, we need to define the long-term supply and our internal vulnerability, the type of Beta we can use and how to certify it, the effects on our product traits and quality, the mix of different variants, how we should store and transport it, and finally, if we should hedge our Beta consumption as well as demand larger rebates from our supplier(s). I feel that we are neglecting to scrutinize all these areas while the time is ticking." The Purchasing Director who is responsible for the Beta situation argues that he has control of everything, except the hedging part whereby the CFO adds that hedging is her responsibility. The Deputy CEO asks if they can agree that the CFO and the Purchasing Director take full responsibility for the Beta project including the issues just mentioned. Everyone concurs.

The Purchasing Director gives the other participants a short summary from his interaction with all Beta suppliers the last weeks. He concludes that the situation looks as expected except for the fact that they should not count with any price decrease on Beta during 2007.

### On the Budget, the P200 Program, and the Goals for 2007

After a short break, the participants start off by discussing the activities in the P200 program and the budget, whereby the CFO states that each individual activity or project is irrelevant compared to the actual outcome of the totality. She adds that Bay Lake has asked them to keep the current Widget and Beta prices in budget even if this will severely decrease the budgeted result. This will vastly hamper their EBITDA goal of 180 million SEK (i.e. 280 million SEK minus the badwill). The Development Director quickly states that they need to strengthen the P200 program, so they achieve the EBITDA goal: "I think we still have a lot to do. We are overstaffed, for example." The Production Director agrees with the Development Director and suggests that they should scrutinize the organization once again. The Deputy CEO presenting Arrow's financial goals concludes the meeting.

## Travel Report From CEO and Sales Consultant's Journey to Oversea Markets

After a week of intense travels on the markets that Arrow terms as "overseas", the CEO and Sales Consultant book a meeting with the management team to present their travel report. The CEO starts off the meeting by stating: "The journey has been extremely interesting and educating for both Arrow and us. The purpose with the journey was to understand our current business on those markets and identify new opportunities." The Sales Consultant continues to explain that they have not realized that the Widgets they sell on these markets for a price below European prices is refined and then sold back to Europe. The Development Director quickly mentions that this is nothing new, but that it is conventional wisdom to the members of the production team. The Sales Consultant responds by arguing that it might be so, but it still overthrows all statistics and assumptions concerning their market share in Europe and perhaps also the position of the firm.

"Our customers on these markets," the CEO continues, "are extremely dependent upon us since they have few substituting products for our S-Widget. I would argue that this is actually a sign of how strong our products actually are. This must make us really question who our customer really is." Taking a more skeptical standpoint, the Deputy CEO asks the CEO and the Sales Consultant if this means that they can find profitability with these customers or on these markets. The Sales Consultant responds by saying that he is comfortable that Arrow will be able to raise its prices towards these customers, but that it might take some time. The CFO quickly adds that this might be interesting; however, they cannot wait for profitability: "If we decide to keep volumes on these markets, they need to be profitable instantly."

After a coffee break, the CEO states that this journey has been extremely valuable and educating for them both and perhaps also a wake-up call that they should not believe in all assumed truths, such as the unviability of overseas markets.

## Bay Lake Wants to Stand on Solid Ground

As I mentioned in our last management meeting, Bay Lake wants us to keep the current Widget and Beta prices in our budget," the CFO says. "They have also said that they will support this decision on the upcoming board meeting and defend us against the other board members who will probably see this as very negative since the EBITDA budget will be halved. They have also sent the message that they want us to calculate according to different scenarios in which we adjust the Widget and Beta prices. They also want to inform us that our current rebates on Beta are insufficient and should be re-negotiated immediately. Lastly, they want us to investigate additional cost decreases in the form of headcount and structural changes."

The CFO informs the other participants that she has been requested by Bay Lake to recalculate the result for 2006 without the Beta subsidy, She then concludes the meeting.

## Another Management Workshop With Brand-Management Consultants

A few weeks before Christmas in 2006, the management teams meets once again with the brand management consultants. The CEO starts the meeting by reminding the other participants that the consultants held a workshop with the management team during their last visit to collect our thoughts on Arrow's future vision, business idea, and values: "They will present their results today and send a printed version of their final report within one week." The consultants start to present an overview of the project participants. It became quite obvious during the presentation that the project had been pushed down the organizational hierarchy: a decision that would have probably looked different today.

The most senior consultant argued that soft values, such as the fact that they are more than a Widget producer, that they have a deep and profound knowledge, and that they are flexible should be held above the more technical traits of the product. We want to separate the formulations into three dimensions: a heart, personality and relationship, and product dimension. He says: "After spending numerous months with you here at Arrow, talking to your customers, and observing your competitors, we have drawn the conclusion that we need to emphasize the following differentiation aspects. You are personal and results-oriented and focus upon the entire meeting with the customer and not only the product that the customers encounter. Furthermore, we believe that your ambition to increase your price premium and, hence, gross margin will be attainable if you increase your focus on customer adaptation - Widget solutions rather than Widgets - a more efficient refinement, and stronger end-result for your customers. Hence, flirting with the end-customers."

This discussion continues with the consultants giving practical suggestions on how this can be actually attained. Following this rather lengthy discussion, the consultants present a few alternative visions and business idea formulations into which the participants delve. The participants are very satisfied with the formulations except one who convincingly argues that their environmental approach or profile should be included in these formulations. The Sales Consultant argues that the customers are unreliable concerning these issues since environmental friendliness today could have a totally different meaning tomorrow.

The participants continue to discuss the formulations, their actual meaning, and the potential impact they might have on Arrow. The discussion that consumes most of the time and energy during these meeting is about the meaning of naming themselves specialists and how this affects Arrow's development.

## Analytical Summary: Why are we Progressing so Slowly…?

The management team discussed Arrow's most important areas at a very central meeting (i.e. the P200 program, the budget and the business plan). The meeting started off by informing all management team members on the discussions and conclusions that took place at the board meeting. The CFO and CEO increasingly nurture a habit of complete transparency towards the management team concerning board meeting outcomes, hence, strengthening the bridge between the arenas. The management team further assumed an increasingly proactive role towards the board, in the sense that it is now propounding that the Beta and energy situation is targeted too slowly and that additional headcount reduction needs to be accomplished. Some participants argued that the management team's tempo should be quicker since profitability needs to be more swiftly established.

# The Board Arena: It's Really Bad, But Really Good

## Sixth Board Meeting: We Wanted to Find our Roots and Future Ourselves

The Chair swings the board gavel for the first time in Bay Lake's office (more or less all board meetings take place at Bay Lake's office from now on) and opens the meeting. All formalities are ticked off a list. A brief discussion on the fact that the bank increased the overnight credit takes place; some annoyed board members argue yet again that they should throw out that bank.

### Financial Situation: The Best Invoicing Month Ever and Still a Loss…

The CFO starts off by verifying that all board members have read the CEO report and understood this month's currency effects: "The volumes look really good and we have been able to strengthen our position in the United Kingdom. In accordance with your requirements, we have also been able to diminish the stock for the first time in ages, but we are a bit worried how this will affect our service levels. However, the average price has continued down due to our increased sales of Spheres instead of Cubicles. We have been hit by increased logistical costs while the other costs have been constant. Lastly, even though we have a negative result, we think that it has been a good month."

For the first time, the CFO presents a tentative price analysis of the factors affecting the price. The Chair adds:

> "We have had the best invoicing month ever and we still have a large negative result. How can that be?"

The CFO replies that the currency hit of 17 million SEK is one important explanation: "We have met with the financial consultants you recommended to define all financial risks in our operation, so that we can focus on the operational issues instead. We are also discretely building a Beta stock since our subsidy will be discontinued within a few weeks." One of the board members concludes that it looks very good on a cash flow level. The decreased stock, the increased accounts payables, and the decreased account receivables have resulted in an operating cash flow in the area of a quarter of billion SEK.

## First Autonomous Budget: Agreeing Upon Challenges and Assumptions for Future Forecasts

The CFO starts by addressing the board and stating that she really wants them to understand the challenges. The CEO adds that these are major conclusions from our business plan work. The CFO continues to state that sales and Beta are the two major components in addition to IT. The CEO adds: "Can we, as an autonomous firm, afford not to invest in an IT structure that supports our business, in terms of calculation and production systems?" The CEO adds that procurement is another focus area since this is key to success and it has been somewhat neglected. "Is it not time to acquire external help with the profitability analysis, so we know where we actually earn money?" a board member asks. The CEO replies:

> "We know exactly where we earn money and on what, but we are unsuccessful at explaining that to you."

A board member adds that it is about time to also start evaluating other cheaper variants of Beta. The CEO reluctantly responds that they have started to investigate it since this change might influence the flexibility of Arrow and the quality of the Widgets. The Chair says that this must be taken to the protocol as a highly prioritized issue. The CEO continues by stating that the P200 program, the covenants, the currencies, and the affectable factors have governed the budget. The CFO presents the following assumptions for 2007:

Table 6.32: Assumptions for 2007

| *Area* | *Goal or Activity* |
|---|---|
| Revenues | Increase sales with 5,000 tons |
| | Reallocate 10,000 tons to profitable customer |
| | Increase geographic cluster Y with 8,000 tons |
| | Increase sales to merchant A with 5,000 tons |
| | Increase sales to merchant B with 3,000 tons |
| | Remove unconditional rebates |
| | Take extra charge for non-standard orders |
| | Increase the Sphere share with 4 % |
| Commission and logistics | Renegotiate with oversea agents |
| | Evaluate the current logistics system |
| | Start benchmarking with two industry peers |
| Variable costs | Decrease Beta share to 22 % |
| | Decrease raw material Z with 8 million SEK p.a. |
| | Renegotiate Beta rebates |
| Fixed costs and personnel | Increase salaries with 2.1 % p.a. over the next three years |
| | Retire 10 FTEs |
| | Diminish headcount with 40 FTEs |
| Investments | Keep investments below 30 million SEK |

The CEO adds that there will be no bonus for employees unless "we attain our EBITDA goal." He continues to state: "If the Widget prices do not increase this year, it might be our last year." While one board member complements the fact that the management team has finally realized how fragile the current situation is, he adds that a rosier future should be painted to the bank. Another board member questions the fact that Arrow's logistics cost are 40 % higher than in the firm he is leading even though they should be at the same level. The board agrees that they should start to benchmark this immediately.

The Chair concludes the discussion by saying that, even though these assumptions are ambitious and attainable, one must continuously focus on cost leadership (i.e. the internal side): "Since we agreed upon increasing the Gamma share, you have to solve it immediately." Another board member adds that this will strengthen our negotiation position toward their current Beta supplier.

## On the Strategy Process: Finding Arrow's Core

The CEO states that the ambition has been to define Arrow's vision, mission, and core values: "This could have been done with the support of consultants, but we wanted to find our roots and future ourselves." The Chair adds that they must remember that flexibility must be a keyword: "The large dragons (i.e. Goliath etc.) are just able to continue in a straight line, while we can be quick at adapting ourselves to new market conditions. The problem for us is that we have to learn to profit from it and charge our customers. Ryan Air is a great example of how you can profit from all the extra services that are usually free." The CEO describes the proposed vision, mission, and values for the board, which leads the Chair to say:

> "It's so good that I almost want to cry; it's a whole new firm."

The Chair continues to emphasize the importance of implementing this throughout the organization and stresses the fundamental importance of the culture. Another board member adds that before you (read: the new CEO) came on board, one used to say that it was impossible to raise prices and that it was a pure commodity business. He continues by stating: "We have to work continuously with this." The union supplements that it is the first time that we actually focus on positive issues rather than problems. The board meeting concludes in a very cheerful way for the first time since the acquisition.

## 7th Board Meeting: Worst Result in 25 years… or Not?

Almost two months after the board meeting, the board members meets again. After all formalities have been ticket off, the CFO starts with the financial results for December and for 2006.

### Financial Situation: Is it Good or Bad?

The CFO says: "2006 was the year of changeover. We have sold 255 thousand tons and we have not lost any customers." The Chair says that he becomes really annoyed when they talk about sold tons instead of the bottom line, since it is all that counts. While the CFO says that she will address that within a short time, the CEO argues that there is a strong correlation between volumes and profitability. The Chair replies: "We have to break this traditional view and assumed correlation that has existed in the Widget industry for decades and focus instead on contribution and profitability." He asks why they do not use contribution charts instead of these volume charts. A board member adds that they still have the confusion of means and goals: "While volume used to be a goal, it is just a means today to attain the profitability goal." Another board member concludes this discussion by saying that the result after tax was at least positive for 2006. However, it would not have been positive without the Beta subsidy.

The CFO restates that the year of 2006 has been a changeover year since they paid a 3 % commission to Goliath, which equals more than 100 million SEK. "We have built a whole new sales and market organization; we have had numerous of pension retirements; and, we have changed several IT systems." A board member states that they have forgotten the most important line on the profit and loss statement: the gross margin.

> "No firm can survive on this low gross margin and, in December, it even fell twenty additional percent."

The CFO responds that she knows that they are very good at working with the cost side and efficiency increases; however, the leverage from this is marginal compared to the top line of the profit and loss statement. A board member adds that he his confident that they have full control of the production side, but when will they actually start to chose customers and work with the profitability? Yet another board member stresses that they have the badwill of more than 130 million SEK per annum for the next two years as well. One of the union representatives adds:

> "This is the worst result since I joined this firm 25 years ago."

The Chair continues to raise a sensitive topic: "When we acquired Arrow, we were informed that approximately 65 % of our sales goes through merchants; it has now come to our attention that more than 90 % of our sales go through merchants. Another board member asks the CEO if they really have the capacity to do an adequate customer analysis. The CEO replies that they have done it; the board requests that this will be presented at the next board meeting.

The CFO tries to conclude the discussion by informing the board "even though we have had a strong cash flow, it should be recognized that the vast majority is coming from changes in operational and financial capital - and not from Arrow's bottom line." A board member adds that it is amazing to have generated a cash flow of approximately 300 million SEK. It is not strange that Goliath is doing so badly when it counted out Arrow, which has such large potential.

## On the Strategy Process: Finding Arrow's Core

The CEO starts off by explaining that they have defined the current situation and formulated the goals for 2007-2011. He asks whether they should present it at the next board meeting or if they first should verify it with some board members. On one of the board member's initiative, also a Bay Lake representative, it is decided that they should verify the goals and the business plan with some board members first.

The CEO continues to present the three overriding goals: an EBITDA goal of 180 million SEK, an efficiency goal of 81 %, and a quality goal stating the maximum number of claims should be <590. The Chair says: "Even though I understand and am satisfied with the first goal, the second is incomprehensible to me." Almost everyone in the board shouts out that it is "world class" at the same time. Another board member holds a more critical attitude when saying that these goals are to production-oriented. Where are the market-mix and logistical goals? "It is also more important to think and plan for how you will achieve these goals rather than merely stating them."

The CFO continues to present a slide illustrating the assumptions behind the assumed result development:

Table 6.33: Assumptions Behind the Assumed Result Development

| *Area* | *Assumption* |
|---|---|
| Widget prices: | Increase in 2008-2009<br>Decrease in 2010-2011 |
| Beta prices: | Decrease in 2008-2009<br>Increase in 2010-2011 |
| Variable costs: | Unchanged |
| Fixed costs: | Increase with 1.5 % p.a. |
| Investments: | Maintenance investments will be done to keep the production intact<br>Quality investments on the Widget machines to increase volumes |
| Logistics: | A marginal increase due to market reallocations |
| Beta and energy: | Primary focus on flexibility |
| Firm financing: | Unchanged |

The CEO elaborates upon the quality investments and states that this is "pocket change". The Chair responds quickly that it is not; this is a lot of money for Arrow due to its weak performance. Another board member adds that emotions or emotional values are irrelevant; ROI is all that matters. Bay Lake's CEO states: "We should find ways to decrease the financing costs of Arrow. Since the shareholder debt is the most expensive debt, we should solve this first. Arrow's CEO adds:

> "To be honest, no one earns money within this industry."

The Chair replies that this is why (we) expect (you) to be world class on every key ratio. It is finally decided which board members will meet with the management team to scrutinize the goals and the business plan.

## Market: Finally Formalizing the Means to Stop the P&L Bleed

The Sales Consultant who now has been invited to the meeting starts off by presenting the long-term sales and marketing goals as well as means.

Table 6.34: Long-Term Sales and Marketing Goals

| *Goals and Means* | *Explicit Definition* |
|---|---|
| Goals: | Reallocate 30,000 tons to profitable customer |
| | Establish a new price list with additional fees for non-standard orders |
| | Standardize the payment terms |
| | Remove the unconditional rebates and bonuses |
| Means: | Meet all key customers |
| | Develop a rolling forecast system |
| | Deploy continuous customer/application/market analysis |
| | An in-house sales organization |
| | Deploy a new calculation system |
| | Develop new products (W-Widget and U-Widget) |
| | Scrutinize the current logistics setup |

The Sales consultant continues to present the expected price increases market by market. One board member bursts out:

> "You have lost more than 20 % on the gross margin. You have to focus on that problem soon."

The Sales consultant agrees with this statement and explains that they are still living in the sins of last summer when they just tried to fill the machines. He continues to elaborate upon the inherent components of the price: (i) the market mix, (ii) the currency effect, (iii) the Beta share, (iv) the Sphere/Cubicle mix.

### Beta Supply: Reviving Former Ideas and Conclusions

The CEO says: "After scrutinizing the Beta and Gamma situation, we have concluded that the current Beta supplier is our best option. We have also been able to negotiate a doubled payment period with the supplier, which will strengthen our cash flow. Our ambition is to increase the flexibility in our Beta usage through increasing the Gamma share to 30 % and continuing to look at other Beta suppliers. We have bought a substantial amount of Gamma to experiment with different Beta–Gamma compositions. There is a large risk in our Beta supply since there only is one additional Beta supplier except for the current one. The strongest advocate of the idea that Arrow should explore new Beta suppliers and new Beta variants states that, given this information, we should increase our interaction with our current supplier and prolong that contract.

## Analytical Summary: Turning the Table

The board meetings are quickly changing in character. The pressure from the board is not only decreasing marginally; the power to interpret and describe the current situation rests more in the hands of the CEO and CFO, hence, the management team. Having switched the board meeting location from Arrow's headquarters to Bay Lake's office might also be a sign of diminished anxiety on the board. The management team increasingly sets the pace and decides what the board meeting agenda should be. Instead of the board's one-directional instructions on what the management team should accomplish, the management team presents what it has done and what it will focus upon next. The management team, not the board, increasingly emphasizes the sense of urgency and crisis awareness: a fact that pleases the board.

The management team has assumed control of its short and long-term objectives and the means they want to deploy in order to accomplish the objectives. Even though the board has numerous comments and critique towards the management team's decisions and actions, the tables seem to be turning when it comes to proactivity.

## The Management Arena: Building Bridges…

During the beginning of the 2007, it was decided that the Development Director would change her position and become the new Marketing Manager. Hence, she moved from the production capability to the sales organization with the Sales Consultant as her direct manager. Put differently, she switched from an internal position to an external one. The management team, of which she had been a part, decided that moving a senior member of the production management team to the sales and marketing side could bridge the understanding and communication between the two departments. Simultaneously, one of the Production Managers assumed her former role as the Development Director.

### Management Meeting to Discuss Regained Control and Future Ambitions

In the middle of the first quarter of 2007, the management team met to have an ordinary management meeting. Since the Sales Consultant was absent, the new Market Manager (i.e. the former Development Director) would fill in for him during this meeting (she was subsequently made a regular member of the management team as she was when she was the Development Director). The CEO started the meeting by concluding that the January result was exceptionally good and the outlook for February also looked strong: "It feels like we are gaining control of our firm, which has lead to a decreased volatility in our results. Hard work usually leads to good results. March looks promising."

The CEO presents the agenda for the rest of the management team, which includes: (i) a discussion on the new product calculation system and financial system, (ii) board information, (iii) goals for 2007, (iv) reports from all functional areas, (v) follow-up concerning the Beta situation, the business plan, and the budget including the P200 program, (iv) investments.

The IT Manager and a Project Leader are invited to the meeting in order to present the new production calculation system and a new financial system for Arrow. A long discussion takes place on the pros and cons with the different systems and how the implementation of these will be preformed. The participants also discuss how the product calculation system will revolutionize the sales department and bridge the customers' requirements neatly into the production capability.

The CEO then presents input from the board meeting that focused primarily on the sales and marketing questions. He explained for the board that it will stop distributing Cubicles to overseas markets since the additional contribution is less than 50 % of the contribution attained in Europe. The new Development Director gently asks the CEO why they have decided this. The CEO explained this with the low additional contribution. The Development Director who was earlier one of the Production Managers rather harshly explained that they have a huge overcapacity in the machines creating Cubicles and the marginal cost for producing Cubicles out of Sphere is more or less zero. Neither the CEO nor the other participants could argue with the Development Director's statement; they decide to continue to deliver Cubicles to overseas markets.

## Scrutinizing 2007 Goals Again

The management team continues to discuss the gross margin/profit and the internal efficiency as the overriding goals leading to the required EBITDA target. After a long elaboration on these levels and their implication on the EBITDA result, one of the participants requires them to lower the result for internal purposes. He argues that they cannot achieve a more thrifty economical approach within the firm if they present a result that is too strong. People will not recognize the fact that the result is actually doped with badwill. After the participants have agreed upon this, the CEO reminds them that they should hand in their overriding goal for their function, area of responsibility, and associated sub-goals.

## On the Financial Outlook

After a coffee break, the participants direct their attention to the CFO who will present the current performance of the firm. She starts off by saying that the performance is really good: "We have strong financial result deriving from the good market mix, the increased prices, the favorable currency development, and the low Beta share. We have further decreased our logistical costs, but we do not know why. We must deploy a profound analysis to see which variables have changed and have, hence, impacted the logistical costs such as market-mix and vehicle utilization. The days of outstanding sales has further decreased from 56 days last year to 44 in February. The Purchasing Director adds that he has been able to lengthening the payment terms with the logistics supplier by more than 30 %. The CFO adds:

> "Finally we have a positive cash flow emerging from our operational activities and not only from balance sheet activities."

## Sales, Marketing, and Production Outlook

The Sales Consultant starts off by saying that one of the Production Managers had identified an error on their price list. The Production Director quickly adds that all the employees in the production capability are very interested in sales and sales development. The Sales Consultant continues to present the contribution levels and the discrepancy between them; the target on each and every market in a very positive tone.

The Production Director takes over and explains that the production capability is running perfectly: "In fact, we are surpassing our targets right now across the board. We have a very high efficiency and producing the high contribution product variants. While everyone seems pleased, the CFO adds that they have to make sure that they understand why the development is so positive. I want to have our success under control so that we can replicate it. This is followed by a 30-minute discussion on the cause and effects of different factors within Arrow.

### Analytical Summary: Bridging New Arenas

The management team continues its quest of building bridges between different arenas. The attention has shifted, however, from bridging the board and the management team to building bridges between the management team and the production capability – hence, internal bridges.

Arrow's current performance has created a paradox since the management team foresees a credibility problem of keeping the organization tight (from a headcount and spending perspective) when the performance is so strong. The urge on the management team to understand and control the factors that generate the current successful performance consumes a large portion of their time.

## The Board Arena: Being Down on a Customer by Customer Level

### 8th Board Meeting: We Must Become More Pragmatic

After the Chair opened the meeting and all formalities had been ticked off, a brief discussion is held on the preparation for the upcoming shareholder meeting. Arrow's two auditors are also participating during the first part of this meeting to present the firm audit they have completed. The board poses several questions to the auditors concerning issues such as whether the badwill can be included in the solidity as a means to strengthen the firm's position when it comes to covenants, to which the auditors answer positively. The auditors feel very satisfied with the audit and argue:

> "There is a strong tradition for control and structure in Arrow."

The only weak part is the management's control over the customer bonuses and rebates. A board member asks the CEO: "We now have a good control over this, right?" The CEO answers that they are working on it.

## The Financial Situation: Increasing the Differentiation on the Top Line of Profit and Loss Statement

The CFO starts the discussion by explaining that February has continued in the same spirit as January: "We are over budget and the currencies have showed us their gentle side again. Explanations for this positive result include a higher share of Cubicles, decreased logistic costs, Beta and energy consumption according to plan, and lowered fixed costs, primarily due to low a maintenance level. The production team has indicated, however, that we have to agree on a strategic long-term level for the maintenance since this might increase the risk in the operations."

For the first time, the CFO presents and elaborates on a price analysis slide indicating the levels, forecast, and implications of the price component's different sub-components: "We have been successful in the market reallocation (i.e. market mix) and increased our share in Europe. We have further increased the sales of Cubicles in contrast to Spheres, and we have been able to somewhat increase the Widget price on particular markets. Lastly, the currency development has affected us positively. All of these factors strengthen the average sales price for Arrow's Widgets. After elaborating upon this and the cash flow situation, the CFO states that this is the first month since Bay Lake acquired Arrow that the strong positive cash flow is actually generated by the operating profits, rather than financial magic and the continuous work of decreasing the capital intensity and working capital.

The CEO adds that the rebates and bonuses will increase by approximately 40 million SEK this year, although they have made them conditional. This statement initiates a lengthy and sometimes hardlined discussion on the future viability of approaching merchants instead of direct customers, since all these bonuses and rebates are going directly into the merchants' pockets. The CEO argues forcefully that the board must understand that merchants are extremely important to Arrow and "we cannot change the map". Since the discussion seems to run out of control, the Chair closes the meeting for now by saying: "We will postpone this discussion, but just remember that all bonuses and rebates must be conditional. Lastly, in response to a board member's question, the CEO says that March will be the best month ever with 24 thousand tons.

## Market: We Have Increased Price, but Did it Bite us in Tail?

For the first time, the CEO presents the market update instead of the Sales Consultant doing so. He starts off by informing the board that volumes are increasing in almost all markets except the two where "we were a bit too tough in our prices increases". A board member asks if they really have the right guy there, whereby the CEO replies that they are currently evaluating that. The CEO continues to present the markets where the contribution margin is below the threshold level to attain a positive result. A board member questions why they are even active on those markets. After a long discussion, it becomes obvious to everyone that the CEO feels attacked by this board member whereby the Chair interrupts and asks whether they are declining any orders. The CEO replies: "Due to our new allocation system, we are able to do just that. It is going to be a very exciting fall (it is March at this time). While this contribution overview per market is good, "we have to go deeper and complement that view with a customer-by-customer view." a board member adds.

## On the Strategy Process: Starting a Continuous Journey of Establishing EBITDA Language

The CEO starts by emphasizing the process and the fact that they are starting to develop a mutual and unified language: "We have transcended from focusing on production measurements to having an EBITDA perspective in all we do." He then present the operational and results-oriented goals. A board member states that he misses benchmarking and gross margin goals. Another board member adds that even though Beta is only quasi-affectable, they need to include it in our goals. Yet another question is whether Arrow has the optimal amount of employees. While the CEO tries his best to answer these questions, it becomes apparent to the board that the management team, perhaps for the first time, has been considering the questions the board would pose in advance. The Chair adds:

> "We obviously won't be disappointed if you reach higher than your goals."

The CEO goes on to present the sales and marketing initiatives that are going to be implemented and the projected outcomes of this. One board member argues that, while the goals and initiatives are good and ambitious, you need to be more pragmatic. "I would like to see a list," he says, "of the top 100 customers that we want." The CEO replies: "We will look into this. In order for us to reach these high EBITDA levels, we will be forced to increase the capacity and quality of our Widget machines in some investments." A board member then says that, if this is supposed to happen, "all of us need to be creative and think if we can accomplish this without investing first."

The meeting concludes with a presentation concerning the findings that the risk/financial consultants found concerning raw materials, currencies, Beta, and other financial and customer related transactions. The Chair adds that they are so extremely exposed to the USD that a 8 % appreciation of the USD would erase the EBITDA for 2007. The CEO adds that the logistics project has been initiated and "we have mapped our logistics, made a customer questionnaire, analyzed the costs, evaluated a new follow-up system, and scrutinized the logistics situation on our largest market."

## Analytical Summary: Is There a Correlation Between Performance and Confidence?

The CEO is becoming increasingly tough and explicit in his beliefs and outlook towards the board. While this is obvious in many areas, his explicit and diametric view and explanation of Arrow's merchant dependency illustrates his determination more explicitly than ever. The fact that he and his CFO simultaneously show a vastly increased level of confidence and analysis as Arrow's performance exceeds expectations probably influences his gained confidence, which is perhaps also why the Chair explicitly defends him in front of the board for the first time.

# The Management Arena: Everyting can be Achieved When You Work for Yourself

## With What are we Satisfied?

The management team meets for an ordinary management meeting in mid-April of 2007. The meeting starts with the CEO presenting the agenda to the other participants. He states: "We will go through the information from the latest board meeting, as always, then have a goal follow-up session, a 5-minute presentation from each and every one of your functions' current status, and then thoroughly go through the Beta situation, the business plan, and the P200 program."

The deputy CEO states that the fact they wrote on the intranet that a board meeting would take place without any information about it immediately initiated rumors: "One year as an independent firm, and we still manage to screw up the information distribution." While everyone agrees that they really need to sharpen the communication skills, the CFO takes over the word and informs on the content of the last board meeting: "The major issue of the day was having us present our first business plan. The board not only approved the business plan and said that it was really good; one of the external board members who is the CEO of a firm much larger and more developed than Arrow said that he wishes his team could accomplish something like that. Hence, the board really has confidence in us right now. After we had presented our business plan, our financial consultant presented the results of their financial and risk analysis." The CEO adds that, while everything looks good the consultants' report indicates that if (our) assumptions in currencies, energy, and Beta diverge with 10 %, (we) still end up with a negative result.

The CEO goes on to say: "After this risk discussion by the consultants, our two accountants presented their audit of Arrow. This was followed by a discussion on how the badwill should be treated and dissolved. We also had a presentation on the current status of the Beta and energy project."

After a short coffee break, the participants continue when the CEO suddenly states that they have to really make the board understand that (our) competitive range is within the medium density M-Widgets. This is not only where the demand is; it is the most interesting application area within this interval. The Development Director concurs with the CEO and adds that they must also make the board understand that they never will attain the aggressive goals of the business plan without focused investments.

These comments lead to heated discussion, and the CFO continues to recount the board meeting by saying that this Beta and energy discussion was followed by the usual long harangue about the market: "They are still requesting us to present the contribution per market, per customer, and per application area. The CFO ends her presentation by saying that the meeting was overall very positive and:

> "…our current financial result makes the board much easier to handle."

The Production Director adds that he has noticed a difference among his employees: "More employees than before follow our goals and their development on the intranet. I have even heard them discussing the positive development over lunch. With this in mind, it gives me great pleasure to say that we have beaten our total efficiency record that is more than 15 years old." One of the participants asks the Production Director why he thinks the record was beaten; he explains this with an increased interest and problem-solving attitude among the employees. He continues:

> "It feels like they [the employees] work for themselves for the first time and for their own future and security."

The CFO adds that it is the positive attitude among the employees that creates these fantastic figures.

### On the Financial Outlook

The CFO starts off the financial presentation by saying that it has been yet another successful month: "I have also seen a growing interest among our employees where they want me to present the financial result to them.

"We have an EBITDA result for the month of almost 20 million SEK and of 50 million SEK for the first quarter. Our logistical costs have further decreased by 14 million SEK for the first quarter compared to the same period last year, although we still have no control over the reasons for this. The fixed costs are still superb, which reinforces the fact that we are world class when it comes to cost efficiency." The CEO adds that, just a few months ago, Bay Lake was arguing that the future looked like a black hole; the Development Director emphasizes the importance of informing the rest of the organization of the positive progress right now.

The CFO continues to explain that the balance sheet looks slim since the stock is at an all-time low and the days of sale outstanding are rapidly decreasing: "We are currently at 42 days. Looking at our new price analysis model indicates that the prices have increased vastly since last year, and that the effect is originating from sources other than market price increases. Our market mix and the favorable currency development have strengthened our average price instead."

The CFO presents the primary factors in the forecast and their current development: "We have an exchange rate development that strengthens our result and a volume development that indicates a sales level of 260 thousand tons this year. The market mix, Beta and Cubicle share, as well as rebate levels are also fairly favorable right now. On the other hand, we have seen an increase in salaries, other personnel costs, administration, and maintenance." The Production Director quickly adds that the Beta share is totally irrelevant as long as they sell profitable tons. While the CFO agrees, she adds that the Beta share is still an important control mechanism. She also says that, given the current development, Arrow will reach an EBITDA of 112-148 million SEK, excluding the badwill.

The Deputy CEO looks a bit aggravated and states that they must immediately initiate new result enhancers since they must reach an EBITDA of 180-200 million SEK, excluding the badwill. Several participants respond persuasively that they still are in the beginning of the P200 program and that the effects will increase throughout the year. The CEO adds that they cannot decrease costs and save money as a means of strengthening the profitability any more: "We should instead redirect our focus to the launch of a brand and positioning strategy." The Deputy CEO agrees, however, still emphasizes stronger cost and efficiency measures. One of the participants argues that initiating a new P200 or P2007 is useless since they are still the same individuals with the same ideas and should be incapable of finding new savings areas or revenue boosters.

After a lengthy discussion on this, the sentiment is that they need to focus more upon marketing activities; the participants actually believe that they will reach an EBITDA of 200 million SEK for the full year. The deputy CEO concludes this part of the meeting by saying that they have a strong business plan and strategy that they believe in and that the future looks really good. Everyone one agrees.

### On the Different Functional Outlooks

The Sales Consultant informs the rest of the participants of the current sales and marketing progress. He explains that both the order intake and the Widget prices have increased during the last month. More importantly, the contribution per ton has surpassed the business plan's goal for the first time. A participant asks the Sales Consultant what is the primary reason for this; he responds that due to the market mix and that they are in position to decline bad orders have increased the average contribution.

The Sales Consultant adds that they have initiated benchmarking activities and approaching the customers of the competing firm that is closing capacity in order to strengthen their position toward those customers.

Lastly, the Sales Consultant explains that Arrow's largest market in Europe is finally becoming stronger and the average contribution per ton there is approaching the contribution target of the entire firm.

The Development Director explains that they now are producing Widgets with 25 % Gamma instead of Beta free from any problems in the production capability or any customer complaints. With that good news, he concludes the meeting.

## Analytical Summary: Confidence Among Stakeholders Increases

From the meeting's agenda, it becomes obvious that the focus of the management team is diametric opposed to what was the focus only a year before. The board meeting's outcome, financials, the P200 program, and the Beta situation are at the center of the team's attention. Arrow's performance further boosts the board's perceived confidence in the management team. The management team senses this. Therefore, there is a vastly increased interest and commitment among the employees, which further strengthens Arrow's position.

The previous sense of urgency and crises awareness, however, is still prevalent. This is visible in the Deputy CEO's outburst when the P200 program and Arrow's level of performance show some negative discrepancies.

# The Board Arena: Crisis is the Mother of all Ingenuity

## 9th Board Meeting: Extra Board Meeting Defining Future Flexibility

The Chair starts by asking if anyone is happy for being here in the middle of the summer vacation; he then starts to tick off all the formalities.

### Financial Situation: A Million is Always a Million

The CFO states that the EBITDA level has exceeded expectations with >30 % for the first six months. The reasons for this result are increased prices, positive effects from currency rates, and a decrease in variable costs due to hedged oil and electricity. On the negative side, one of the Widget machines has been standing still for the past four days due to a low order intake from overseas customers. This last comment makes some of the board members mumble "we should investigate whether we should put this Widget machine into hibernation."

The CFO continues to explain that they perhaps have a formal forecast of 200 million SEK for 2007, which will be communicated to the important constituencies, such as the bank, and that they predict an internal or informal forecast of 100 million SEK. While scrutinizing the financial forecasts, one of the board members asks how they could expect the Beta price increase to be so severe without assuming that the Widget price could be increased. The CEO replies that they will be able to increase the prices, yet not to the same extent. The board member replies: "We then have to find an alternative plan to trim the costs." The CEO responds that this is what (we) will do directly after the summer. A board member adds: "I think this is too late, given the fact that large savings have a long time lag." Another board member adds that (we) should ask the HR Director (now Deputy CEO) to run through the P200 program one more time to find new savings. The CEO agrees that this might be a good idea, but rationalizations have a marginal effect compared to the hit from the increased Beta prices. The board member quickly adds that a million is always a million. The Chair concludes that the board expects a full analysis of the costs by the next board meeting in August and "please do not forget to include the logistics this time (!) since it is more controllable and affectable than both energy and Beta consumption." He says:

> "This should really create a sense of urgency, or even crises awareness!"

The Sales consultant mentions that the standardized price list with addendums for additional services is currently being implemented, which will affect the logistic costs. One of the board members who leads a similar firm argues that (we) easily could decrease the costs by 50-60 million SEK per annum. The other board members add similar comments that visibly annoy the Sales Consultant; however, he says that they are in the process of hiring a logistics expert. The Chair says that we should leave this discussion since the message to the management is clear.

## Beta Strategy: Beta or Gamma, Beta or Beta?

The Chair says: "We wrote a harsh letter after the last meeting concerning the Beta supply to Goliath, which resulted in a meeting with five Goliath representatives." He continues to inform the board that Goliath's legal expert claimed force majeure, which is why they received an expert opinion from a professor in civil law who rejected the force majeure argument as being preposterous.

The CEO presents the background for the Beta strategy: "The balance in the market will remain until 2020 even though we can see a paradigm shift in the location of production capacity. The assumption is that the price is falling in the long-term perspective. Given these assumptions, we will do the following:

Table 6.35: Actions in the Beta Strategy

| *Actions in the Beta Strategy* |
|---|
| Increase the flexibility by contracting more suppliers |
| Triple the number of used Beta variants |
| Increase the Gamma share to 50-100 % in the long-term |
| Increase the flexibility by quickly being able to adapt and change the Beta and Gamma share |

"Given these goals and assumptions, we need to invest 70 million SEK in an upgraded Beta/Gamma machine." The Chair responds: "This makes me really pleased. Only a year ago, you said that it was impossible to run on anything but 100 % Beta from our current supplier. How would it look if we used 100 % Gamma today?" The CEO replies that the quality of the Widgets would probably be the same if not even better. The Chair then says: "Arrow's largest Widget machine has a sister machine in Asia that uses 100 % Gamma. You should contact them for benchmarking." While another board member adds that this is a detrimental issue for Arrow, the Chair exclaims:

> "Crisis is the mother of all ingenuity!"

He asks how large the investment would be to attain complete flexibility between Beta and Gamma, whereby the CEO answers approximately

130 million SEK. "There is definitely a lot to think about in this business," the Chair says. A board member, namely Bay Lake's CEO, adds that (we) should convince (our) current Beta supplier to finance half of the investment and they will receive a long-term contract for our Beta deliveries in return. The HR Director addresses the board by questioning whether they can have the mandate to make a deep analysis of this investment. Everyone say yes, and the Chair states that it is a very large investment for a firm that earns close to nothing. Bake Lake's CEO adds that a 130 million SEK investment must strengthen Arrow's EBITDA with by least 26 million SEK per annum (130/5) since (we) calculate with an EBITDA exit multiple of 5x (4.5x in the IM). He continues to say that they perhaps should use the consultancy firm who made the due diligence of Arrow to investigate this, whereby the Sales Consultant laughingly questions whether the firm that believed Arrow's market was worthless should really be the ones evaluating this project.

## 10th Board Meeting: Finally Regaining Front Seat

Approximately a quarter later, the board meets again. The meeting begins according to the normal modus operandi where the formalities are, once again, checked off the list; one board member quickly asks when (we) are going to focus upon segmentation, so that (we) can discard the bulk image we have of (ourselves): "We have to segment our customer in an application dimension instead of just continents, clusters, and countries." The CEO replies that they are doing it right now and will present it at the next board meeting.

### Financial Situation: Where did all the Money go?

The CFO initiates her presentation by stating that they have once again exceeded their forecast. "More thoroughly," she says, "We have surpassed our EBITDA expectations even though our volumes have somewhat decreased, the quality complaints have increased, and the energy costs have started to climb." The Chair adds that the most pleasant surprise is the strong gross margin development. The CFO says that it is primarily due to a more beneficial market mix and a more favorable currency development: "However, we have been weak at controlling the Sphere–Cubicle share. Lastly, we have been able to decrease our fixed costs further, which in total has lead to an EBITDA that is 10 % higher than the forecast."

One of the board members mentions that he has interacted with some of his acquaintances in the business and has been convinced that (we) should rebuild one of the Widget machines to produce larger Cubicles. While the CEO seems very reluctant to this proposition, he promises to have a discussion about this with his management team and production team, in particular.

In a very bothersome tone, the same board member adds that there must be something severely wrong with the data in the financial statements: "Even though we had a positive cash flow of 160 million SEK, our debt has not decreased. Where did the money go? Something must be wrong." Another board member stresses the finding and adds that the CFO and management team need to investigate this and make a presentation at the next board meeting. He furthermore adds:

> "Being an old industrialist, I wonder if we don't focus on too many parameters."

Perhaps we should strengthen our focus on cash flow and try to discard some of the less important objectives.

> "Cash flow is all about looking in your kitchen drawer at the end of the month and seeing how much money you have."

## Market: Where did Price Increases Evaporate?

The CEO starts by explaining that they have increased our order intake even though the market has contracted by 1 %: "We have finally been successful in reallocating volumes to Northern Europe." A board member adds that (we) should start to compare our growth figures with the specific segments (we) focus upon and not to an aggregated figure from an industry organization. While the CEO reluctantly agrees, he continues by saying that they have been able to move 10,000 tons to Europe. Yet another board member asks how much the price has increased over the year. The reply is 36 SEK, and several board members become furious: "You have been saying all year that the prices have increased and now you change your statement." The Chair adds that, since so many of Arrow's peers are currently bleeding from the inside, (we) should not be that disappointed.

> "In the last European Times, they condemned the entire Widget industry to death!"

Another board member says that the only successful actors are the ones that are focusing upon much niched parts of the market. One of the board members is noticeably annoyed with the absent Sales Consultant regarding the price development most time is spend at pie-throwing directed towards the industry giants such as Goliath. The Chair adds:

> "We have to remember that we are doing a lot better than pretty much all our competitors."

A board member concludes the discussion by saying that, from now on, they need to get the price changes presented to us on a weekly instead of bi-yearly basis: "We really need better control of this on the board, since the information we receive is obviously distorted." Another board member suggests that the Chair and the CEO should perhaps do a roadshow to meet with the management teams of the large global merchants. He continues:

> "We just have to decide to increase the price and then just go through with it. How much can we really lose?"

It is decided that the management team will present a sensitivity analysis between volume and price at the next board meeting.

## P200: Impeccable Control on Everything Below Gross Margin

The Deputy CEO who also is the P200 General presents the current outcome of the P200 improvement program:

Table 6.36: The P200 Improvement Program

| *P200 Goal Areas* | *Actual (Goal) in SEK* |
|---|---|
| Revenues (market activities) | 20 (250) |
| Variable costs | 78 (80) |
| Fixed costs | 71 (60) |
| Organization and headcount | 24 (28) |
| Total | 193 (422) |
| | 45.7 % goal achievement in total and 103.6 % on the cost side |

He states that, while it is obvious that they are very efficient and successful to adapt the internal conditions and costs of Arrow, they are not as successful in the relationship with the customer. Hence, the majority of the focus will be directed to the top of the profit and loss statement from now on: the logistics, freights, as well as bonuses and rebates, which all affects the gross margin of the firm.

## Financial and Operational Assumptions Underpinning Strategy Process and Business Plan

The CEO and CFO go through the majority of assumptions in the new business plan for the first time as well as the overriding goals. The CEO starts by stating: We are building our three-year objectives and forecast upon known facts. We assume no Widget machine investments during

2008; we assume unchanged discounts on our Beta purchases, and we continue to assume an oil price of USD 70 per barrel. Furthermore, we aim to invest 96 million SEK in maintenance and increased Beta–Gamma flexibility. Both gross and net margins will follow the business plan and the logistical costs have decreased due to the closure of several international warehouses and the increased occupancy level in our transports." Both variable and fixed costs will follow a plan, except for some salary increases; the Beta costs have risen by 6.5 % more than planed." The Chair adds that this Beta price increase can only absorbed by increasing the Widget prices: "A EUR 120 price increase per ton would give us strengthened annual EBITDA of 328 million SEK, given your assumption of 272 thousand tons for 2008." The CEO goes on by presenting the main activities for 2008 according to the business plan:

Table 6.37: Primary Activities During 2008

| *Primary Activities During 2008* | *Primary Activities During 2008* |
|---|---|
| Move volumes to profitable markets | Move volumes to profitable markets |
| Focus on specific application areas | Focus on specific application areas |
| Lower the customer bonus/ton | Lower the customer bonus/ton |
| Lower purchase costs with 1 % | Lower purchase costs with 1 % |
| Increase the total production efficiency with 0.2 % | Increase the total production efficiency with 0.2 % |

Bay Lake's CEO thinks this looks incredibly good. The Chair agrees, but adds that it is important that we escape the bulk trap very quickly and start talking about segments and application areas. He continues:

> "We shall die last!"

The CEO agrees, and adds the problem is that they have no clue where their products end up, since more than 80 % go through merchants. The new Development Director is invited into the meeting. The CEO explains why they have made the former Development Director, "who has a strong reputation on the production side of the firm," the new Market Manager: "a large ambition of ours has been to become more commercially-oriented throughout the whole firm." The new succeeding Development Director has been in charge of one of the three Widget machines for many years. He explains to the board that all the focus is currently directed toward decreasing the consumption of Beta as well as testing new Beta variants, to map and understand all competing products, and to decrease production costs throughout the production process: "We also have to find out how loyal our customers actually are through lowering the quality of our products and decreasing the costs." While the board members find this very compelling, one wants to widen the perspective of the development capability to look at new products for very small, but highly profitable niches. He continues to give three product examples that might be suitable to Arrow.

The discussion about assumptions and objectives becomes the Beta and Gamma strategy. The CEO presents an analysis indicating that a 64 million SEK investment needs to be initiated right away in order to increase the flexibility between Beta and Gamma since there is an 11-month planning and implementation period. While the board is ready to decide upon this investment, its only demand is that the management team first needs to be creative and find alternative financing possibilities. One board member mentions that they should persuade the Gamma supplier to finance this in exchange for an exclusive supplier contract for a certain period.

In terms of the question on employee bonuses, the Deputy CEO states that (we) want to create a performance driven culture at Arrow, which means that they want to implement a profitability bonus where the personnel will share 5 % of all profits exceeding the EBITDA target. A board member agrees, but adds that it is important to reflect upon how one wants the bonus to affect employee behavior. Perhaps 50 % of the bonuses should be connected to the degree of innovation within the firm. The discussion is lengthy, and the CEO and HR Director elaborate upon this and present results later.

The CEO continues to speak about the ambitions and accomplishments of the logistics capability: "We have been able to close no less than five of our international warehouses and have substantially increased the occupancy level of our deliveries. The benchmarking is also up and running and we have established a logistics position."

The last discussion of the meeting concerns the new Arrow M-Widget concept. While the CEO presents the idea and concepts, he stress that, for the first time, "we need to understand and take advantage of our uniqueness." He presents the product uniqueness from a technical point of view. The Chair interrupts him by asking why they do not emphasize the environmental attributes and try to assume "the" green role within the industry: "We have to start to communicate our high environmental ambitions externally. We should not limit our uniqueness to the physical product and technical traits, but also stress the firm itself and our high service-level and flexibility. Hence, we have to promote the meta factors and create and aura around the brand since differentiating the product in technical terms is hard to pull off. We have to promote our people and our culture." Everyone agrees, and the CEO continues to present the application areas that they will focus upon from now on.

## 11th Board Meeting: Handing Over Arrow's Business Plan (2008-2012)

The board member meets again three months later. The Chair starts by stating they have a lot of very important things to go through, and then continues to tick off the formalities.

### Financial Situation: The Backside of Reallocating to Europe

The CFO initiates the financial overview by informing the board that they are somewhat below the forecast and that the full year is predicted to be approximately 5 % below budget: “High sales volumes characterized November, a small downward turn in the Beta prices, and the energy costs have probably peaked. The production levels have been below expectations and the fixed costs have increased slightly.” The usually critical board member wonders how large of a surprise was the 4 % unit drop in gross margin. The CFO explains this with a low share of Cubicles as an effect of reallocating volumes to Europe. The board member continues to ask about the difference in contribution margin between Spheres and Cubicles, but the Sales Consultant ignores him.

The CFO continues to inform the participants that, in order to minimize the currency exposure, their Beta and Gamma suppliers will invoice them in the currencies (we) desire so (we) can match incoming and outgoing currency flows. A board member asks the CFO how she perceives the future; she says that the first six months of 2008 will be tough.

## Market: The Rat Race to Europe and the Need to Find Suitable Rat Hole

The Sales consultant initiates the discussion by stating that, on the positive side, a large amount of production capacity has closed down in the market place, even though there is still overcapacity. On the negative side, the depreciating USD has made more of our European competitors inclined to move volumes home to Europe: one of the strongest competing product family is the U-Widget that has had strong margins for a long time: “For the first time in decades, this product family has experienced deteriorating prices, which is why I am happy that we did not refocus our production to this product family.

“Furthermore, we are making a new attempt to increase our prices in the first quarter of 2008. However, the strong EUR has attracted a lot of overseas actors to strengthen their position in Europe. The current situation with lower sales on overseas markets has vastly decreased the machine occupancy to alarming levels. Hence, we realize that, if we should go through with the ambition to leave the overseas market, we have to shut down one of our three Widget machines.” One of the board members asks for a deeper analysis on Spheres versus Cubicles: “After all, we have an additional contribution of 10 % for Cubicles." The Sales Consultant confirms the board member's assumption. He continues to say that they have identified the application areas that are the most frequent Cubicle users and that they have formulated actions to approach these application areas. A lengthy discussion takes place on how important it is to focus on the right application areas and to have a robust analysis at the bottom of the decisions.

## On the Future Energy: The Environment as a Key to Success and a Means to Flexibility

The CEO mentions that it has become more and more apparent in the discussions with the board and with the customers that an increased flexibility and a more explicit environmental standpoint is a prerequisite for success. He continues to say that they want the yellow jersey when it comes to the environmental position. The Chair has propounded this idea on several occasions and thinks this is self-evident; the next step, he argues, must be to get there fast: "We should become "the" green Widget firm." The CEO continues to inform the board that Arrow's two largest markets are the driving forces within this development on the customer side: "We have a large opportunity and an important strategic decision to make: that is, whether we want to rebuild our energy sourcing to a sustainable solution. The CEO presents four different investment alternatives:

Table 6.38: Four Different Investment Alternatives

| *Viable Investment for a Sustainable Energy Sourcing* | *Size of Investment in Million SEK* |
|---|---|
| Energy investment A | 170-190 |
| Energy investment B | 400 |
| Energy investment C | 600 |
| Energy investment D | 40-44 |

After scrutinizing the calculations behind these investment opportunities and the background material that was submitted to the board a week ahead of the board meeting, the Chair declares:

> "This gives us the opportunity for reinventing ourselves and our image through an energy change!"

He continues to state that this is an enormous opportunity since the pay-back period is less than three years. The alternative that everyone has their hearts set on is alternative A; it will be financed by a combination of money from the government and other NGOs. The CFO adds that they will be able to finance approximately 50 % through leasing, which the board finds very attractive. Board member and Bay Lake CEO says: "Even though we all know that we have a lot of cash, we will need it for the rough times ahead of us, which is why we should lease as much as we can." He declares:

> "It is starting to develop into a survivor game!"

The CEO adds that the window-of-opportunity to do this investment is closing since "if our peers are as creative as we are, they will be able to finance the deal in a similar way and the funds are only enough for one or two actors." The Chair concludes that they should do this, however, they have to encapsulate the risk in the base deal as much as possible.

## On the Strategy Process: The Ceremonial Hand-over

The CEO opens a box and proudly distributes to the board a 108-page hardcover business plan with the title *Arrow 2008-2012*. A ceremonial feeling is present in the room and one of the board members expresses his feelings:

> "I don't think I've waited so long for anything before!"

The CEO proudly says: "While the overriding goals have been presented before, we are proud to hand out the underlying analysis. He presents the new volume calculations, the investment plan, and how the fixed and variable costs are to be developed over the time period. The business plan also includes a complex elaboration on the contribution development within the different segments and application areas. The plan also includes an extensive description of all Arrow's functional areas, as well as goals and activities. The table of content looks as follows:

Table 6.39: Arrow Business Plan 2008-2012

| *Arrow Business Plan 2008-2012: Table of Contents* |
|---|
| Executive Summary |
| Introduction |
| Company and Strategy |
| Organization and Management team |
| Information Technology |
| Industry, Market, and Competitors |
| Procurement |
| Production |
| Products |
| Logistics |
| Marketing Approach |
| Sales Approach and Distributions |
| Financials |
| Appendix |

Arrow's strategy is also condensed and explicitly formulated for the first time on roughly 25 pages with accompanying graphs, tables, and bar charts. After the presentation of the business plan, which receives a standing ovation by all board members, the CEO presents the business plan's underlying assumptions. The board members start to underline and question some of the assumptions in the plan following the presentation. The Chair argues that the ambition to lower the logistic costs by only 3 % is a very modest objective: "We have been talking about this for more than one-and-a-half years, so I think we should double our objective to 6 %."

The Chair and another board member are involved in a heated argument about the assumptions; for the first time ever, the Chair sides with the CEO and his management team over the other board member. The CEO concludes the presentation by presenting the development team's new focus. He says the vision has transcended from a pure cost focus to a focus upon the following:

Table 6.40: Additional Focus Areas of Development Capability

| *Additional Focus Areas of Development Capability* |
|---|
| Product development (physical) |
| Product and firm packaging (meta physical) |
| Production and operational innovation |
| New sales channels |

The CEO provides an overview of the Gamma project's progress, and then concludes the board meeting.

## 12th Board Meeting: You Have Done an Amazing Job

After yet another three months, the Chair opens the board meeting by ticking off the formalities. He then  hands over the word to the CEO to recapitulate 2007.

## Recapitulating 2007: Absorbing the Bolting Cost Level in the Market and Leveraging on New Freedom

The CEO begins: "I will start the summary of 2007 by describing the external environmental factors that have affected our development. The average price on our markets decreased in contrast to our expectations and the Beta price increased; this was also in contrast to our expectations. We have seen sharp increases on the energy side in both electricity and oil during the two last quarters of 2007. Our spending on logistics increased in 2007 due to increased prices as an effect of the sharp increase in the oil prices. Our spending on other raw materials has been constant even though the prices have increased due to tougher competition. Lastly, the wage negotiations for 2008-2010 have resulted in higher salary increases than expected.

The CEO continues: "So how did we survive this non-munificent environment?"

Table 6.41: Means of Survival

| *Means of Survival* |
|---|
| Formulated and implemented Arrow's first business plan |
| Built a sales and market organization and made Arrow commercial |
| Built a new productions organization |
| Implemented the new M-Widget concept to escape the bulk trap |
| Established a new communication strategy (internal and external) |
| Assumed a leading environmental position within the Widget industry |

He continued: "With the exception of these huge and fundamental changes, we have also established a business innovation center so that we can leverage on our size, flexibility, and autonomous position. We have invested or decided upon investments for an increased environmental flexibility. This has been accomplished by focusing on substituting Beta for Gamma, on sustainable energy sources, and on a new IT system to increase the production utilization.

"Despite the aforementioned challenges, such as the decreases in Widget prices, we have been able to increase our average selling price by 448 SEK due to the reallocation of 12,000 tons from overseas markets to Europe. Furthermore, we have been able to absorb 25 % of the price increase in Beta and have decreased our logistical costs by 20 million SEK. We have saved 4 million SEK in electricity costs due to hedging and the production efficiency has increased by 0.9 % compared to our goal for 2008 of 0.2 %. This has lead to a new production record in number of tons produced in one year. Lastly, we have decreased the headcount and lowered the commission costs.

"All in all, I am very satisfied with our accomplishments for 2007."

## P200: Still Excelling on Cost Side, but P200 Needs to be Complemented with a P130

The HR Director continues to present the development and outcome of the profitability program P200 by showing the following table.

Table 6.42: The outcome of P200

| *P200 Goal Areas* | *Actual (Goal) in Million SEK* |
|---|---|
| Revenues (market activities) | 50 (250) |
| Variable costs | 68 (80) |
| Fixed costs | 71 (60) |
| Organization and headcount | 28 (31) |
| Total | 217 (421) |
| | 51.5 % goal achievement in total and 97.8 % on the cost-side |

He says: "As you can see, the large potential still exists on the revenue and marketing side. We have fully integrated the P200 program into our business plan." A board member asks what they should do if they do not achieve the goal of 280 million SEK in EBITDA. The CEO responds by saying that the current rolling twelve months (RTM) is 196 million SEK. The board member asks: "Should we then start a P130 or what are we doing to achieve the 280 million SEK… just waiting for a better market?" The CEO replies: "Pretty much, except for the energy project that is going to strengthen the result." With an annoyed voice, the board member says that the whole "twitch" was to start a continuous program that points to 280 million SEK, so they have no choice but to put in the next gear now. The Chair adds that, even though the board member is right, he thinks that the management team has done a fantastic job: "Without this effort we would have been penniless." Another board member states that it is still a viable question: "What do we do if we do not attain 280 million SEK? I think the time has come to rollover the Beta cost increases on our customers". The Chair agrees that they must strengthen the P200, which is integrated in the business plan, and perhaps launch a new additional P130 program. We have to further strengthen our dialogue with the largest merchants. A decision is made that the management team will establish a P130 program; the Chair and Bay Lake's CEO will meet with the owner of the largest global merchant who also is Arrow's largest customer.

### On the Strategy Process: Amendments to Business Plan and Note on How We Are Perceived

The CEO informs the board that "we have strengthened our ambition to decrease the logistic cost with 6.4 % instead of 3 %" in accordance with the agreement at the last board meeting. "We have revised the energy cost forecast and the intended investments," he says. "More importantly, for the first time in our history, we have conducted a global customer survey with a famous market research firm, which has conducted interviews with more than 50 % of our customers. The conclusions are the following:

Table 6.43: Survey Conclusions

| *Survey Conclusions* |
|---|
| 90 % of our customers have a positive or very positive view of Arrow and our products |
| Our absolute strength is within the product M-Widget |
| The separation from Goliath went very well |
| We are not as strong in all the areas we expected |
| On average we are better than we think |

As you can see, we have a fantastic market position with primary strengths: (i) good consistent product quality, (ii) good relations, (iii) high flexibility, (iv) short lead times. While a board member says that they just have to charge their customers for these lead times and flexibility, the CEO continues to describe the segments where Arrow's competitive advantage is the strongest and which M-Widget and S-Widget application areas have the best fit for customers' needs/expectations. The CEO adds that, while this is very much in line with our ambitions and activities in the business plan, we have a large challenge to position ourselves within the two application areas where future growth is located. He proudly concludes that Arrow has a stronger environmental profile than expected and that Arrow has the most loyal customers in the industry.

## Market: Should we Commit a Collective Seppuku?

The Sales Consultant begins by stating that waves of price increase announcements are currently taking place in the industry: both in Central and Northern-Europe. He continues: "I would say that we have a faulty position on more or less every market in which we could be both good and bad. He continues:

> "I genuinely believe that the executives in this industry, myself and some of you included, have committed a collective hara-kiri; thus, we should collectively fire ourselves!"

A lengthy discussion takes place where it is determined that the market acted irrationally and wrong due to its consistent focus upon volumes instead of profitability and that they have a chance to break this paradox. The Chair says that an additional problem is that the actors who goes bankrupt does not close down; they are acquired instead. The Sales Consultant add: "One way of increasing the profitability focus is through the "shit list" we have established in order to continuously remove our worst customers."

The CEO presents a new vision and mission for Arrow and, as he concludes the meeting, he says: "Since the board was not satisfied with our preliminary formulation, we have developed a new vision and business idea together with the Chai. We are very satisfied and very proud."

## Analytical Summary: Formalizing The Success Story…

The board meetings encapsulated many of the ideas that the board had demanded since its entry into Arrow. The performance exceeded expectations; however, the board's requirements constantly increased in order not to lose its pressure on the management team. That is to say, no opportunity to generate value was left to chance. Ideas to instantiate another PXXX program (i.e. profitability program) emerged on numerous occasions during the remaining period; this originated both with the management team and the board. The management team's control of Arrow's front seat continued to increase over the period even though the board continued with its tough and occasionally unrealistic demands. The management team's strong control of the cost side continued to dominate even though the revenue control steadily grew. The P200 program, the budget, and the business plan merged during the period and the business plan became the guiding template for both arenas as well as for many other Arrow employees. In addition to the performance, this business plan became the most important piece of the puzzle when Arrow was to exit its investment. In fact, the business plan was synonymous with the success story that the board and Bay Lake had tried to build from the start. This was a success story that also contained the tale of how a weak management team could become a strong ditto, according Bay Lake's successors.

# Chapter 7

# Summary and Conclusions

## How Sensemaking Affects Strategizing and the Strategic Change

The quest of reshaping Arrow in order to increase its profitability as well as strengthen its strategic position to create value for the new owner marked this study's starting point. Consequently, the focus has been on the arena(s) where Arrow has seen the process of shifting resources or changing its strategic, operational, and financial set-up. In other words, the loci has been in a private equity context in general or in the private equity arena(s) in particular, where the strategic agenda and change processes emerge in a firm that a buyout firm has recently acquired. This, is addition to examining the co-existing strategizing and sensemaking processes during Arrow's enhancement phase. However, the emphasis was not directed toward the value creation per sé; rather, it was aimed toward the strategizing and sensemaking that evolved in the same arena.

I have explored how the strategic thinking (i.e. sensemaking) changed over time and how it affected the process of strategizing and the strategic change at Arrow by studying and directly observing the communication and interaction between certain individuals and groups in real-time during a period when Arrow changed at a revolutionary pace. Sensemaking is about the interplay of action and interpretation, and be defined as "the meaning construction and reconstruction by the involved [actors] as they attempt to develop a meaningful framework for understanding the nature of the [strategic change]" (Gioia & Chittipeddi, 1991, p. 442).

Arrow's board and management team, as actors, were the chosen decision makers based upon their abilities or possibilities to influence the strategic agenda and, thus, the strategic change. Therefore, the focus was upon their interpretations and actions or, in other words, their sensemaking. Hence, they were chosen based upon their active role in the strategic change process as well as upon their ability and/or possibility to influence, formulate, and realize the strategic agenda.

## Studying and Interpreting the Conversational Process(es)

Communication and interaction between the individuals and groups were studied in order to depict how sensemaking developed over time and how it affected the process of strategic change and strategy formation.

An intense and prolonged contact was, therefore, maintained in order to facilitate capturing these process-related attributes. This has been of utmost importance in understanding the actors, their experiences and reflections of the occurrence (i.e. strategic trajectory) as well as any changes in these. I have argued that studying and observing through lengthy contact (in which the key decision makers communicate and (inter) act) has been necessary in order to explore, elaborate, and understand the sensemaking and the way in which it affects the organization, its members and, subsequently, the strategic change processes.

I have placed the emphasis upon broadly conceived thought patterns and how they become intertwined with the social circumstances of the organizational activities at the expense of a precise and unambiguous measurement system; thus, an interpretive method has been used to explore the sensemaking processes.

## Exploring (Inter) Actions and Interpretations

With the support of a vast body of literature, I have argued that cognitive mapping methods focused exclusively upon cognition rather than behavior are likely to ignore the tacit components of knowledge that cannot be readily retrieved and explicated by (my) respondents. Therefore, it would have been inadequate of me to exclusively study cognitions that focus upon symbols and that ignore action and interaction.

I have discarded the idea of complete and utter trust in documentation and have attempted to understand the social processes of decision-making and strategy in action by turning my attention toward the more subtle aspect of shared meaning instead. In other words, I have concentrated upon decision-making in action, thus, watching decision-making and listening to stories that unfolded in the specified arena(s).

In association to this, it is important to unambiguously and undoubtedly clarify that I do not have the ability to see into people's minds; rather, I use sensemaking as a proxy for strategic thinking. Sensemaking is subsequently compounded of (inter) actions and interpretations as I have seen and heard in real-time. To the best of my knowledge, I have tried to interpret and describe the actors' emotions and respective states of mind that have been primarily observed and, at times, even discussed with them. Hence, this has been an issue of language, talk, and communication. As I set up in the theoretical framework, sensemaking is all about the interplay of action and interpretation through a conversational process. Consequently, this sensemaking allows the actors to create rational accounts of what to change, how to change it, and why it needs to be done. This, as a result, enables action. Thus, the actors have compared, challenged, interpreted, and negotiated the (and their) reality through a process of conversation.

Based upon the aforementioned assumption, the focus has been directed toward the accounts and interpretations that the actors provided during the (process of) strategizing. As a consequence, the trace of the sensemaking processes was not in the limelight per sé; the focus was instead upon the conversational processes captured during the individuals' and actors' accounts of the change: the ways in which they changed, how they made sense of it, and the reasons why.

The thesis has illuminated how a wide set of interpretations, (inter) actions, and beliefs developed in and between two different actors – the board and the management team – and the ways in which this affected the development trajectory of the portfolio firm, Arrow.

This has also been well in line with the research field of strategy-as-practice, thus, the doing of strategy. In other words, I have watched and listened to who creates the processes, what they do, the way in which they do it, the methods they use, and the implications these have in shaping the strategy. In contrast to mainstream strategy research; I have, therefore, observed living beings whose emotions, motivations, and actions have shaped the strategy of Arrow. The central concept of strategizing has been vital to the sensemaking of these multiple actors: that is to say, their (inter) actions and negotiations and the situated practices upon which they draw in order to accomplish the strategic change.

## Incrementally Showing How Sensemaking Affects Strategic Change

The remainder of this chapter will focus upon six central themes and their interconnection to the central concepts of sensemaking and strategizing.

*Traits That Stand Out*: As its title indicates, this section will explore and elaborate upon the traits that are considered unique to this specific case. These include the fact that I observed the revolutionary and broad strategic change of a company that a private equity firm owned. The fact that a private equity actor was involved certainly distinctly influenced the timeline, risk profile, and governance.

*Embodiment of Board's Perception*: This part explores and elaborates upon the idea that the boundaries of the potential changes and adaptations, as well as the world-view, were either consciously or unconsciously cemented early on in the process. This boundary assumed the form of the depictions, projections, and intended value enhancement activities, as portrayed in the Investment Memorandum. This section will elaborate upon the emergence and effects of the iron-cage formation of this Investment Memorandum since its content dominated the discussions and actions on the arenas, thus, manifesting the board's initial interpretive dominance.

*The idiosyncrasy of Arrow* transcends from a production mindset to a commercial ditto; it explores and elaborates upon how Bay Lake's entrance affected Arrow's idiosyncratic language and how, on some occasions, this language failed to find a unique response to a new situation. Furthermore, I discuss how this idiosyncratic language facilitated as well as hampered Arrow in general, and specifically its management team and CEO, to adapt to a "new world order". Individual experience as well as Arrow's past strategic experience molded this language. While the existence and development of jargon, labels, and concepts are manifestations of language building; they can only represent strategic problems of the past since they were generated to categorize particular occurred events.

*The P200 Program: Imposing a New and Fabricated View Upon Strategic Challenges and its Remedy* explores and elaborates on how labels were (intentionally and unintentionally) used during this strategic change and the implications thereof. Since sensemaking concerns the construction and reconstruction of meaning by the involved actors as they attempt to develop a meaningful framework for understanding the nature of the intended strategic change the existence of labels becomes highly interesting.

*The correlation Between Weak Performance and Board Interference* explores and elaborates upon the perceived negative correlation between Arrow's performance and board interference in the operational work of the management team. I have showed how the board's executiveness simultaneously developed as a normal distribution curve as Arrow's performance developed in a diametrically opposite way (i.e. with a negative correlation). The section will shed additional light upon the development and the potential consequences thereof.

*Concluding Interpretation of the Change Process and Theoretical Underpinnings* explores and elaborates upon the revolutionary strategic changes and its supposed success from a more theoretical stance.

## How Does a Private Equity Owner Make it Special?

Since the ambition has been to illuminate how a wide set of interpretations and (inter) actions developed in and between Arrow's board and management team, and how these two different actors affected Arrow's development, certain general characteristics of the actors and the case in particular needed to be fulfilled. The doing of strategy, which is a characteristic from the strategy-as-practice research field, was also in the limelight. Certain requirements about the case and actors were essential to be fulfilled in order to watch and listen to who and what they do, the way in which they do it, the methods they use, and what are the implications for shaping strategy.

### Empirical Requirements and Owner Ambitions

I was required to know in advance that a certain firm of substantial size (headcount, revenue, investment, and so on) was going to be acquired and that a substantial post-acquisition strategic change was to begin. In fact, these conditions were fulfilled and formalized in the Investment Memorandum to which I enjoyed having access once a relationship with the private equity firm Bay Lake had been established. Bay Lake, as the imminent owner was committed to doing everything it could to realize this strategic change and to generate substantial value accordingly. Moreover, I had to know that I would receive a strong sponsorship in terms of access from both the private equity and the portfolio firms.

The intentional strategic change was, in fact, explicitly described in the value enhancement plan section of the Investment Memorandum. However, I am not proclaiming that the value enhancement plan was fulfilled in the way it was intended by the owner; nonetheless, the key elements of the value enhancement plan to fulfill the intended or ambitioned value generation could be clustered into four sections, which fit reasonably well with what was accomplished in the end.

First of all, the general and perhaps primary ambition had been to transform Arrow from being a corporate production and supply center within a large group to becoming an independent and customer focused firm. Arrow had, indeed, become autonomous in the sense that its dependence upon the Goliath group was eliminated; interestingly, the firm had developed a dependency upon the new board and its involvement instead. Arrow increased its customer focus and interaction as a consequence of eliminating Goliath's sales organization as the layer between the company and the market (i.e. customers). The customer and business orientation would be accentuated, and a position as leading European Widget producer in its niche would be established (this fulfillment could be challenged). A stronger and more innovative product development and customer service capability would also support this new orientation and focus. As we have seen, the view between the board (including the Sales Consultant) and the management team was diametrically opposed when it came to the function of customer service. The fact that the management team viewed product development as the exploration of the products' actual technical traits while the board (including the Sales Consultant) included product positioning (i.e. a form of exploitation) further elucidated the initial discrepancy in respective points of view.

Secondly, a new sales organization was to be built around a set of newly recruited key competencies. Relations with new sales/distributions channels and direct customers were also to be established according to the Investment Memorandum. I have shown that, while the sales organization was successfully established, the idea of directly approaching end-customer (i.e. circumventing the merchandisers) proved to be very challenging and unbeneficial. The sales force and, subsequently, the production capability would also be driven by contribution per order rather than volume or sales. What I have illustrated is how the management team (with the board's influence) incrementally developed its performance measurement system (i.e. from performance measured by produced volume to sold volume, to volume per country, to contribution per country and, lastly, to contribution per customer and application area). Moreover, the yield perspective that would be introduced (i.e. contribution per production-hour) was very hard to attain and did not, in fact, succeed to achieve a foothold in Arrow due to measurement complexity and pedagogy.

Thirdly, the primary profitability drivers were projected as four-fold. The deployment of a business plan with targets focused upon sales and cost leadership was paramount to the three that followed. I will elaborate more extensively upon this in a following section; however, it became apparent that the process of developing a business plan originated with the Investment Memorandum that defined the budget's short-term and long-term assumptions that transcended into a forecasting process that the management team had set in place in order to decrease the monthly performance volatility and, hence, interference from the board. This model subsequently merged with the P200 program that lastly merged into, and consequently constituted, a central part of Arrow's business plan. A plan that was finalized approximately a year after Bay Lake had made the acquisition (i.e. under the leadership of the 2nd CEO). A central part of the Investment Memorandum and the business plan was to find markets with the highest possible contribution in order to ensure the EBITDA margin growth ambitions. This was partially accomplished since only 50 % of the intended tons were, in fact, reallocated due to changes in assumptions compared to the Investment Memorandum. Moreover, while the procurement department had been much entangled with Goliath's corporate procurement function, it was to become more goal-oriented and commercial. In fact, Arrow's purchasing prices decreased due to the increased swiftness of the new autonomous purchasing department and its new opportunity to buy input factors on the spot market. Lastly, Arrow's cyclicality would also decrease by optimizing Beta and currency flows. The reconstruction of Arrow's Beta usage was one of the most energy consuming processes during the period; in contrast to the management team's initial beliefs, it did adapt the production capability to become supplier and Beta variant independent (more on this later). This also opened up to new sourcing opportunities that facilitated currency flow optimization and decreases in purchase prices.

Fourth and finally, *cash flow* would increase by applying a lean approach to the balance sheet and capital expenditures in order to free cash to facilitate a rapid decrease in the senior acquisition debt and vendor notes. The primary means to accomplish this was to optimize Arrow's capital structure and reduce its tax obligation, thus, minimizing capital expenditures (e.g. by reducing the management team's investment autonomy by approximately 80 %), and tightening the inventory control and account receivables, which subsequently diminished the inventory levels and the amount of receivables.

## The Large Emotional Strain Affected the Change Process

All the aforementioned changes put a lot of strain and pressure on the members of the management team (and occasionally on the board as well), which became visible by how it acted and what it communicated. The examples are numerous; the high work-pace, the many late nights, the complaints of not getting sufficient sleep, and the emotional outbursts are just a few. This, together with the fact that they personally had invested a large fraction of their personal assets and that many of them had pledged their personal belongs (e.g. house) as deposit for the bank loan (i.e. to finance the investment in sweet equity) made this a very emotionally and mentally challenging process.

This particular case was also additionally personal for reasons other than just their personal loans and reputation. A couple of months after Bay Lake's acquisition, employees and the management team became well aware of the fact that Arrow was in the state of decay. They knew that Arrow was, by far, the largest private employer in the area and that a default would not only affect them, their careers, and their employees; it would also impact their families, friends, neighbors, and the community at large. They had also the dismissal of the CEO and the Sales Director fresh in mind and, hence, felt that they had to do everything in their power to turn Arrow's performance around quickly. Other not very commercially-oriented departments, such as the production department, also started to support the sales department and identified flaws in the customer price lists and contributed to the development of new unique selling points. Thus, the ability and necessity to control the firm's and one's own future developed into an increasingly stronger force with the organization.

Thus, the "rich mother" (i.e. Goliath group) with its watchful eye was no more, meaning that they had to transcend from non-independent to autonomous in a very short time.

## Private Equity Firms as Owners Have a Unique Modus Operandi

Another rather interesting reflection pertains to how Bay Lake, as a private equity actor, differs from other actors in its quest to commence a strategic change in an operating firm in order to generate value. As shown, Bay Lake had a cemented view from the beginning on what should be done with Arrow in terms of the strategic change. In fact, the Investment Memorandum not only specified what was to be done; it also stated who the potential buyer of Arrow would be after the firm was "refitted". While the strategic change activities the board and management team deployed were not unique to those deployed in firms with other owners; instead, the large discrepancy between Bay Lake as a private equity firm and other actors seemed to be in the time-horizon, amplitude of the change, board involvement, view on short vs. long-term, opportunism, investment rationale (i.e. investments in done in the operating company), and pressure/requirements.

In terms of time horizon and amplitude of change, Bay Lake has an investment scope of 3-5 years (with a median equal to the Nordic private equity market, thus, closer to three than five years). Hence, the swiftness of the change was principal; this also obviously affected the need to promptly deploy the changes and prove their effectiveness in a short period of time. The conventional 90-day rule in private equity (i.e. all changes need to be deployed within 90 days of the acquisition) is most certainly a consequence of this. Thus, Arrow required deployment early in the enhancement phase in order for the strategic changes to not only be implemented but to also have a real impact upon Arrow's performance (within the investment period). In terms of the amplitude of the strategic change, there was a large need to demonstrate that Arrow not only had been changed for the better; there was a material improvement as well.

This story has elucidated how this has been addressed in a two-fold manner. A set of "real" changes in Arrow's structure, organization, modus operandi, autonomy, strategic position, operational efficiency, financial effectiveness, etc. were deployed. Even more interestingly, the starting point for Arrow's (success) story under Bay Lake's ownership was greatly downgraded by shifting (both expected and unexpected) costs, investments, and RATEX (without doing any accounting violations) in time as well as projecting certain mistakes on the former owner Goliath's part. This not only protected Arrow's development from covenant breaches; it dramatically steepened Arrow's development curve under Bay Lake's ownership. A large fraction of the required operational investment was also done early in the enhancement phase to further steepen Arrow's development and performance curve.

The aforementioned amplitude of change in combination with the rather short time horizon for the strategic change implementation also made Arrow's change impetus revolutionary rather than evolutionary in character. In combination to this revolutionary approach, Bay Lake admitted that the fit between Arrow and its investment requirements were rather weak and that the decision to invest was based solely upon the relatively, if not very, low price indicates opportunism. In terms of operational investments within Arrow, the calculative and opportunistic outlook was even more prevalent. The fact that all investments immediately needed to be short-term lucrative from a firm value perspective demonstrated the relatively short time horizon. Hence, even if the annual EBITDA improvement stretched far beyond five years, which is well in line with its ambition to generate substantial value for themselves and their investors, an investment that strengthened the annual EBITDA with 20 million SEK in combination with an EBITDA multiple assumption of Arrow's value of 5 would have to be extensively lower than 100 million SEK in order to be viable. Therefore, the valuation multiple in itself possessed a vast influence on Arrow and its future. A multiple that Bay Lake, through the board and management team, tried to influence by changing Arrow's strategic position and redefining its market space in order to increase its market share and value.

Bay Lake's assumption was that, in order to accomplish all the aforementioned within a limited time frame, they had to be substantially more executive and aggressive than its normal modus operandi (i.e. within firms not acting in a private equity context). Thus, they not only brought the necessary preconditions to the table; they also supported and sometimes controlled the management team in the formulation and implementation (i.e. formation) process. As will be seen in a forthcoming section, the board's executiveness correlated negatively with Arrow's performance. The waves of executiveness differed over time, while the thumbscrews were constantly tightened. More explicitly, every time the management team had accomplished what the board expected the board additionally raised the bar. This has been evident in numerous processes, such as the performance measurement process (i.e. from performance measured by produced volume to sold volume, to volume per country, to contribution per country, and to contribution per customer and application area), the Beta independence process (i.e. from changing supplier, to changing Beta mix, to becoming completely flexible in terms of Beta variant, which will be further discussed in a subsequent sub-chapter), and the cash flow improvement process (through an increased focus and emphasis on investments, stock, as well as accounts payables and receivables).

An interesting observation was Bay Lake's perception of the bank and its discretion concerning Arrow's development; it is common knowledge that this type of owner (i.e. a private equity firm) changes its portfolio firms' risk profile from both a financial and operational perspective. While the financial risk changed in the sense that Arrow's financial leverage after Bay Lake's entry was substantially higher; the management team's focus and emphasis upon interest payments were prioritized. The fact that Bay Lake had a long withstanding relationship with the bank probably decreased the financial risks. There was a decrease in large interest payments in concert with a focus upon decreasing the working capital while substantially increasing the operational risk since funds for required maintenance investment. From an exploration perspective, Arrow's funds for operational innovation were also impeded due to the risk of not being able to meet the interest payments and net debt reduction.

In the context of financial risks, Bay Lake's reaction when the loan covenants were breached was interesting. Bearing in mind that this happened less than a year before the financial storm in the global credit market and the subsequent global recession, they explicitly said that breaching covenants is a non-issue since banks seldom act upon it; in fact, the firm called it "covenant light" even though the terms for Arrow's loan facilities were tougher than normal in that period of time (most probably due to the turmoil within the widget industry). This became particularly prevalent when one of the initial bidders (i.e. an actor competing with Bay Lake in the process of acquiring Arrow) filed for bankruptcy less than one year after Bay Lake acquired Arrow. This was very favorable to Arrow since that bidder was not a financial actor; rather, it was one of Arrow's competitors.

# The Embodiment of the Board's Mutual Perception or Belief Agreement – The Iron Cage of the Investment Memorandum

## The Main Influencer: Interpretive Power was Embodied in an Artifact

As discussed in the theoretical framework, I adhere to the notion that the concept of interpretive dominance could conceptualize a belief system as an active arena in which interest groups compete to impose their preferred order upon others. As aforementioned, the Investment Memorandum came to constitute the mutually shared view that Bay Lake had Arrow as an investment opportunity. This was a view that matured during the six months the Bay Lake partners spent scrutinizing Arrow and compounding the memorandum (i.e. with the support of numerous external stakeholders). Thus, it conveyed and accentuated the "facts", ideas, and projections that Bay Lake held as believable or desirable and concealed what was assumed to be irrelevant, unlikely, or less beneficial to portray within an investment proposal. Whether these augmentations and diminutions were intentional, unintentional, or a mix in-between is irrelevant here; however, it is clear that they had real effects upon the actors' views and upon Arrow's strategic change trajectory. The Investment Memorandum affected and, in some sense, established both the boundaries of the decision terrain as well as the navigation heuristics for the individuals who not only came in contact with the memorandum, but also utilizing it as a foundation for deciding whether to invest in Arrow and become actively involved in its upcoming journey.

In other words, this Investment Memorandum was how the external board members initially encountered Arrow and most likely shaped their initial perception of the firm, its opportunities and risks, as well as its potential strategic change trajectory when Bay Lake initiated its discussions with potential board candidates on whether any would be interested to invest in Arrow alongside Bay Lake and, more importantly, serve as board members. I have showed how this initial view shaped the board candidates' perception of Arrow, its history, its future, and how the gap would be bridged. Thus, the memorandum was perceived as the strongest influencer upon the board members' mutual views and, subsequently, those of the management.

While the memorandum consequently portrayed numerous "facts" and assumptions, some had larger implications than others upon this change process.

## The Investment Memorandum Defined What was Actually Arrow

Bay Lake and the board assumed that Arrow would be a highly focused niche actor with a market share of approximately 15 % that had outlived numerous economic downturns and recessions. While the statement is interesting; the assumed characteristics are even more interesting. Seeing as Arrow had survived so many economic downturns must mean it not only has inherent survival-strength and change proneness; it must also be due to its niche position and large market share, as well as its ability to set - or at least affect - the market price of its products: an assumption that proved to be both ambiguous and hard to break (as illustrated in the empirical exposé).

Moreover, the memorandum also indicated several of Arrow's strengths (including its strong and proven management team, which was quickly reduced by 50 % and two of its most important members were exchanged) and the financial construction with vendor notes (later on complemented by the Beta agreement, which made it an unsinkable construction); it also disregarded the factors that did not fit Bay Lake's investment criteria (e.g. heaviness of the balance sheet, the business cycle sensitivity, and the distance to the end-customers).

The memorandum posed numerous assumptions about the internal and external development as well as the activities that were to be deployed after the acquisition; this include more or less all value-creating mechanisms elaborated upon in the value generation chapter. Issues that can be accentuated include: the owner's wish to bypass the merchants and establish direct contact with the end-customers. The eagerness to bypass the merchants and directly approach the end-customers, thus, expanding the margins, was one of largest clashes between the board and the management team; however, it eventually ended up with the opposite: a strengthened merchant cooperation. The second issue was the leverage on its strong brand (the brand's strength became increasingly questioned throughout the process since it became evident that approximately 90% of the products were sold through merchants and Arrow had no idea under what brand name they were sold. The third issue was the change in contribution view (this highly incremental change was elucidated in the former section); the fourth issue was to diminish the dependence upon a specific type of Beta (this will be elaborated upon in the next section). The fifth issue included building a new and highly commercial sales organization: a process that was initiated right from the start by the first CEO and finalized by the second CEO approximately 9 months after Bay Lake's entry. The sixth and last issue was raising the price of the product; this issue of price increase, Arrow's assumed niche position, and its subsequent power to affect the market price not only consumed a large fraction of the management team's and board's energy and focus, it also had numerous dismissals and conflicts on its conscience).

The expected gross margin and revenue growth were depicted as marginal or absent, yet the improvements in the operational efficiency (i.e. costs), which paralleled the theory of value creation, were considered to be large. Interestingly, all external factors affecting Arrow and its projected trajectory indicated a favorable development in the Investment Memorandum but, as we have seen, almost all uncontrollable factors went in the opposite direction.

As aforementioned, Arrow was depicted as an actor with a significant market share in its core market. In fact, with its focused product-strategy compared to its competitors, Arrow was depicted as the second largest player in its specific niche, however, a small player within the overall Widget industry. The board's perception of the delimitation between the different segments or niches were explicit and unambiguous in the memorandum; the delimitation's blurriness grew with time. This led to a conflicting perception of Arrow's market share, in the sense that the board perceived Arrow as a market leader and, hence, a price-setter; the management team perceived itself as a small fish in a big pond that had to take the market price as a given.

As I have showed, the Investment Memorandum and its rigid assumptions became a mental iron cage of sorts that both defined the boundaries of the decision possibilities as well as the plausible actions. I have illustrated how the management team and the CEO(s) spent months, if not years, trying to break free from the memorandum's explicit and sometimes premature preconceptions. This process further affected the relationship between the Chair and the first CEO to such an extent that the relationship quickly deteriorated.

# The Idiosyncrasy of Arrow – Transcending From a Production Mindset to a Commercial Ditto

## An Idiosyncratic Language: What it is and What it does

As discussed, I have observed sensemaking and strategizing. As posed in the theoretical framework, sensemaking is all about the interplay of (inter) action and interpretation through a conversational process. This sensemaking consequently allows the actors to create rational accounts of what, why, and how to change, which enables action. The actors have consequently compared, challenged, interpreted, and negotiated the (or their) reality through a process of conversation.

In order to be effective, this process of conversation needs a language in which strategy concepts can be expressed. While this language is influenced by many sources, such as strategic management textbooks, educational, social backgrounds and experiences, most organizations (e.g. Bay Lake and Arrow) develop an idiosyncratic (strategic) language: idiosyncrasy, in the sense that the language might differ and that different actors charge the same labels or concepts with different meaning/content. This language is primarily based upon the strategic experience that the organization has experienced in the past. While the existence and development of jargon, labels, and concepts are manifestations of language building; they can only represent strategic problems of the past since they were generated to categorize particularly occurred events. These categorizations are generally attributed to specific situations. Consequently, using existing language as a means for categorizing new situations will, almost by definition, fail to completely describe a new reality. Assuming this, there is a necessity for a conversational process in order to search for a response, thus, using yesterday's concepts in order to find a new unique response to new situation.

Individuals (apart from the group or organization) with emotions, hopes, and values carry individual or shared language repertoires based on past experiences or endowments. This should not be ignored.

More interestingly, I assumed and subsequently saw that the new actor (i.e. the new owner and board) with somewhat different backgrounds and experiences introduce a new (strategic) language that affected the management team and its shared language.

Throughout its long and, according to Bay Lake, successful and change-prone history, Arrow had developed a language based upon its experiences. While this has been discussed extensively in the empirical part of this research, it has become apparent that several preconceived assumptions had a strong foothold in the organization: assumptions that vastly affected Arrow's strategic change. These included the idea that production is the predominant activity in any successful Widget firm and that quality is a goal rather than a means. Other ideas with a strong foothold in Arrow were that a Widget firm cannot survive without annual volume investments and that Beta changes were unthinkable.

There is a large interest in how this strategic language was affected by the new actors (i.e. the new owner and board) and, consequently, the implications on the strategic change process. Even though this has been extensively illustrated in the empirical chapter, this section will elaborate upon some threads concerning the subject.

Another inherent and also intriguing problem is that this language simultaneously transforms complex information environments into tractable ones as they might blind decision and strategy makers. Hence, they create the boundaries as well as affect the navigation within them. This blinding characteristic might include the concealment of important changes in the (or their) environment, thus, compromising their capability of making sound strategic decisions or they might reveal new vast business opportunities that turn out to be premised on false information.

Moreover, I have illustrated that strategic change involves the constituting of a new reality in the minds of organizational members. Language (through conversations) is heavily implicated in this process. That language not only describes the social world; it also categorizes it and brings phenomena into sight. Hence, it has an active rather than passive relationship to reality. Furthermore, it affects what is considered to be objects of concern (paralleling the Investment Memorandum for the board) and the implicated actions; it also frames how people come to understand and act with respect to an issue.

Interestingly, Arrow's initial CEO expressed the problem on one occasion by stating that he as well as rest of the management team were products of what was seen as important by the former owner (i.e. production and technology-oriented capabilities) and that this impeded his and his colleagues' possibilities to succeed in this new climate. He argued that the new owner supported the team in widening its outlook and, subsequently, its options by extending the boundaries.

## Making a New Sense of Self

The board propagated on numerous occasions that the key to Arrow's success and, hence, Bay Lake lay within its strategic turn-around: that is, transcending the perception of oneself and ones stakeholders. Arrow had to transcend from being a production-oriented cost-center intertwined with an inertial industry giant, to become an autonomous customer and results-oriented firm. This meant moving from being a small fraction of a giant to an apparent leader in a distinct niche through the focus upon sales, sales organization, customer interaction, and product development. Hence, both tangible and intangible aspects were in the limelight. The board had emphasized the importance of implementing this throughout the organization and stressed the fundamental importance of a cultural change within Arrow. In other words, it stressed the need to first change Arrow's self-image, thus, how the organization in general and the management team in particular made sense of itself.

This change in self-image was to be done during a period of severe crises in the Widget industry. In fact, as aforementioned, only a year after Arrow was acquired, one of its primary competitors went into default (the same actor that simultaneously presented the same bid as Bay Lake). The management team and the CEO explained the default as a consequence of omitted volume investments during the last decade. While the two Widget firms were more or less identical a decade ago, Arrow had increased its production capacity by 60 %, which was thought to ensure its survival strength; this was an idea that most certainly manifested the management team's view, ceteris paribus:

> "Widget firms that don't invest usually die!"

An assumption that probably also strengthened the management team's belief that investments, in volume in particular, were one of the most important drivers for success in the Widget industry. There was never a discussion about whether factors other than the lack of volume investments could have caused the default.

## The Concept of Performance Seems to Have Different Meanings

Investments as well as other preconceptions were continuously (intentionally and unintentionally) addressed in board discussions. The change in preconceptions and taken-for-grantedness was also addressed more covertly through the Sales Consultant and his position as a central part of the management team. Hence, the influence emerged from the inside as well. However, this was a reciprocal process since the Sales Consultant's change in mind concerning some assumptions from the Investment Memorandum influenced the board's view through his interaction with the Chair (e.g. the issue of the products' niche position and ability to attain a price premium).

One of the most apparent discrepancies in views was the one between means and goals. While the board believed that profitability was Arrow's paramount goal that could be fulfilled by volume increases, quality changes, cost reductions, and other means, the management team and the CEO held the notion that Arrow's overriding goal and overall vision was to produce 300,000 tons of Widgets. Hence, while one actor propagated for autonomy, profits and cash flow, the other part propagated for volume and production efficiency. Whether this was a relic of the former owner or an integral part of the volume investment assumption is undisclosed here; however, as in the case of customer bonuses, it was as it had always been. Hence, the management team did not question it. The fact that the board started to question an increasing number of assumptions held by the management team stressed the CEO; he admitted that there must be a decoupling between the actors' perceptions and language arsenal since he neither understood what they meant nor what they wanted. In fact, the CEO believed some of their ideas to be absurd and totally diametric to conventional wisdom – hence both undesirable and undoable. He expressed his sincere anxiety over the questions from the board and the Chair. He felt that the questions revolved around different things all the time; thus, he was unable to understand what the board members perceived as important. Furthermore, they constantly requested a business plan, but "I admittedly explained that I did not understand what a business plan was".

The focus of the management team during their management meetings was largely focused on internal issues and production. Investments, variable and fixed costs, quality, and customer complaints were discussed and always on top of the agenda rather than sales, contribution, EBITDA, and cash flow. However, a few months into the process (i.e. just before the Sales Director and CEO were dismissed), the interest of the management team members transcended toward more sales and market related questions. This also paralleled the timing when the Sales Director's colleagues increasingly questioned him. The view and language changed incrementally to include and center more upon revenues and profits. The CFO stated on one management meeting that Arrow's strength is the cost side, but the key to its success was more on the revenue side.

## Did the Breaking Point Correlate With Weakening the Old Paradigm?

The discrepancy in language and outlook on the management team became increasingly evident during the team's first strategy session. The HR Director initiated the meeting by presenting the agenda and the underlying purpose of the meeting, hence, the need to define the long-term strategic goals to ensure Arrow's profitability. Even though this was a well-attended meeting comprised of the full management team and all of Arrow's key employees, the CEO abruptly interrupted him within seconds and made it clear that they could not afford to waste time on the long term when the current is trembling (even if this was the negotiated agenda for the day). He continued to stress that the long-term (i.e. three years from now) was irrelevant. Instead, they had to focus on the upcoming days, weeks, and months if they wanted to survive. Hence, the long-term strategic outlook was substituted for the day-to-day activities with a bias toward produced tons and costs. The vast stress on the CEO concerning Arrow's performance as well as the pressure from the board had probably narrowed his perception span toward the direct and tangible short-term activities.

## Bridging the Outlook and Language Repertoires

In terms of language, focus and outlook, the discrepancy between the CFO and the HR Director on the one hand and the CEO on other became increasingly prevalent. The CFO's financial language repertoire started to permeate the language of the management team (remember: she was not a part of the management team prior to Bay Lake's acquisition) and this paralleled the concepts and models that the board utilized. From a language point of view, her repertoire and understanding served as a bridge between the board and the production oriented-management team jointly with the Sales Consultant's sales and marketing terminology.

The financial discussions that were absent at start began to permeate the management meetings and climbed up each meeting's agenda. It was as though the CFO unintentionally tried to marry the earlier decoupling between input and outcome (cf. input and output) or operations and finance (cf. operations and tons). Hence, the CFO and the Sales Consultant seemed to affect to a larger extent the language on the management team and the others in support of the board and the Investment Memorandum. The HR Director had a similar role. His opinions seemed to parallel those of the CFO and Sales Consultant. He was also relatively new to Arrow and adapted quickly rather to Bay Lake's modus operandi of using management models and explicitly connect actions to margin an EBITDA impact. His structured, unambiguous, and measurable way of presenting findings strengthened his position with the board to such an extent that he was appointed Acting CEO directly after the CEO was dismissed and, subsequently, Deputy CEO after the new CEO had been employed.

An interesting reflection is the strong influence (i.e. dominance) the first CEO had on the management team's interpretations and actions. Was his leaving the firm the actual breaking point, thus, catapulting the board and management team to approach each other? In fact, during the first management meeting following the CEO's dismissal and under the leadership of the HR Director (now Deputy CEO), the management's objective was turned completely on its head. The agenda actually transcended from decreasing the variable and fixed costs and producing as much as possible to the following:

> "…The management team should operatively plan and coordinate Arrow and its departments given the strategic decisions we and the board mutually take."

He continued to argue that the focus should be upon performance enhancements through sales development, as well as maintaining and developing the production. He presented an idea on the kinds of activities that they should be focusing upon in the short and long term: ideas that were diametrically opposed to the earlier focus (i.e. a business as well as a market plan and external communication).

The role of the Sales Consultant (now the new Sales Director) paralleled that of the CFO and Deputy CEO in the sense that he continuously challenged the management team's preconceptions and taken-for-granted assumptions: one of the more prevalent ones being Arrow's dependency upon a certain Beta supplied by former owner Goliath.

## Question Management Team's Taken-For-Granted Assumptions

A few months after the Sales Consultant entered Arrow, he presented his view to the management team quite early on in the process. He argued that, in order to become profitable, management should explore other Beta variants in order to increase flexibility and decrease costs. Hence, the goal was to transcend from a pure exploitation modus operandi to an explorational ditto. This proposal was met with ridicule. In fact, according to the management team, Arrow was built to fit one type of Beta, which was the one supplied by its former owner and employer Goliath. Thus, his statement was not met with skepticism or rational counter arguments; it was with blatant mockery.

I have already presented and illustrated how the management team was bound by the industry logic. However, the fact that the board and Sales Consultant wanted the management team to try a new, more accessible, and cheaper Beta was perceived as both shocking and absurd to the team at that specific point in time.

The board increasingly discussed and propagated this notion with the Sales Consultant, as Arrow's profits continued to shine with its absence. The management team entered a period of exploration and Arrow's going concern trembled; that is to say, the team started to explore during a six-month period any new variants and suppliers rather than exploit the current Beta situation. The team ended up in a much more flexible and cost-efficient production capability that vastly strengthened Arrow's profitability.

## Making Something Increasingly Controllable Through Language

A similar example of breaking with earlier beliefs concerns the discrimination between what was and was not deemed controllable. Arrow's price setting power was discussed throughout Arrow's ownership and most probably afterwards as well. The board admitted approximately a year after the acquisition that they had overestimated Arrow's niche position, its market share and, consequently, its power to affect the product's market price. The management team, on the other perceived the price as completely uncontrollable to increasingly controllable. Right from the start, the Beta and energy prices as well as the price of its product were seen as the largest risk due to their uncontrollability. As aforementioned, management's transformation in Beta perception and, subsequently, Beta usage resulted in this large uncontrollable factor becoming increasingly controllable.

The crises at Arrow grew. Meanwhile, the CFO and her finance team started to discuss how the price of Widgets could be made more tangible, accessible and, subsequently, affectable. This process lead to the CFO presenting at a management meeting a decomposition of the Widget price into its four intrinsic components:

Table 7.1: Components of the Widget Price

| *Components of the Widget Price:* |
|---|
| Market mix (controllable) |
| Share of Cubicle (controllable) |
| Currency effect (quasi-controllable) |
| Market price (uncontrollable) |

With this model, the CFO was, for the first time, presenting a Widget price analysis model that dissected the components of the Widget price in order to see the cause of price increases or decreases. This transcended the Widget price from being perceived as a completely uncontrollable factor to a semi-controllable ditto. In fact, Arrow's average Widget price was compounded of the four factors of which three were reasonably controllable or at least affectable, as seen in the upcoming table.

This table and the CFO's presentation of it essentially transformed the management team's view on the price components and made it semi-controllable and, hence, not an untouchable risk.

I have illustrated the two short illustrations on the processes surrounding the Widget price component and the Beta flexibility in extensio in the empirical chapter. This illustrates that the management team's interpretations of different factors can dramatically change with the right influence, the right contextual preconditions, how they are labeled and packaged.

The new CEO expressed it this way:

> "(We really need) to think outside the box. There are so many truths at Arrow and in the industry (…) and we really have to question the legitimacy of these truths."

He continued to emphasize that the management team was on its way of developing a mutual and new language that would transcend it from a production heritage to an EBITDA perspective in all that it did.

# The P200 Program: Imposing a New (Fabricated) View on the Strategic Challenges and its Remedy

## Introducing and Redefining Concepts

Using an existing language as a means for categorizing a new situation will, almost by definition, fail to completely describe a new reality. Therefore, how has Bay Lake affected this language and, more importantly, how did it affect the strategic change?

An interesting reflection concerns the relationship between the "reality" and its impact upon the language and labeling. With the support of a vast body of literature, I have argued that managers identify strategic issues to impose order. However, this could assume that the meaning of strategic issues is inherent in external events, while it is the internal organizational characteristics that determine what and how meaning evolves for a specific issue. The process of attaching meaning, classifying the (strategic) issues, and deciding upon how the organization should (re)act is governed by the use of linguistic labels. The board developed an extensive use of labels to instigate the desirable actions and attitudes, rather than to try and correctly describe the reality: he most evident during this change process was the P200 program. Hence, labeling could be seen as a central way to influence the (idiosyncratic) language and, consequently, the sensemaking.

Bay Lake introduced numerous concepts that were new to Arrow (e.g. contribution per customer) and redefined some concepts that were already in at Arrow (e.g. the view on performance). Thus, the way in which different organizations respond to similar environmental events or how Arrow responds over time to similar environmental events (as language changes) might vary extensively since its actions regarding these strategic issues follow from the meaning attached to them. This meaning is governed by the values, assumptions, beliefs, and ideas of the ones imposing the interpretations (i.e. managers).

I have earlier used the label *sensegiving* to encompass the processes of imposing interpretations and the process where managers attempt to influence the sensemaking and meaning construction of others toward a preferred redefinition of organizational reality.

The board posed numerous rhetorically loaded expressions to make sense of the current situation and instigate the correct actions (on behalf of the board). These included:

> "A firm's long-term goal is survival."
>
> "The one who's in debt isn't free."
>
> "It's do or die for Arrow!"

"The occupation at Arrow is over!"

This section will delve into the P200 program that the board launched as a means of ensuring a sense of urgency and to center all the management team's attention around the issue that the board found most imperative for Arrow's survival and prosperity and, thus, for Bay Lake's success.

## Gathering Focus and Energy Around New Central Concept

I have discussed in the value generation chapter how a portfolio firm's profitability will be more likely strengthened by cost reductions than by revenue boosts. Bay Lake's objective was to generate substantial value. This could have been accomplished by numerous means, including an increased control of corporate spending, reduction of overhead costs through the reduction of management team, and the reduction of other staff functions such as finance, administration, marketing, and HR. Increased control of production costs and a heightened focus on production efficiency were also means to strengthen the performance of the portfolio firm and, hence, its value. Bay Lake launched all of this at Arrow under the headings *Cost Leadership* and *The Firm's Overriding Goal is Survival.*

I have shown that Bay Lake a few months after their acquisition launching an initiative called the P200 program (that is, Profit 200 million or increasing the EBITDA with SEK 200 million), which to a large extent emphasized cost cutting, margin improvements, and a heightened capital efficiency. The board and Bay Lake argued that, by performing a back-casting exercise, they arrived at an EBITDA goal of SEK 280 million, which they felt to be reasonable.

The board subsequently fabricated a common and mutual goal with a strong and unambiguous label that everyone on the board and management team was to adopt. The board explained that this was due to the fact that the situation looked so unfavorable and that it had to be mitigated if they wanted to survive. The board explicitly explained that the necessity for this program was due to the fact that the forecast supplied by the management team during the acquisition had failed on each and every point. The board further explained that the management team's failure to perform was the key motivating factor for the program.

One Bay Lake partner explained how the firm had arrived at the EBITDA target of 280 million SEK and asserted that Arrow was missing approximately 200 million SEK, given the current performance reduced for the two dopes (the badwill and the Beta subsidy). The DuPont model it had supplied earlier was going to be the conceptual and financial backbone of the program. This was, in fact, a model that had been positively accepted by the management team in a rather pedagogical way since it interconnected production and sales, as well as the profit and loss statement and the balance sheet. Hence, it coupled parts that were earlier given to the management team. The Chair added that, since the spread between the Widget prices and the Beta costs continuously decreased, the P200 program was the only means for survival (i.e. a firm's most important long-term goal, according to the board).

## The P200 Program Became Instigator, Motivator, and Rationale for Strategic Change

The P200 program was increasingly discussed and received a rather dominant role in all board and management meetings after it had been presented. Thus, while the management team had adopted it relatively quickly, an increasing amount of other processes started to merge with, or be consumed by, the program. The management team and the CFO started to describe it as a continuous process rather than a program; important concepts and processes, such as the budget and forecasts, were absorbed by it. The board repeatedly emphasized how the program's biggest advantage was its effect upon the thinking processes and how they made sense. Through the P200 program the board via the management team could inform Arrow employees that there was no room for investments in the current crises and why this was good for Arrow; this was in contrast to the wide-spread belief and trust in volume investments. Hence, the P200 program became a tool to legitimize what was and was not ok for Arrow. The program also transformed by the management team from a largely cost-focused program into a result-enhancement program; this was achieved by the inclusion of an increasing amount of revenue and gross margin improving activities.

The new CEO explained in one specific hall meeting that the P200 had become the mutual foundation of the firm, in terms of views on the current and future, as well as the raison d'être, hence, the mutual strategic outlook. The program's rationale was to fulfill the owner's yield requirements: honoring the interest payments, handling depreciations, and keeping the firm intact – thus, attaining a performance improvement. He continued to say that it defined the groundwork for them and transcended from a cost to a profitability-focused firm.

As time elapsed, the management team assumed more control and ownership of the program. On one occasion, a management team member advocated that the team needed to strengthen the P200 program and define a complementing set of activities. She argued that they were overstaffed; this was an opinion that was shared with another member who argued that management needed to scrutinize the organization again to find additional savings and efficiency increases. This opinion would have been unimaginable before the birth and center around the P200 program and its fulfillment. It was as though Arrow's vision had become the fulfillment of the P200 program. Put differently, it was as though the board's control and intentions had been embodied in the P200 program, which subsequently had been embraced and adopted by the management team; hence, the proactivity, autonomy, and ownership of the future was once again in the hands of the management team.

# The Correlation Between Weak Performance and Board Executivness

## Become Autonomous or Lose Your Discretion to Make Decisions

The idea that the relationship between the management team and the board becomes vastly strengthened after an acquisition has been elaborated within the theoretical chapter as well as seen in the empirical ditto. While the reasons for this might be numerous, including board control and transparency requests from, as well as the continuous evaluation of the management team, the board's very active role became noticeable right from the start (even though the members call themselves non-executive board members).

In contrast to many other forms of ownership, it was also explained that private equity firms are very active in their governance and their advising role toward the portfolio firms' management team. Bay Lake's continuous and informal communication with the CEO and CFO proved from the start to be non-executive and consultative in nature, which was also evident in the board's outlook:

> "It can really go to hell if we have a weak management team and the board will start to govern the firm!"

The board argued that the management team had to quickly accept that its old supervisors at Goliath were gone and that it had to assume the role of both formulator and implementer. In other words, the board had to mentally leave Goliath and leverage on its new freedom and autonomy in order to advance Arrow's performance.

The first CEO declared that, in contrast to the other potential acquirers (both financial and industrial), Bay Lake had a profound long-term approach and seemed very enthusiastic and dedicated to Arrow and its future development. Moreover, it possessed a turn-around experience that seemed to be absent with the other actors. Last but not least, the board emphasized the autonomy of the management team and the idea of leveraging on the management team's visions and capabilities. The fact that one of Bay Lake's advisors (i.e. the Sales Consultant) would assume an operational role within Arrow was seen as being exceptionally good.

However, this intended autonomy and discretion deteriorated quickly as Arrow's performance shined with its absence.

## The Rise and Fall of Executiveness

As seen relatively early, the board's involvement in Arrow's operational tasks grew rapidly as the performance deteriorated; it did, in fact, meddle into numerous areas including sales and sales channel focus, geographic reallocations, customer interaction, logistic setup and costs, gross margin development, etc. The board's intervention expressed itself by giving the CEO and CFO and, later the management team, increasingly detailed instructions on what to do and how to do it. This intervention took place with both the board and management. More interestingly, the board covertly instructed and controlled the management team and individual management team members through the Sales Consultant, who had became an integral part the management team.

The Sales Consultant frequently mentioned that logistics was more of a problem; this was actually the Chair's words being transmitted through him. The same goes for the fact that he tried to persuade the CEO that the Sales Director has played out his role at Arrow; this was an idea that was first posed by the Chair. Lastly, when the board tried to convince the CEO that a business plan was urgent and the CEO expressed his lack of experience with business plans, the Sales Consultant suggested that he could be responsible for the work. He actually showed the CEO a business plan template, which he had covertly received from the Chair.

The CEO increasingly complained about the interference and discussed the matter with the rest of the management team. All were very concerned with Bay Lake's increasing focus upon operational rather than strategic issues. This operational focus of the board was founded on Arrow's weak performance and distrust in the management team's ability to quickly solve the situation. This subsequently led to the CEO's and Sales Director's respective dismissals. The CEO explained just a few days later that, when he met Bay Lake for the first time, it emphasized that the firm never meddles in operational issues since its role was to monitor through the board function. He argued that, right from the get go, he realized that one of the board members had opinions about all or nothing. More explicitly, he argued that one of the board members quickly transcended from being a support and follow-up mechanism to becoming a "demand-machine".

## When the Performance and Trust Pendulum Returns

As seen in the empirical chapter, the proactivity and autonomy of the management team leaped after the two dismissals. We do not know whether this was because Arrow's performance started to improve or because the board demanded more participation from all management team members - or a combination of both. However, the board did ask the management team to assume a wider scope of responsibility so that momentum would not be lost and to give the Acting CEO (i.e. the HR Director and subsequent Deputy CEO) all the support it could.

## What Did Arrow Become?

No less than 1,064 days later, that is, less than three years after Goliath and Bay Lake had signed the SPA, and Bay Lake had become Arrow's new owner, they once again initiated a process of negotiation. In contrast to the first time (in the Goliath-Bay Lake negotiation) when Arrow was positioned as a old and tired cost-oriented production center in a large industry group (although with a lot of potential), Arrow was now positioned as a highly successful, commercial, cost-efficient, and well-positioned autonomous Widget firm. This was due to the well-synchronized board and management team. More importantly, Bay Lake was now on the other side of the negotiation table - as a seller - negotiating with a large North European Widget group about acquiring Arrow. Moreover, a few months into the negotiations, Arrow achieved the best EBITDA result ever attained in its lifetime. And Arrow is not a young firm; it neither originated in this century nor in the last. The EBITDA had grown with 440 % in the first quarter of 2009 compared to the first quarter of 2006, and with 825 % compared to the second quarter of 2006 (adjusted for seasonal variations). This was the first full quarter in which Bay Lake owned Arrow, and could be perceived as an achievement since the first quarter of 2009 is characterized by a severe economic recession and, as shown, Arrow was and still is very sensitive to the business cycle.

## A Concluding Interpretation of the Change Process and its Theoretical Underpinnings

By studying the two actors' (inter) actions and interpretations – thus, sensemaking - in a strategic change process, I have been able to observe the board and management team's theory-in-use rather than their espoused theory (Argyris & Schön, 1974, 1978) during the strategic change. These actions, interpretations, and strategic change have taken place in a (organizational) reality that was socially constructed, in the sense that individuals with dissimilar mindsets and worldviews interacted. The focus has included the interplay of both managerial interpretations and actions since "these chains of thinking and acting shape strategic processes" (Lindell et al., 1998, p. 77).

The shaping of the strategic processes and, subsequently, the (tangible and intangible) strategic change of Arrow has occurred due to numerous sensemaking and sensegiving processes fighting for interpretive dominance, thus, shaping and reshaping the accepted view of Arrow, its primary assumptions, its environment, and its strategic initiatives. These shifts in interpretive power between the two actors has been illustrated in the two last chapters and have assumed the shape of what has been termed *temporal dynamics* by Corner et al. and Fiol (1994; 1994). Hence, how the strength of specific beliefs developed over time was enacted as a belief system that changed over time as different actors competed for interpretive dominance and, hence, the discretion to control Arrow's sensemaking or perception of itself, its environment, and subsequently of its intended development. The inclusion of the concept of temporal dynamics is motivating since it introduced human agency into the nature of belief systems, as it acknowledges that beliefs are actively developed, manipulated, and diffused by people. Thus, it brings human actors and their actions and interactions to the center stage of this study.

This interpretive dominance that was dominated by an artifact (i.e. the Investment Memorandum) right from the inception was continuously and iteratively challenged by the CEO and the management team and, subsequently, by the board as well. Hence, the power to control the interpretation (i.e. the prevailing belief system) and impose beliefs of the firm and its environment onto others (i.e. sensegiving) has been the guiding process throughout this study. I have illustrated how the strategic beliefs and assumptions were compared, challenged, and negotiated within and between the board and management team through conversational processes. The language used in these conversational processes, earlier referred to as an idiosyncratic (strategic) language, was based upon the actors' historical experiences; in Arrow's case (probably also in that of Bay Lake), they were filled with taken-for granted assumptions (e.g. volume investments). Thus, the aforementioned artifact and the board heavily influenced Arrow's jargon, labels, and concepts.

Since the environment and challenges had changed, Arrow's language was neither able to explain nor respond to this "new reality".

Therefore, how did Arrow change and how could Arrow's seemingly successful strategic change or turn-around become realized?

## Owning the Interpretive Dominance Through Impudence, Executiveness, and Change in Power Balance

Right from the start, the new owner's intention was to extensively change Arrow - impudently and profitably – hence, to instigate a revolutionary strategic change based upon a projected success story. Numerous tangible changes depicted in the Investment Memorandum were implemented in the first months with the liberation of Goliath and the intended autonomy as the central ones. While this autonomy materialized from an operational perspective, the governance dependency was substituted from the Goliath group to a new Goliath (i.e. the private equity firm and Arrow's new board).

Different perceptions were compared, challenged, and negotiated in the context of these two actors. It has been shown that the interpretive power and supremacy to not only describe the social world, but to also categorize it and bring (chosen) phenomena into sight, has iterated between the two groups (i.e. actors) as well as between individuals (e.g. the CEO and Chair). This active relationship between the language and interpretive power – thus, the perceived reality - extensively affected Arrow's development. The language and possession of the interpretive power or ability to impose its order onto others affected what was considered to be objects of concern such as Beta, logistics, or the P200. This was in contrast to volume investments, production efficiency, and merchandiser relationships. Hence, the board increased its power by defining what was to be considered as important and the implicated actions thereof, as well as how people came to understand and act with respect to the objects. I have shown how disagreements and agreements (i.e. the belief system as an active arena) concerning numerous issues evolved over time in and between the two decision-making groups, as well as their affects upon Arrow.

When interpretive dominance or control over the belief system was hard to attain, numerous actions were deployed to undermine the prevailing view. These include removing individuals with large interpretive power (i.e. the CEO and Sales Director), launching initiatives that center attention around what the board acknowledged to be important (i.e. the P200 program), and to strengthen the position of people with views aligned with those of the board (i.e. moving the HR Director to Acting CEO and, subsequently, Deputy CEO, making the CFO part of the management team and the board, and promoting the Sales Consultant the firm's new Sales Director). Other means to increase the interpretive power include describing a reality as alarming and deteriorating, as well as explicating that the management team's recipes, logics, and presumptions were inadequate to solve the situation. Hence, numerous forces intentionally and unintentionally undermined the interpretive dominance of and on the management team.

The fear of failing to generate value through dramatically changing and swiftly deploying all activities defined in the Investment Memorandum within a context that internal decay and environmental turmoil had characterized, drove the board to do what it hardly ever had to: go executive. Hence, they operationally intervened in the battle to acquire the right to define the situation and the initiatives to rectify it. In other words, the board interfered more profoundly in Arrow's operations, hence, increasingly affecting the reciprocity between the old and new language in order to shift the evolutionary change into a revolutionary ditto.

## Attaching and Reattaching Meaning to Strategic Issues

Sensemaking concerns the involved actors' construction and reconstruction of meaning as they attempt to develop a meaningful framework for understanding the nature of the intended strategic change. The existence and intentional and unintentional exploitation of linguistic labels was highly interesting in this context. The board tried to actively impose its order on the environment and the path that Arrow was taking through labels. The board affected what the management team determined as being important and its classification thereof. Hence, linguistic labels such as the P200 program extensively affected Arrow's development trajectory through affecting the management team's sensemaking of the environment and of itself. Thus, the way in which different organizations respond to similar environmental events might vary extensively since their actions regarding these strategic issues follow from the meaning they have attached to them (through their own sensemaking or sensegiving from others and being more in control of the interpretive power). This is governed by the values, assumptions, beliefs, and ideas of the ones imposing the interpretations. This iterative process of making sense of and giving sense to the organizational reality that has been shown neatly fits into to the issue of stability and change in managerial cognition.

## Sensemaking's Tight Intertwining With Other Organizational Variables Makes it Difficult to Disentangle Their (Causal) Impact on Behavior and Outcome

This research took its point of the departure in Bay Lake and the company's intended value generation journey. We have observed throughout this story many of the means that the board generally deployed and the particular sensemaking processes that were to facilitate this value generation journey.

When Bay Lake divested Arrow to a new large group approximately three years after its entry, the value increase expectation did not just materialize; it had actually become its best investment yet. We can only speculate whether this value was primarily generated due to winning the interpretive battle over the management team or for other reasons since cognitive constructs prove unfortunately difficult to measure in the field (Meindl et al., 1994). The reason for this is their tight intertwining with other organizational variables that make it difficult to disentangle their (causal) impact on behavior and outcome. There are numerous other factors such as uncontrollable and unforeseeable environmental jolts, inertial forces of organizational structures, and a myriad of other non-cognitive factors that are all plausible alternative explanations for any supposed influence of cognition on organizational outcomes.

However, nothing can change the fact the Arrow was a very lucrative investment for Bay Lake.

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# Appendix A – Buyout Definitions

## On the Different Types of Buyout Investments

The general buyout term is comprised of leveraged buyout (LBO), management buyouts (MBO), management buyins (MBI), and institutional buyouts (IBO); thus, a brief account for their differences will be given in the following:

*Leveraged Buyout* (LBO): Leveraged buyouts do not explain who acquires the firm, division, or business unit (in contrast to MBO and MBI); rather, they tell how the acquisition is financed. Consequently, the acquisition is financed through the use of a very high debt ratio in the capital structure of the new firm, usually secured against the resource base of the same (EVCA, 2005). However, it is important to acknowledge that MOST MBOs and MBIs are LBOs, thus, financed through a high debt ratio.

*Management Buyout* (MBO): In this approach, the management team of the target firm acquires the whole firm, division, or business unit from the current shareholders with support of a buyout firm (EVCA, 2005).

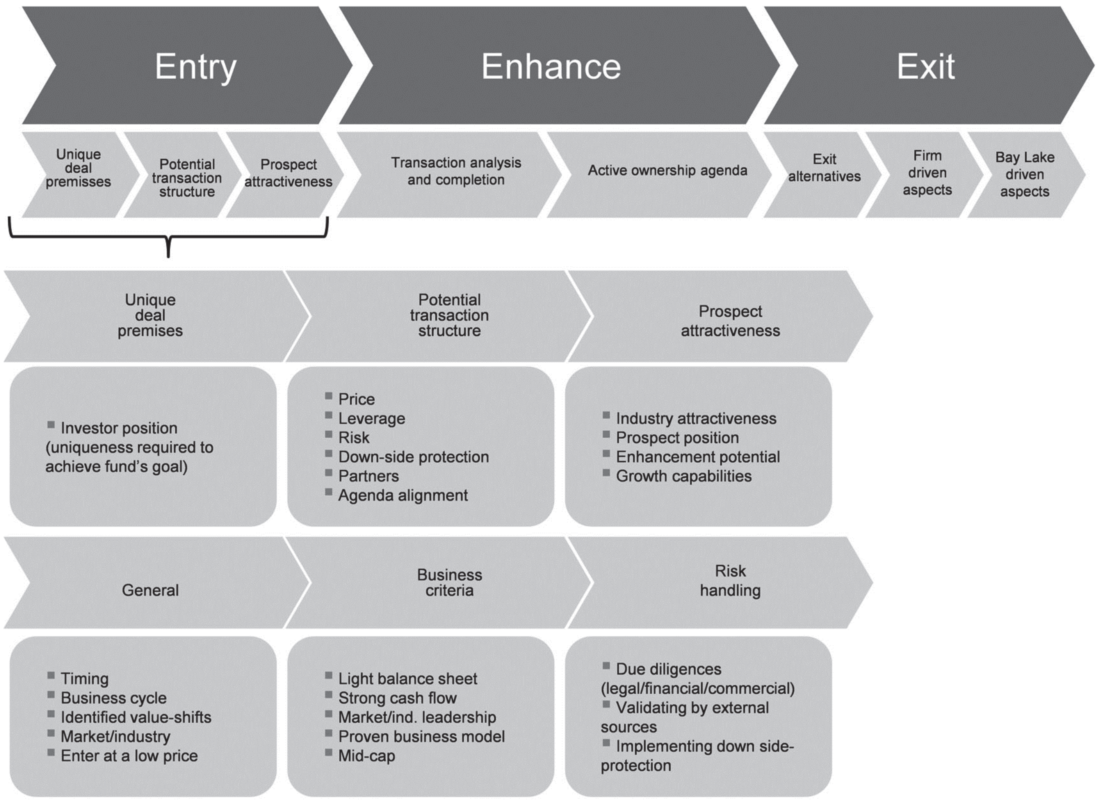
*Management buyin* (MBI): Management buyins are less common than MBOs although they are very similar. The only difference is that in MBIs a group of external managers take over the firm, division, or business unit (with the support of a buyout firm) (EVCA, 2005).

*Institutional Buyout* (IBO): This less commonly used term resembles the former approaches in that the old management could be replaced with outsiders (MBI) or the old management team remains within the new firm (MBO) (EVCA, 2005). The difference lies instead in that the investors are institutional investors such as investment firms, pension funds, mutual funds, insurance firms, or endowment funds.

# Appendix B – Bay Lake's Business Model

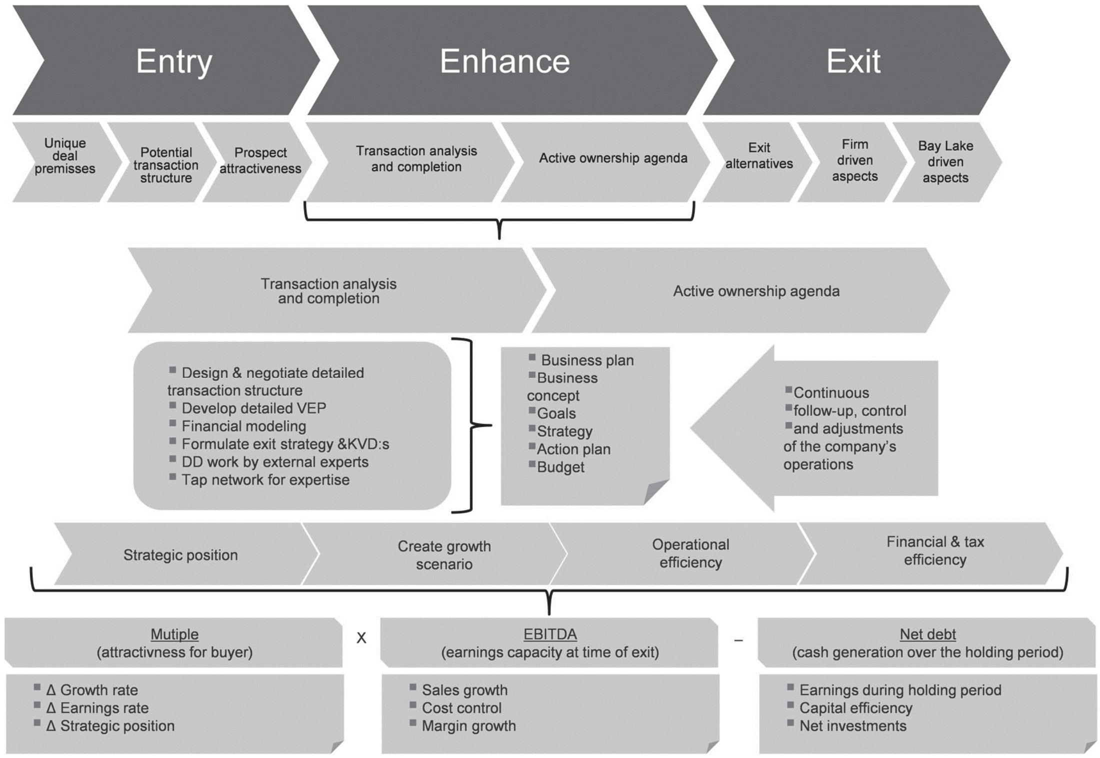
## First Investment Phase of Bay Lake's Business Model

Figure B.1: Bay Lake's Business Model With an Emphasis on the First (i.e. Entry) Phase



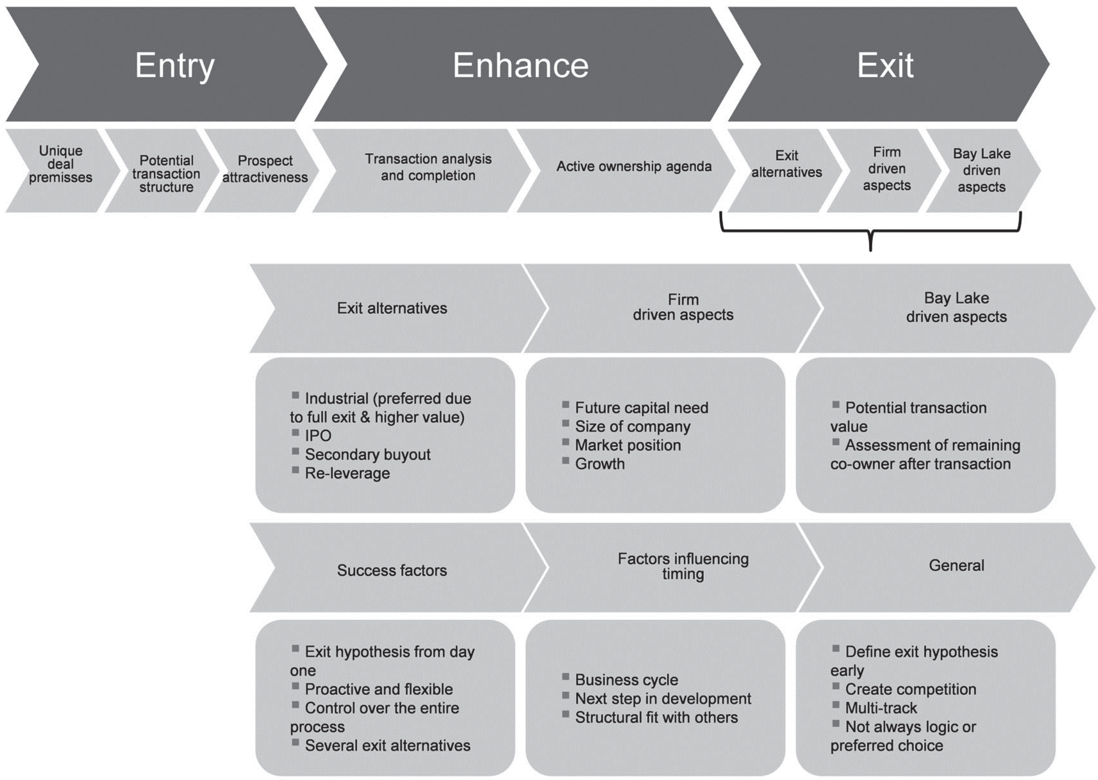
# Second Investment Phase of Bay Lake's Business Model

Figure B.2: Bay Lake's Business Model With an Emphasis on the Second (i.e. Enhancement) Phase



# Third Investment Phase of Bay Lake's Business Model

Figure B.3: Bay Lake's Business Model With an Emphasis on the Third (i.e. Exit) Phase.



# Appendix C - Interview Guide

Background Questions

1.) What is your role and what is its purpose?
2.) What are your primary goals (both professional and private)?
3.) Could you describe you professional background and education

Questions Pertaining Exclusively to Arrow

1.) What are Arrow's primary strengths and weaknesses (and have they changed since the acquisition)?
2.) What are Arrow's primary opportunities and threats (and have they changed since the acquisition)?
3.) How would you describe Arrow's current market and strategic position?
    (i) How does Arrow differentiate within its segment?
    (ii) Is Arrow's position an active choice?
    (iii) Will the actors within this segment look the same within five years?
    (iv) Is this a good market position? (what is good or what needs to be changed)?
4.) Why did Goliath want to sell Arrow?

Questions Regarding Bay Lake's Ownership of Arrow

1.) Why did you want to buy Arrow or why did Arrow want to buy you?
2.) What do you think Arrow is expecting from you and the rest of the board or what do you expect from them?
3.) With what do you think you/they can contribute?
    (i) What did you expect to change after the acquisition (strategically, operationally, and/or financially?)
    (ii) Has that view changed during the initial period after the acquisition?

   (iii) Is the management team or board focusing on those areas that you expected?

4.) How do you think the management team or board perceives the firm's market position?
   (i) How and why do you want to change that market position?
   (ii) What tools and/or models will you/they deploy to change that position?

5.) What will be the primary change?
   (i) What will the largest impediments to this change be?

6.) What will be the largest challenge in the process of building an in-house sales and marketing organization as well as implementing a customer-oriented approach?

Questions Regarding Specifics

1.) Strategy and Governance
   (i) What is Arrow's vision and what should it be?
   (ii) What is Arrow's business idea and what should it be?
   (iii) What are Arrow's primary markets from a non-geographical perspective and what should they be?
   (iv) What does Arrow sell?
   (v) What are Arrow's overriding goals?
   (vi) What is the board and owner's role?
   (vii) What is the management team's role in this specific case?

2.) Distorted Perceptions and Interpretation Barriers
   (i) Who are Arrow's customers?
   (ii) What are the sales and distribution channels?
   (iii) What external communication and information channels are used?
   (iv) What is Arrow's market?
   (v) What is Arrow's pricing strategy?
   (vi) Does Arrow have many substitutes?

- (vii) What are Arrow's primary unique selling points?
- (viii) Is there any important information in Arrow's environment that they/you do not want or can perceive?
- (ix) Are there any fundamental premises in Arrow's organization or environment that they/you want or can perceive?

3.) Motivation
- (i) What are the direct costs and/or cannibalization costs of the strategic change you are about to conduct?
- (ii) Is there alignment between the interests of the board, management team, and the rest of the organization?
- (iii) Has Arrow completed or failed any larger strategic changes the last decade of which you are aware?
- (iv) How do you perceive the change proneness of Arrow?

4.) Creative Acts
- (i) Do you believe that the surroundings and Arrow's prerequisites are changing at such a pace that they neglect or miss to do the necessary analyses?
- (ii) Do you believe that the strategic vision is strong enough, and what is it?

5.) Political and Cultural Deadlocks
- (i) How "change-prone" do you think Arrow is and do you think the change-climate is good?
- (ii) Are there a lot of departmental politics and what is their effect?
- (iii) Are there groups within the organization that have incommensurable beliefs and, if so, why and what can be their effects?
- (iv) Are there any deep cultural traits within Arrow that might affect the strategic change?

# Appendix D – Attended Meetings

The following table provides an account of the attended meetings in this study as well as some important traits (AR = Arrow and BL = Bay Lake). Please note: when it says the "CEO and I", it means that I was a part of the discussion:

| Topic of Meeting | Location | Attendants | Meeting Duration | Arena | Date |
|---|---|---|---|---|---|
| 1st night at a hostel next to Arrow | n/a | n/a | | TBD | 2006-03-15 |
| 1st day at Arrow HQ | AR HQ | AR CEO & co-workers | 30 min | CEO | 2006-03-16 |
| Discussing headhunting & CEO friends | AR HQ | AR CEO & I | 10 min | CEO | 2006-03-16 |
| Meeting with Arrow's new bank | AR HQ | AR CEO, CFO & Bank | 35 min | (CEO) | 2006-03-16 |
| Recruiting a new sales force | AR HQ | AR CEO, Sales Dir. & a external headhunter | 120 min | CEO | 2006-03-16 |
| Lunch meeting to discuss problems | AR HQ | AR CEO + 6 from finance & production mgmt | 30 min | CEO/mgmt | 2006-03-16 |
| Advisory meeting with a consultant/CEO friend | AR HQ | AR CEO + consultant/friend | 180 min | CEO | 2006-03-16 |
| The Goliath separation To-Do team | AR HQ | AR CEO + 5 from mgmt | 145 min | CEO/mgmt | 2006-03-17 |
| Monthly mgmt meeting (finance team) | AR HQ | AR full mgmt team | 90 min | Mgmt | 2006-03-17 |
| Monthly mgmt meeting (prod. team) | AR HQ | AR full (prod.) mgmt team | 210 min | Mgmt | 2006-03-17 |
| Recruiting a new sales force | AR HQ | AR CEO, Sales Dir., & consultant (ind. expert) | 150 min | CEO | 2006-03-22 |
| In-depth presentation about me | AR HQ | AR CEO, Sales Dir., & consultant (ind. expert) | 30 min | TBD | 2006-03-22 |
| CEO debriefing | AR HQ | AR CEO & I | 10 min | CEO | 2006-03-22 |
| Ad-hoc discussion of legal agreements concerning using Goliath as a sale channel | AR HQ | AR CEO, Sales Dir., & consultant (ind. expert) | 60 min | CEO | 2006-03-22 |
| Meeting an important current supplier | AR HQ | AR CEO, purchasing Dir. & two supplier reps. | 135 min | CEO | 2006-03-22 |
| BL comes to AR for a full presentation before closing | AR HQ | Full AR mgmt (prod. & finance) + all from BL | 420 min | Mgmt | 2006-03-23 |
| Meeting concerning insurances and shifting costs between different points in time (i.e. before or after the actual acquisition) | AR HQ | AR CEO & CFO & BL CEO | 45 min | CEO | 2006-03-23 |
| CEO debriefing | AR HQ | AR CEO & I | 30 min | CEO | 2006-03-23 |
| The Goliath separation To-Do team | AR HQ | AR partial mgmt team | 35 min | Mgmt | 2006-03-24 |
| In-depth presentation about me | AR HQ | AR CFO & HR/Admin Dir. | 80 min | | 2006-03-24 |

| | | | | | |
|---|---|---|---|---|---|
| Meeting with a industry peer for advice on setting up an European sales org. | At industry peer's site | AR Sales Dir., AR Sales consultant & CEO and Sales Dir. of the industry peer | 180 min | CEO | 2006-04-02 |
| CEO debriefing | Telephone | AR CEO & I | 15 min | CEO | 2006-04-03 |
| CEO debriefing | AR HQ | AR CEO & I | 15 min | CEO | 2006-04-05 |
| Mgmt meeting (new composition) | AR HQ | AR full mgmt team | 340 min | Mgmt | 2006-04-10 |
| CEO debriefing | AR HQ | AR CEO & I | 10 min | CEO | 2006-04-10 |
| Short ad-hoc meeting with AR CEO | AR HQ | AR CEO & I | 30 min | CEO | 2006-04-11 |
| Product/production development meeting | AR HQ | All production managers | 120 min | (Mgmt) | 2006-04-11 |
| Short ad-hoc meeting with AR CEO | AR HQ | AR CEO & I | 10 min | CEO | 2006-04-12 |
| Monthly union meeting | AR HQ | AR CEO, CFO, HR/Admin Dir. + the union reps. | 150 min | TBD | 2006-04-12 |
| Meeting to define the forecast for 2006 | AR HQ | AR CEO, CFO & controller | 70 min | CEO | 2006-04-12 |
| Compound the forecast for 2006 (to be presented at the first board meeting) | AR HQ | AR CEO, CFO, HR/Admin Dir. & two controllers | 30 min | CEO | 2006-04-12 |
| Discussion with AR CEO just before the board meeting | AR HQ | AR CEO & I | 60 min | CEO | 2006-04-18 |
| 1st Board Meeting | AR HQ | AR CEO, CFO, own & board | 330 min | Board/own. | 2006-04-18 |
| Discussion with the board and AR CEO after the board meeting | AR HQ | AR CEO & board | 20 min | Board/own. /CEO | 2006-04-18 |
| Discussion with one of the owner representatives after the board meeting | In a car | Bay Lake rep. & I | 150 min | Owner | 2006-04-18 |
| Owner discussions | Stockholm | BL Chair and a partner | 30 min | Owner | 2006-04-19 |
| CEO debriefing | Telephone | AR CEO & I | 30 min | CEO | 2006-04-21 |
| Meeting with an executive search firm to find a Production Dir. | Stockholm | AR CEO and headhunter | 75 min | CEO | 2006-04-28 |
| Meeting with the new house bank | Stockholm | AR CEO, CFO, purchasing Dir. & three bank reps. | 120 min | CEO | 2006-04-28 |
| Owner briefing | BL HQ | Owner reps. & I | 30 min | Owner | 2006-05-06 |
| Mgmt meeting | AR HQ | Cancelled | n/a | Mgmt | 2006-05-08 |
| CEO debriefing | AR HQ | AR CEO & I | 30 min | CEO | 2006-05-09 |
| Discussing Sales responsibility before the new Sales Dir. arrives | AR HQ | AR CEO & consultant (ind. expert) | 60 min | CEO | 2006-05-09 |
| CEO debriefing with consultant (ind. expert) | AR HQ | AR consultant (ind. expert) & I | 40 min | CEO | 2006-05-09 |
| 2nd Board Meeting | AR HQ | AR CEO, CFO, own & board | 270 min | Board/own. | 2006-05-10 |
| Discussion with the board and AR CEO after the board meeting | AR HQ | AR CEO, consultant (ind. expert), & owner reps. | 90 min | Own./CEO | 2006-05-10 |
| Presentation of sales plan | AR HQ | AR CEO, Sales Dir., & consultant (ind. expert) | 60 min | CEO | 2006-05-11 |
| Brand consultant workshop | AR HQ | AR CEO, Sales Dir., consultant (ind. expert) & two brand consultants | 120 min | CEO | 2006-05-11 |
| Discussion with a sales administrator | On site | AR sales adm.& I | 10 min | TBD | 2006-05-17 |
| CEO debriefing | AR HQ | AR CEO & I | 20 min | CEO | 2006-05-17 |
| Meeting with students for an internship | AR HQ | AR CEO & a student | 30 min | CEO | 2006-05-17 |
| Mgmt meeting | AR HQ | AR full mgmt team | 240 min | Mgmt | 2006-05-17 |

| | | | | | |
|---|---|---|---|---|---|
| Responding to an upset merchant | AR HQ | AR CEO & Sales Dir. | 45 min | CEO | 2006-05-18 |
| On the ethics of recruiting from Goliath | AR HQ | AR CEO | 10 min | CEO | 2006-05-18 |
| Activity plan discussion concerning production | AR HQ | AR CEO, Sales Dir., and production mgmt | 80 min | CEO/mgmt | 2006-05-18 |
| Evaluating individuals for Production Dir. & Nordic Sales Mgr. position | AR HQ | AR CEO & headhunter | 190 min | CEO | 2006-05-18 |
| CEO debriefing | AR HQ | AR CEO & I | 10 min | CEO | 2006-05-22 |
| The long-term planning day | Off-site | Full mgmt incl. production mgmt | 570 min | Mgmt | 2006-05-23 |
| Ad-hoc sales meeting | AR HQ | AR CEO, Sales Dir. & consultant (ind. expert) | 120 min | CEO | 2006-05-24 |
| CEO debriefing | Telephone | AR CEO, Sales Dir. & I | 15 min | CEO | 2006-06-01 |
| CEO debriefing | Telephone | AR CEO & I | 10 min | CEO | 2006-06-01 |
| CEO debriefing | Telephone | AR CEO, Sales Dir. & I | 10 min | CEO | 2006-06-02 |
| Presenting buyout/mgmt tools | AR HQ | AR mgmt& owner | 150 min | Own./mgmt | 2006-06-02 |
| Presenting how a mgmt/financial report should look | AR HQ | AR CFO, controller & owner | 70 min | Owner | 2006-06-02 |
| CEO debriefing | Telephone | AR CEO & I | 10 min | CEO | 2006-06-20 |
| Discussion with AR CEO just before the board meeting | AR HQ | AR CEO & I | 60 min | CEO | 2006-06-29 |
| Preparing the decisions before the board meeting | AR HQ | AR CEO & owner | 90 min | Own./CEO | 2006-06-29 |
| 3rd Board Meeting | AR HQ | AR CEO, CFO, own. &board | 330 min | Board/own. | 2006-06-29 |
| Leadership/governance discussion | BL HQ | Owner reps. & I | 45 min | Owner | 2006-06-30 |
| Discussion with AR CEO a week before the board meeting | Telephone | AR CEO & I | 75 min | CEO | 2006-08-09 |
| 4th Board Meeting | AR HQ | AR CEO, CFO, own. &board | 270 min | Board/own. | 2006-08-15 |
| Discussions with the bank | AR HQ | AR CEO, CFO & owner | 60 min | Own./CEO | 2006-08-15 |
| The consultant (ind. expert) prepares the internal sales team for the big bang | AR HQ | AR consultant (ind. expert) & 5 market assistants | 45 min | TBD | 2006-08-16 |
| The chair/owner informs the mgmt team that the CEO is fired | AR HQ | AR mgmt& chair/owner | 20 min | Own./mgmt | 2006-08-16 |
| The chair/owner informs the union that the CEO is fired | AR HQ | AR union & chair/owner | 30 min | TBD | 2006-08-16 |
| CEO handover under chair supervision | AR HQ | AR old CEO, temp. CEO (i.e. the HR/Admin Dir. & chair/owner | 45 min | CEO/own. | 2006-08-16 |
| Debriefing on the former CEO's first reflections | AR HQ | AR CEO & I | 10 min | CEO | 2006-08-16 |
| Debriefing of the consultant's (ind. expert) reflections on the CEO termination | AR HQ | AR consultant (ind. expert) & I | 10 min | TBD | 2006-08-16 |
| 1st mgmt meeting post the CEO termination | AR HQ | AR full mgmt team | 180 min | Mgmt | 2006-08-21 |
| 1st production mgmt meeting post the CEO termination | AR HQ | AR partial production team | 20 min | Mgmt | 2006-08-21 |
| Debriefing on the former CEO's reflections | AR HQ | AR CEO & I | 20 min | CEO | 2006-08-23 |
| The long-term planning-day | Off-site | AR full mgmt team & owner | 570 min | Mgmt/own. | 2006-08-24 |

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| Mgmt meeting (finance & production) | Off-site | AR finance & production mgmt + other key employees | 570 min | Mgmt | 2006-08-29 |
| Mgmt meeting | AR HQ | AR full mgmt team | 245 min | Mgmt | 2006-09-18 |
| Meeting on the CEO's reflections on being fired | CEO home | AR CEO & I | 180 min | CEO | 2006-09-19 |
| Budget meeting (finance, production & mid mgmt) | AR HQ | AR finance & production mgmt + mid-mgmt employees | 180 min | Mgmt | 2006-09-25 |
| Information about the new CEO to the union | AR HQ | Owner, temp CEO (i.e. the HR/Admin Dir. & union | 30 min | Owner | 2006-09-25 |
| Information about the new CEO to the mgmt | AR HQ | AR finance & production mgmt + owner | 30 min | Mgmt/own. | 2006-09-25 |
| Information about the new CEO to all employees | AR HQ | All employees in Arrow | 60 min | | 2006-09-25 |
| Mgmt meeting | AR HQ | AR full mgmt team | 210 min | Mgmt | 2006-10-02 |
| Post mgmt meeting | AR HQ | New AR CEO, HR/Admin Dir. & consultant (ind. expert) | 60 min | CEO | 2006-10-02 |
| Business idea, vision, and value workshop | Off-site | AR full mgmt team | 225 min | Mgmt | 2006-10-12 |
| Post business idea, vision, and value workshop | Off-site | HR/Admin Dir., Development Dir. & Production Dir. | 45 min | n/a | 2006-10-12 |
| Mgmt meeting | AR HQ | AR full mgmt team | 195 min | Mgmt | 2006-10-16 |
| Sales meeting | AR HQ | Consultant (ind. expert) & 10 market coordinators | 45 min | n/a | 2006-10-24 |
| Mgmt meeting | AR HQ | AR full mgmt team | 210 min | Mgmt | 2006-10-24 |
| Mgmt meeting | AR HQ | AR full mgmt team | 60 min | Mgmt | 2006-10-31 |
| Sales meeting | AR HQ | AR CEO, consultant (ind. expert) & the sales dept. | 540 min | n/a | 2006-10-31 |
| Mgmt meeting (budget process, brand consultants, business plan discussion) | AR HQ | AR full mgmt team | 330 min | Mgmt | 2006-11-06 |
| 5th Board Meeting | AR HQ | AR CEO, CFO, own. &board | 360 min | Board/own. | 2006-11-08 |
| Meeting to present the sweet equity | AR HQ | AR mgmt and owner | 60 min | Mgmt/own. | 2006-11-08 |
| Mgmt meeting (workshop) | Off-site | AR full mgmt team | 180 min | Mgmt | 2006-11-13 |
| Mgmt meeting | AR HQ | AR full mgmt team | 120 min | Mgmt | 2006-11-27 |
| Business idea, vision, and value workshop | AR HQ | AR full mgmt team & brand consultants | 210 min | Mgmt | 2006-12-05 |
| 6th Board Meeting | BL HQ | AR CEO, CFO, own. &board | 180 min | Board/own. | 2006-12-18 |
| 7thBoard Meeting | BL HQ | AR CEO, CFO, own. &board | 300 min | Board/own. | 2007-02-07 |
| Mgmt meeting | AR HQ | AR full mgmt team | 240 min | Mgmt | 2007-02-15 |
| 8th Board Meeting | AR HQ | AR CEO, CFO, own., board & accounting firm | 300 min | Board/own. | 2007-03-26 |
| Mgmt meeting | AR HQ | AR full mgmt team | 240 min | Mgmt | 2007-04-17 |
| 9th Board Meeting | BL HQ | AR CEO, CFO, own. &board | 300 min | Board/own. | 2007-07-19 |
| 10th Board Meeting | BL HQ | AR CEO, CFO, own. &board | 300 min | Board/own. | 2007-10-18 |
| 11th Board Meeting | BL HQ | AR CEO, CFO, own. &board | 240 min | Board/own. | 2007-12-17 |
| 12th Board Meeting | BL HQ | AR CEO, CFO, own. &board | 240 min | Board/own. | 2008-03-10 |

Phone contact with owner and AR CEO on a bi-weekly basis until 2009-06-01