Corporate Strategy & Capital Structure
-An analysis of their relationship within SMEs in the Swedish manufacturing industry

JACOB BJÖRKLUND

Master of Science Thesis
Stockholm, Sweden 2016
Företagsstrategi & kapitalstruktur
- En analys av deras relation inom SMEs i den svenska tillverkningsindustrin

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Examensarbete
Stockholm, Sverige 2016
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Examensarbete INDEK 2016:62
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Abstract
A company's need for an effective and suitable corporate strategy is higher than ever due to fierce and increasing competition in the current business landscape. In order for companies to finance their chosen corporate strategy, as for instance conduct investments for growth, they need proper funding. Moreover, the capital structure defines and outlines a company’s available mix of debt and equity. Financial theories and studies further conclude that it is paramount for companies to understand the relationship between the corporate strategy and the capital structure in order to remain competitive. However, the current amount of empirical studies that have been conducted in this area is very limited. Therefore, this study has analysed and examined the relationship between the corporate strategy and the capital structure for small and medium-sized enterprises (SMEs) in the Swedish manufacturing industry. Indeed, the purpose of the study is to examine this relationship.

The study has been executed by conducting five case studies where five different SMEs in the Swedish manufacturing industry have been analysed. The companies represent both family ownership as well as ownerships via external investors. The five case studies consisted of semi-structured interviews with the CEO of each firm. A questionnaire was also provided to the five respondents, which enhanced the possibility to benchmark the results from the companies.

The results of the study indicate that the relationship between the corporate strategy and the capital structure differs depending on a company’s type of ownership. In conclusion, for externally owned companies (e.g. owned by private equity companies), the corporate strategy tends to drive the choice of capital structure. On the other hand, for companies owned by the founding families, the relationship seems to be inverted where the capital structure rather drives the choice of corporate strategy.

Key-words: Corporate strategy, capital structure, company ownership, pecking order theory, trade-off theory, SME
Sammanfattning

Ett företags behov av en effektiv och passande företagsstrategi är högre än någonsin på grund av hård och ökande konkurrens på den nuvarande marknaden. För att ett företag skall kunna finansiera sin valda företagsstrategi, som exempelvis att genomföra investeringar för tillväxt, krävs det en väl avvägd finansiering. Vidare definierar och beskriver kapitalstrukturen ett företags tillgänglighet gällande dess mix av skulder och eget kapital. Samtidigt visar finansiell teori och studier på området att det är av största vikt för företag att de förstår sambandet mellan dess företagsstrategi och kapitalstruktur för att de skall kunna förbliv konkurrenskraftiga. Dock är antalet studier som är gjorda på området mycket begränsade. Således har denna studie analyserat och undersökt sambandet mellan företagsstrategin och kapitalstrukturen för små och medelstora företag (SMEs) inom den svenska tillverkningsindustrin.


Resultaten av studien indikerar att sambandet mellan företagsstrategin och kapitalstrukturen varierar beroende på typ av ägarskap av ett bolag. Sammanfattningsvis så tenderar valet av företagsstrategi att driva valet av kapitalstruktur för bolag ägda av externa investerare (exempelvis bolag ägda av private equity-företag). Å andra sidan tenderar förhållandet snarare vara inverterat för företag ägda av sina grundarfamiljer, där kapitalstrukturen snarare driver valet av företagsstrategi.

Nyckelord: Företagsstrategi, kapitalstruktur, företags ägandeskap, pecking order teorin, trade-off teorin, SME
Foreword
This master thesis report was written by Jacob Björklund at the Royal Institute of Technology, Stockholm, Sweden, at the department of Industrial Engineering and Management. The master thesis project was conducted during the period of January 2016 and June 2016, although, a brief pre-study was conducted during the autumn of 2015 in the course Research Methods in Industrial Engineering and Management.

Acknowledgements
First and foremost, I would like to express my gratitude to my supervisor at KTH, Tomas Sörensson, Associate Professor in Industrial Economics and Management, with specialization in Corporate Finance. During the master thesis project, Sörensson has been able to supervise and coach me with excellent advices during the entire project. His guidance has always aided me in improving my thesis project, and I can undoubtedley say that my thesis project benefitted from his assistance. Moreover, with Sörensson’s many years of experience within the business world, he was also able to give me valuable insight tips that were utilized during the entire project.

Thank you, Tomas!

I would also like to express my gratitude to the five respondents in the case companies of this study who agree to be interviewed, despite the fact that they were all very busy within their respective company. Without them, this thesis would not have been able to be written.

Thank you everyone for all your valuable inputs and knowledge!

- Jacob Björklund, Stockholm, Sweden, 2016-06-01

List of Abbreviations
BoD – Board of Directors
EBITDA – Earnings Before Interest Taxes Depreciation and Amortization
M&A – Mergers and Acquisitions
NPV – Net Present Value
PE – Private Equity [Company]
ROIC – Return On Invested Capital
SME – Small Medium Enterprises
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1 Introduction

This chapter intends to provide the reader a background of the subject which this thesis intends to investigate and why it may be of interest, as well as the purpose of the study. The introduction will also define the research question the thesis intends to answer. The chapter also discusses potential contributions of the findings of the thesis, as well as necessary thesis limitations that have been set.

1.1 Background

The business world is becoming more and more competitive and companies are forced to align their strategies to attain more focused approaches, in order to increase their concentration of core businesses and cut off unprofitable operations and/or divisions (Kent, et al., 2014). An increasing number of companies are selling off so-called non-core business operations while also launching cost-cutting programs in order to maintain long-term competitiveness and survival in their specific industry (Kent, et al., 2014). Yet, in order to remain long-term profitable, a company needs to focus on growth since the growth of market shares/sales etc. are means to achieve long-term profitability (Varaiya, et al., 1987). The small medium enterprises (SME) segment, defined by the European Commission (2016) as companies ranging between a turnover of €2 million and €50 million, is further a highly competitive segment with increasing internationalisation (Rubio & Aragón, 2009). This puts pressure on the actors to grow and have suitable strategies for increased profitability and growth (Rubio & Aragón, 2009).

These types of strategic decisions to become more profitable and grow are parts of a company’s corporate strategy; defined as the scope and direction a specific firm is aligned towards in order to achieve its long-term goals (Johnson, et al., 2007). Conclusively, the chosen strategy sets the core means that the company uses in order to achieve its set of long-term objectives (Dransfield, 2001). Thus, it could be said that an effective and well-planned corporate strategy has never been more important and more challenging than in today’s tough global competition (Stanleigh, 2015). However, the chosen strategy cannot be executed without the necessary amount of funding: A firm that for instance has chosen to focus on market growth will always require a certain amount of financing in order for the firm to achieve this objective (Forrester, 1986).

Therefore, another vital part of a firm’s strategy is its capital structure, defined as the mix of a company’s assets, specifically its mix of financial liabilities (i.e. debt) and equity (Berk & DeMarzo, 2014; Koller, et al., 2010). In other words, the capital structure determines the type of securities the firm needs to issue, in order to assess its chosen strategy, such as funding commenced investments with either debt and/or equity in order to enable market growth for instance (Lang, et al., 1996). Consequently, the debt-holders and equity holders are generally the main types of investors in a company. However, there will always be asymmetrical information costs within a company (Koller, et al., 2010). Therefore, the pecking order theory can to some extent explain the way a company aligns their strategy in terms of funding operations and investments in order to minimize asymmetric information (Berk & DeMarzo, 2014; Koller, et al., 2010). According to this theory, a company should firstly prioritize internal financing, followed by external debt and lastly raise capital with external equity (Myers & Majluf, 1984). However, another important theory in relation to a company’s capital structure is the trade-off theory, which addresses that a company has to find the right balance between debt and equity in order to balance benefits (e.g. interest tax shield) and costs (e.g. bankruptcy costs) with leverage (Frank & Goyal, 2005).

Thus, a dilemma for every company is to find a strategy with a suitable balance between debt and equity in order to increase and maximize the company’s value in a sustainable way (Berk & DeMarzo, 2014; Koller, et al., 2010; Singh, et al., 2002). Consequently, the capital structure partly regulates a company’s
flexibility in terms of strategies, and which corporate strategy can be utilized in order to be resistant to internal and external pressures and enable firm-growth (Koller, et al., 2010). Rocca, et al., (2008) further state that “a good integration between strategy and finance dimensions can be tantamount to a competitive weapon”. Yet, Ward and Grundy (1996) argue that the corporate strategy and financing are, with very few exceptions, in “schizophrenic tension”, meaning that they are often directly opposing each other. Furthermore, as researchers have concluded that the capital structure and the strategic management tend to depend on very different parameters and paradigms, it can be argued that the relationship between them is highly complex (Barton & Gordo, 1983; Bettis, 1983). In particular, the corporate strategy tends to be affected by current market conditions, the different company stakeholders, the amount of assets or funds which are available, and competitors’ decisions/investments etc. (Johnson, et al., 2007; Ward & Grundy, 1996). On the other hand, the capital structure is often influenced by more specific parameters, such as liquidity constraints, institutional structures, tax regimes and banking relationships (Titman & Wessels, 1988).

Moreover, there is also a general ambiguity among researchers on whether the corporate strategy drives the choice of capital structure or the opposite (Attar, 2014; Rocca, et al., 2008). On the one hand, given the currently low interest-rate environment, it might be possible to argue that a company firstly prioritises the choice of funding, and thereafter takes decisions regarding the alignment of their core strategy (Baker, et al., 2011). On the other hand, the ultimate goal of a company is in general always to create long-term shareholder value (Koller, et al., 2010). This is represented by the level of the company’s actual rate of return, which is compared with the company’s required rate of return (Bender & Ward, 2013). According to Bender and Ward (2013), this can only be achieved with the right amount of investments that are generating positive net present values for the company. Therefore, Bender’s and Ward’s (2013) findings could be said to support a conclusion for that a firm’s corporate strategy drives its capital structure. Goedhart, et al (2006) further conclude in their findings that it is of high importance to make “the capital structure supports the company’s chosen strategy”. The authors also conclude that a firm is unable to improve and change its capital structure without fully interpreting and understanding its future investments requirements (Goedhart, et al., 2006).

In essence, by combining the theories by Berk and DeMarzo (2014), Koller, et al. (2010), Rocca, et al. (2008), Ward and Grundy (1996), Titman and Wessels (1988), Barton and Gordon (1983) and Bettis (1983) stated above, with the fact that there is an increasingly global competition in the business world, it can be argued that this topic is indeed complex but yet very contemporary with the current business environment. Moreover, it is crucial to understand it from a managerial point of view. Indeed, understanding this complex relationship from a managerial perspective may enrich and aid a company’s competitive advantage and ability to compete in a tough market environment (Rocca, et al., 2008).

1.2 Problem Formulation
The business world’s increasing global competition has led to growing awareness of the importance of having an effective corporate strategy focusing on core activities, which enhances a competitive advantage. Companies’ capital structure determines the way they can finance their chosen strategy, such as investments in growth opportunities. Therefore, it can be concluded that the corporate strategy and the capital structure are intertwined and influenced by each other to a high degree. Researchers also argue that a good integration between a company’s corporate strategy and capital structure is paramount in order to create a competitive advantage today. Thus, it is arguable to say that it is crucial for senior management within companies to understand this important relationship. Yet, the firm’s choices of corporate strategy and capital structure tend to depend on very different parameters and paradigms, something which makes their relationship highly complex and challenging to fully understand. Therefore, it is problematic for managers to incorporate this relationship completely, and decisions
regarding strategy and its funding tend to sometimes occur on ad hoc basis. Thus, the main problem of not understanding this relationship is that it may lead to suboptimal governance, resulting in many ad hoc decisions that could be regarded as inefficient. Therefore, a better understanding of this relationship could enhance the decision-making progress regarding strategy and financing within companies and ultimately enrich possibilities of competitive advantage.

There is further a general ambiguity among researchers whether the choice of corporate strategy drives the choice of capital structure or the opposite within mature companies. This ultimately increases the complexity of the relationship. Yet, in order to remain competitive with respect to a mature industry, companies should understand and incorporate the knowledge of this relationship in their decision-making process. Therefore, it can be argued that it is of high importance to understand and interpret which one is the driving force in order to better incorporate this knowledge in the decision-making process.

In regard to the theories briefly described in the background above, the initial proposition of this thesis is that “a company’s choice of corporate strategy is driving their choice of capital structure”. This proposition is the initial starting-point of the problem formulation and is what this thesis intends to investigate more thoroughly in order to establish clarity of this relationship within Swedish manufacturing companies in the SME segment.

1.3 Purpose
The purpose of this thesis is to investigate the relationship between a company’s corporate strategy and capital structure as well as determine how the choice of strategy is affecting the capital structure decision within a company. This analysis aims to be evidenced by empirical data from Swedish small-medium enterprises (SME) in the manufacturing industry. To be more specific, the research will have an initial proposition that the chosen alignment of the corporate strategy is driving a secondary choice of capital structure within a firm. Therefore, the aim of the thesis is to examine whether this is the case in the Swedish manufacturing industry for SMEs. By examining this proposition, the general and high-level purpose is also to gain more knowledge of the overall relationship between the corporate strategy and the capital structure and also analyse factors that may affect the relationship, e.g. different types of corporate ownership. In addition, the findings of this study can also be used for extrapolation to a general perspective in the Swedish industry landscape. This knowledge can then be used by senior managers within different mature firms in several industries.

Lastly, as the capital structure and the corporate strategy also have traditionally been investigated separately, the purpose of this study is also to diminish the gap of empirical evidence regarding their relationship. The entire Swedish SME manufacturing industry currently lacks participation, thus is what this thesis intends to address.

1.4 Research Questions
Concerning the fulfilment of the purpose and objective of this study, the thesis intends to investigate and answer one specific main research question:

“How is a firm’s corporate strategy affecting its choice of capital structure for SMEs in the Swedish manufacturing industry?”
1.5 Thesis Limitations

Due to time limitations, the focus of this thesis regarding the term capital structure will be on the general perspective of it: Companies nowadays have a large variety of instruments which can be used in order to finance their operations; ranging from the traditional “common equity” and “normal debt”, to very exotic instruments as for instance “convertible preferred equity” or “commodity-linked debt” (Koller, et al., 2010). In the light of this, this thesis will focus on the aggregate level of companies’ financing, i.e. equity and debt. Conclusively, the thesis will not focus on specific financing methods, e.g. exotic financing, and how they may affect the relationship between corporate strategy and capital structure.

1.6 Expected Contribution

There is currently a knowledge gap regarding the relationship between the corporate strategy and the capital structure for SMEs, and in particular Swedish companies within the manufacturing industry. Therefore, this thesis will contribute to this rather unexplored area by subsidizing it with empirical data. Consequently, the thesis will complement to the few studies that have already been conducted in the area, which currently mainly consists of Attar (2014) and Rocca, et al. (2008).

The overall findings of this study can further be used as a first tool for future studies with objective of fully clarify the relationship between the corporate strategy and the capital structure for all types of companies, regardless of size, industry, ownership and country etc.

1.7 Outline of the Thesis

This master thesis consists of eight chapters:

The first chapter, the Introduction, contains the background of the problem, why it is of importance as well as the purpose of the study. The chapter also contains the main research question that will be answered in this research, as well as expected contributions and necessary limitations.

The second chapter, Methodology, presents the overall methodological approach as well as the research design that will be used in this thesis in order to gather information and answer the research question.

Chapter three, the Literature Review, comprises all relevant and existing knowledge in regard to the thesis subject. This chapter will focus on theories about corporate strategy and capital structure and will present information and knowledge that will be useful in order to analyse the relationship between these two.

Chapter four, Interview and Questionnaire Questions, will entail a presentation of the interview questions for this study. The questions will be derived from the literature and theoretical review found in chapter three. It is intentionally chosen to place this chapter after chapter three instead of within the methodology in chapter two. In order to formulate suitable interview questions, it is essential that the literature and theoretical review are conducted before. Conclusively, the natural order for this chapter is to be placed after the literature review.

Chapter five, The Interviewed Companies, will present the case companies that will be investigated in the thesis. Their presentation will include brief information about their key financials (revenues and EBITDA-margin), their ownership, the interviewee that represents the company and their capital structure in a historical perspective. General information about their businesses will also be presented.

Chapter six, Result and Analysis, will contain the empiric results from the interviews and questionnaire, along with an analysis regarding every specific key question. Thus, an intertwined presentation method will be used, where the results are analysed directly instead of analysed in a separate chapter.
Chapter seven, *Discussion*, will present an argumentation of chosen methods for the thesis. The chapter will also present a discussion and examination of the generalizability of the research. Lastly, the chapter will contain a discussion about the reliability and the validity of the research.

In chapter eight, *Conclusions, Implications and Future Studies*, the research question is answered while key findings are also brought up which evidences the answer to the research question. The chapter will also contain a discussion about implications and proposals for future studies in relation to the thesis subject.
2 Methodology

This section presents the proposed course of action and research design of the thesis. In other words, the methodical approach that is intended to give access to the empirical data that is required in order to answer the research question and fulfil the overall purpose of the research.

2.1 Methodological Approach

The purpose of this research is to enrich the rather unexplored area regarding the relationship between a company’s corporate strategy and capital structure and subsidize it with empirical data. Therefore, this study incorporates an abductive research approach, which combines and alters between theoretical and empirical observations (Blomkvist & Hallin, 2015; Goddard & Melville, 2004). This is a highly suitable approach when answering the proposed research question of the thesis: An answer should be forged with both empirical evidence from observations, as well as theoretical knowledge applied in case studies with target companies.

As stated in chapter 1, the thesis intends to enrich this subject with evidence from the SME segment in the Swedish manufacturing industry. Therefore, this study will be based on data from five different SMEs in the Swedish manufacturing industry. Representatives from these companies will be interviewed in order to gain a deep but yet granular knowledge of the topic. Conclusively, this study will be based on five case studies, where each targeted company will represent one case. Therefore, the relationship will be investigated with data from prime sources in relation to the thesis topic. Both Yin (2013) and Baxter and Jack (2008) point out the relevance of case studies in studies that aim to facilitate knowledge of a complex phenomenon. In Baxter’s and Jack’s (2008) findings, the authors are in particular endorsing case studies where more than one company is chosen. The authors argue for that it will “ensure that the issue is not explored through one lens, but rather a variety of lenses which allows for multiple facets of the phenomenon to be revealed and understood” (Baxter & Jack, 2008). Yin (2013) further promotes the use of case studies when the research area is of exploratory type since the case study then will be a tool in order to define the phenomenon in real-life context. Moreover, after the data have been collected, it will be benchmarked in order to find patterns, similarities and differences among the five case companies.

The reason for selecting five companies from the manufacturing industry is two-folded: Primarily, because the capital structure and corporate strategy are often highly industry- and/or company-specific (Berk & DeMarzo, 2014). As a result, an investigation of only one company could potentially result in that incorrect and misleading patterns will be found, which would be highly company-specific, leading to a company-specific conclusion. Secondly, by benchmarking data from various SMEs in the manufacturing industry, the study will also gain more holistic and general data since more information will be gathered and processed. Consequently, by choosing five different companies, the outcome of the research will be in terms of more general conclusions that other companies may be able to use as well. However, if there had been more time, more companies would have been selected in order to increase the generalizability even further as well as increase the depth of the research.

2.2 Research Design

This study intends to investigate the subject by incorporating a mainly qualitative method: The methodology will be conducted principally by semi-structured interviews with company representatives within SMEs in the Swedish manufacturing industry. Yet, in order to ensure that a benchmarking of the companies can be conducted, some questions will also be specifically formulated so they only can be answered on a fixed scale (thoroughly described in subchapter 2.4.1 below). Therefore, it is also arguable to say that the interviews will also be partly of “semi-quantitative” nature. Furthermore, a pre-
study will also be conducted with the principal aim of investigating the companies’ capital structure and overall business alignment. Thus, the pre-study will have a particular focus on analysing financial data from the companies’ financial statements with emphasis on their capital structure. Thus, it could be further argued that the thesis is of partly “semi-quantitative” nature.

Moreover, a so-called iterative methodology will be used during the entire thesis. An iterative methodology implies that key parts of the thesis, e.g. problem formulation, purpose, research questions and overall literature review, will be continuously developed and updated during the work process (Blomkvist & Hallin, 2015). An iterative process is highly suitable together with an abductive approach: The iterative process will enable the theoretical framework to be updated and developed, which will shape and align the research towards the most suitable end-goal. Moreover, after the empirical data is collected and the data is considered reliable, the stages of data analysis and further conclusions are initiated. The overall research design is objectified in Figure 1 below.

![Figure 1. The research design of this research.](image)

Figure 1 illustrates how the initial problem was set, upon which a literature review is conducted in order to gather necessary information about the problem. When relevant literature and theories are gathered, a pre-study will be initiated where five companies will be chosen and more thoroughly investigated. These companies are thereafter targeted for qualitative semi-structured interviews. The double-headed arrows in Figure 1 represent the iterative process where the report will be constantly updated after relevant findings. The analysis phase will be initiated after the interviews have been conducted and the data is reliable. The large arrow in the bottom of the figure symbolizes that the thesis is continuously written during all phases.

### 2.3 Literature review

The literature review will mainly be a source of information and foundation for the empirical studies and the interviews that will be held. The purpose of the literature review is to facilitate themes that will be analysed to a great detail in the interviews. Therefore, the literature review is continuously updated and reviewed during the research. Conclusively, the literature is an important tool, both in terms of facilitating knowledge in order to conduct accurate interviews, but also in order to understand and analyse the results from the interviews. The literature review also incorporates relevant information from earlier studies in regards of the thesis topic. In essence, the literature review is seen as the secondary sources of this study that will be triangulated with the findings from the interviews.

The section with the literature and theoretical knowledge is divided with a thematic approach; an approach that is “identifying, analysing and reporting patterns within data” (Braun & Clarke, 2006). The main benefit with adapting to a thematic approach is that it aids the alignment of the literature review, ultimately helping the reader understand the common thread throughout the chapters (Braun & Clarke, 2006). Lastly, the thematic approach also enriches the readability of the literature and theoretical review (Braun & Clarke, 2006).
Relevant literature and theory are gathered from multiple sources, including sources from SSRN, KTHB Primo and Google Scholar. Due to the limited number of earlier studies in the area, the literature review for this research is focusing on gathering as much theoretical information as possible regarding the chosen research area. Searchable key-words that are frequently used, and combined, in order to find relevant literature and theories are: “Capital structure”, “corporate strategy”, “investing strategy”, “debt-equity ratio”, “leverage”, “growth”, “growth opportunities”, “organic growth”, “inorganic growth”, “pecking order theory”, “trade off theory”, “leveraged firm”, “financing operations”, “strategy and shareholders”, “financial stakeholders”, “non-financial stakeholders”, “firm ownership”, “family-owned companies”, “externally owned companies”, “investor-owned”, “ownership”, “equity holders”, “debt holders”, “capital structure and stakeholders”, “optimal capital structure” and “efficient capital structure”.

2.4 Qualitative Research Approach

The research will entail a combination of structured and semi-structured interviews for a qualitative sample where five SMEs will be targeted and interviewed within the Swedish manufacturing segment. These interviews will be crucial for this study in order to fill the gap of empirical data in the Swedish SME segment and establish an answer to the research question. Therefore, the interviews will be the primary sources for the gathering of data and are seen as the principal method of this study in order to gather crucial industry expertise. Hence, the interviews will also serve for establishing a deeper understanding and knowledge of the formulated problem. In essence, the purpose of the interviews is to investigate the companies’ corporate strategies and capital structures, in order to be able to connect them to literature and theory with the aim of facilitating and exploring the actual relationship between the corporate strategy and the capital structure. Therefore, the interviews will consist of various questions based on the literature and theoretical review regarding this subject. The questions will be thoroughly described in chapter 4. The reason for why the presentation of interview questions are placed in chapter 4, and not within the methodology, is because the literature and theoretical review have to be conducted before the questions can be formulated.

In terms of the semi-structured questions, the questions will be prepared in advance and be formulated as open-ended in order to constitute an open discussion. This approach is chosen since the relationship between corporate strategy and capital structure is highly complex, thus needs to be discussed, conferred and reflected on, which also is what open-ended questions in semi-structured interviews attain (Collis & Hussey, 2013). The interviews will be designed to focus on the targeted companies’ corporate strategies and capital structures with linkage to the theoretical framework of this thesis, which is found in chapter 3. The interview questions will be sent to the interviewees in advance in order for the interviewees to come as prepared as possible to the interviews, thus, maximize the data collection and depth of the interview. Each interview will start with an introduction of the researcher, the background and purpose of the research, followed by a discussion about confidentiality where the interviewees will have the opportunity to be anonymous.

Furthermore, for the majority of the semi-structured questions that will be asked, related so-called clarification-questions will also be provided (i.e. the structured part of the interview). These types of questions will only have pre-set answers to choose from and can be described as a simplified questionnaire that will be conducted in relation to the interviews. Thus, the respondents can easily choose the alternative they find most suitable, which then will enrich the possibility of benchmarking the results between the companies. In essence, this approach will aid the process of establishing clearer

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1 In the absence of a more suitable name, “questionnaire” is what this approach will be called throughout the study
and more transparent conclusions. The questionnaire will be more thoroughly described in subchapter 2.4.1. An example of how an interview question and its related questionnaire-question could look like is provided below. The initial, semi-structured, question could be:

- *Does your firm have a target capital structure?*

The related questionnaire question to this interview question, with its pre-set answers to choose from, is thereafter:

- *To what extent would you say that you have achieved a potential target capital structure?*
  - We do not have a target capital structure
  - Not at all
  - To a low extent
  - To some extent
  - To a high extent

Conclusively, both the interviewees’ unstructured answers provided during the interview, as well as core data in terms of ratings, will be gathered.

Lastly, since the researcher’s knowledge is relatively limited compared to the interviewees’ expertise, so-called probes will be used in all interviews. Probes serve as follow-up question to clarify what the interviewee said, to gain more details or ask for variations or circumstances in regards to an answer (Collis & Hussey, 2013). Thus, probes will be used in order to better understand the data and information the interviewee provides (Collis & Hussey, 2013). Conclusively, this approach will enrich the clarity and depth of the interviews and the overall study.

### 2.4.1 Questionnaire Design

As stated above, most interview questions will have relevant questionnaire questions that will be designed to only enable answers through pre-chosen alternatives, thus will comprehend closed-ended questions. These closed-end questions are normally easier to analyse according to Collis and Hussey (2013), as well as better enable benchmarking of the case companies. Conclusively, the questionnaire questions that will be formulated for this study will have multiple pre-chosen alternatives to choose from. The respondents can then select the most suitable alternative in relation to their position and specific company. The results of the questionnaire will also be excellent add-ons to the results from the semi-structured interviews and will be good complements to each other. However, it is important to note that the questionnaire will not be typical questionnaire per definition, which normally is sent out to multiple recipients (Collis & Hussey, 2013). The questionnaire for this study will solely be sent to the five respondents that will be interviewed. By exclusively sending it do the targeted case companies, the benchmarking of them will be clearer and easier. Similarly, all data from the questionnaire will be possible to link to interviews, thus leading to more clear and transparent conclusions.

The questionnaire is composed of nine questions and is therefore relatively small in size. This is intentionally chosen since the targeted senior executives of these five firms are normally very busy at work. Therefore, a short questionnaire will increase the chances that the executives might be able to fill it in before the interview despite a tight schedule. Nevertheless, more questions than nine would eventually enhance the depth of the analysis. However, when considering the trade-off between a high number of questions in a questionnaire and a high response rate, high response rate is considered of higher importance for this study. If the respondent will not able to fill out the questionnaire before the interview, the questionnaire questions will be asked in relation to the actual interview. By keeping the questionnaire brief, the focus on the chosen problem area will also be more concentrated (Collis &
Hussey, 2013). The specific questions in the questionnaire can be found in subchapter 4.2. In the same subchapter, it can be seen that the questionnaire questions are also very much aligned with the interview questions, thus will also be used as indirect probes to the interview questions.

After the drafts of the interview questions and the related questionnaire is constructed, they will be tested in a so-called pilot test. Conducting a pilot test is of high importance in order to ensure that all questions are clear and there are no problems with understanding and interpreting the questions (Bell & Bryman, 2013). The results of the pilot test can be found in subchapter 4.1.

2.4.2 Research Target Group
As stated in the introduction, the geographical focus of this thesis is on Sweden. Accordingly, all targeted firms for the analysis will be located and mainly operating in Sweden. The targeted firms will all be representatives in the Swedish manufacturing industry. They will also represent five different segments of the industry in order to increase the granularity of the research. In order to conduct the research with chosen methods, access to top executives in the targeted firms is necessary; i.e. CEOs, CFOs, board members or other financial or strategic managers. However, as top executives of firms are in general difficult to get in contact with, this is initially seen as a potential boundary of the study. This potential issue will be dealt with by calling and e-mailing a huge number of different Swedish SME manufacturing firms, until five companies are found that can be interviewed and included in the study. By going broad and choosing five companies from five different manufacturing industries, the generalizability of this study will also be enhanced. The companies will both represent companies focusing on volume as well as companies focusing on customization and margins. Moreover, in order to increase the generalizability further and properly investigate the relationship between the corporate strategy and the capital structure in the SME segment, the companies should also be of different sizes. Therefore, the sizes of the companies that is chosen for this study will vary from SEK 25 million to SEK 300 million in annual revenues, thus almost incorporating the full range of SMEs according to the European Commission’s definition of SMEs (European Commission, 2016). However, their CEOs also have to be seen as experienced and must have had a rather long involvement in their respective companies. This is an important requirement for this study since the research field requires interviewees that are highly aware of their companies’ strategies and financials. This type of information can be something a rather newly hired CEO may lack full information about in the beginning. In terms of the actual selection of the five companies for the study, the companies that first revert to the phone calls/e-mails, and positively express themselves for conducting interviews, will be included. However, they still have to meet all criterion mentioned above. The case companies can be found in chapter 5.

2.5 Pre-Study
The pre-study will consist of an information retrieval of the chosen case companies, with particular focus on their specific businesses and strategy, capital structure, and overall financial situation. It is crucial to come prepared to the interviews, partly as a sign of respect to the interviewee, but more importantly: it is essential knowledge to be aware of in order to actually understand the answers that is provided by the interviewees. The pre-study further aids in conducting up-to-date interviews with the companies. Collis and Hussey (2013) further argue that pre-studies are useful tools when the researcher needs to become more familiar with the overall context and gain specific knowledge before the interviews are held.

This approach will to a large extent be based on the financial statements from the sample of firms in the study, which are found in their annual and quarterly reports. The financial data and financial statements
for the targeted companies will be gathered from Retriever\(^2\), a search engine and leading supplier of corporate information for both public and private companies. The aim of this approach is to gain an understanding of the companies’ typical behaviour regarding capital structure. Therefore, the process will be backwards-looking where a historical financial period is analysed. The number of years investigated will vary between the companies depending on their age since foundation, as the analysis aims to include as many years as possible in the financial analysis. Lastly, additional information, such as information about their businesses, will also be gathered from their homepages. The information that will be gathered during the pre-study can be found in chapter 5.

In order to gain further knowledge about the subject prior to the main interviews, a shorter interview will be held with Mats Juhl, currently CFO of Tengbom. Juhl has had several CFO roles in different industries before Tengbom, e.g. CFO of Swedish Arena Management (financial chief for project “Friends Arena”) and CFO for ENEA (global supplier of software platforms). The aim of this pre-study is to gain an overall knowledge of the thesis subject in relation to the business world, with the ultimate aim of better conducting interviews with the five case companies. The results of the pre-study with Juhl can be found in subchapter 5.1.

2.6 Qualitative Analysis Procedure
The data analysis procedure will consist of:

- Identification of critical instances in relation to the themes, thus highlighting of important key-passages from the transcripts conducted after the interviews
- Identification and categorization of themes and patterns emerged during the interviews
- Description of the identified phenomena in order to enable the ability to draw general conclusions between the interviews
- In terms of processing the data from the questionnaire, all data will be gathered in Excel for analysis
- The questionnaire data will thereafter be aggregated in order to create diagrams for better visibility of the results

\(^2\) http://www.retriever-info.com
3 Literature and Theory Review

This chapter presents existing knowledge and studies of the relationship between corporate strategy and capital structure. Rather few studies have been conducted on the specific subject, leading to that the literature review is limited in terms of earlier work with empirical contributions. For this reason, the chapter aims to facilitate a critical base knowledge of corporate strategies, capital structures and their linkage on a theoretical level for further empirical analyses. A short summary of the literature review is provided in the end of the chapter.

3.1 Corporate Strategy

The corporate strategy is the alignment of a firm regarding what businesses and operations it should execute in order to meet major long-term plans (Johnson, et al, 2007; Dransfield, 2001). Hence, the corporate strategy could be regarded as the overall strategies that reflect the long-term plans with the purpose of aid in achieving long-term objectives in a changing business environment (Johnson, et al, 2007; Dransfield, 2001). Therefore, the strategies are the core means which the company uses in order to achieve their set objectives, such as growth or increased profitability (Dransfield, 2001).

The corporate strategy is developed by senior management and Board of Directors (BoD) of the firm (Dransfield, 2001). When the corporate strategy is implemented and executed, it guides the rest of the organisation to align their decisions and division-specific strategies accordingly (Dransfield, 2001). Conclusively, inappropriate and inefficient corporate strategies will affect the entire organisation negatively (Koller, et al., 2010; Dransfield, 2001). Dransfield (2001) further concludes that the core decision process of the senior management could be regarded as one of the most important processes in order to set an appropriate corporate strategy. When considering the complexity of these decisions due to the large number of dynamic variables, e.g. current available capital or competitors, it is easy to understand the difficulty of them (Dransfield, 2001). Nonetheless, the decisions are crucial since they will set a foundation for building the firm’s future health (Dransfield, 2001). In short, this process could be broken down into 4 stages: Understanding, Formulation, Implementation and Monitoring. The linkage between these four stages is objectified in Figure 2 below. The double-headed arrows in the figure symbolise that the process is dynamic and goes back and forth in order to constitute the most efficient strategy.

Figure 2. The dynamic decision making process, derived from Dransfield (2001).
In terms of understanding, it is crucial that the management has the full understanding of the firm’s strategic situation, as well as an understanding of the current market environment (competitors, customer behaviours etc.) (Dransfield, 2001). Dransfield (2001) further concludes that factors such as interest rates and overall global macro-economic environment are also of significant importance. Therefore, this demands a high level of strategic audit in order to gain an understanding of the current industrial environment (Koller, et al., 2010; Dransfield, 2001). This knowledge will help the management to better set boundaries and conditions for the decisions that will be taken (Dransfield, 2001). Moreover, Formulation is the stage where the actual strategy is formulated in relation to future objectives of the organisation, thus also includes setting or agreeing on long-term objectives (Dransfield, 2001). This stage generally involves the development of the firm’s mission, but it is also encouraged to involve the firm’s values at this stage (Dransfield, 2001). By intertwining these two elements, the entire organisation will be aligned towards the same long-term objectives (Dransfield, 2001). The stage called implementation is where the chosen corporate strategy becomes implemented into the entire organisation, hence forces managers on all levels of the organisation to align their sections accordingly (Dransfield, 2001). However, the implementation and outcome from it have to be evaluated and frequently checked, which is called monitoring (Dransfield, 2001). Monitoring is of importance since the wrong strategy needs to be adjusted and changed as quickly as possible. Thus, potential errors need to be discovered in an as early stage as possible in order to minimize the inefficiencies and damages (Dransfield, 2001).

Moreover, a common objective within to the corporate strategy is growth (Koller, et al., 2010). Therefore, growth will be further investigated in this thesis in relation to the linkage between the corporate strategy and the capital structure:

### 3.1.1 Growth

The term growth could simply be defined as that the company is growing faster than it peers and competitors, or relative the general economy in the specific market (Stanley, et al., 1997). In general, companies want to grow in order to achieve long-term targets such as increased sales or increased market share (Koller, et al., 2010). However, they may also want to grow for the simple reason that their competitors are focusing on growth, forcing them to also grow in order to not become acquired (Stanley, et al., 1997). Enabling and taking advantage of growth opportunities for a firm is essential in order to survive in a competitive environment for mainly two reasons: Firstly, keeping the business at so-called steady state is almost impossible due to the continuously changing market landscape and erratic competitors (Musso & Schiavo, 2008). Secondly, growth is also a major key component in the valuation of businesses (Koller, et al., 2010; Penrose, 1995). Therefore, in order to create long-term value for the company, it needs to grow (Musso & Schiavo, 2008; Penrose, 1995). Furthermore, overall growth is also important for several other reasons: A slow growth rate for a company may, for instance, imply that fewer interesting opportunities are presented to managers, thus leading to that they will have problems retaining and attracting new talents to the company (Koller, et al., 2010). A company that is not focusing on growth is also facing a larger likelihood of becoming acquired by another larger or faster-growing firm (Koller, et al., 2010). Indeed, Koller et al., (2010) find that, in the last 25 years, over 340 companies have been acquired by larger or faster-growing companies and disappeared from the S&P 500.

However, growth is only profitable if the investment creates a higher return on invested capital (ROIC) than the cost of capital (Koller, et al., 2010). It is of high importance to have the right balance between ROIC and growth in order to have long-term value creation: Companies that already have a generally high ROIC tend to benefit more from increased revenues than increased ROIC (Jiang & Koller, 2007). Therefore, these types of companies should instead let their ROIC decreases slightly in order to attain a higher growth rate according to Jiang and Koller (2007).
Regarding growth and shareholder value, studies show that firms which are outperforming the market in terms of growth also tend to enhance their overall revenues faster than companies that are not achieving set growth targets (Baghal, et al., 2007). Furthermore, increased revenues are one of the main factors for increased shareholder value (Koller, et al., 2010). For this reason, it can be argued that growth may create shareholder value in a long-term perspective (Rappaport, 2006). There are generally two ways a company can grow; either organic or inorganic.

**Organic growth**

Organic growth can be achieved with either portfolio momentum or market share performance (Baghal, et al., 2007). In general, organic growth entails increased output and/or enhanced sales (Baghal, et al., 2007). Thus, this growth rate is measured by excluding all excess revenues or general growth that is acquired from either takeovers, acquisitions and mergers (Baghal, et al., 2007). Furthermore, in terms of portfolio momentum, this type of organic growth is achieved by a general market growth in the different segments in which the company is operating in (Baghal, et al., 2007). Baghal, et al. (2007) further conclude that one way to achieve a portfolio momentum is to introduce a new product category in the market and by that indirectly create market growth (Baghal, et al., 2007). Therefore, this can either be achieved by the company itself, as well as from a competitor or new entrants (FitzRoy, et al., 2012).

In the latter case, the company can replicate the competitor in order to increase its own portfolio and by that grow as well (FitzRoy, et al., 2012). FitzRoy, et al., (2012) further conclude that growth in terms of portfolio momentum either reflects the future performance of the company or reflects historic portfolio decisions. According to studies performed on global market leading firms, portfolio momentum generally represents 46% of the contribution to growth (FitzRoy, et al., 2012).

Moreover, the second organic element that affects the growth rate of a firm, the market share performance, captures how a company performs relative its market and whether or not it is gaining or losing market shares (Baghal, et al., 2007). Baghal, et al., (2007) define a firm’s market share as the firm’s “weighted-average share of the segments in which it competes”. Market share performance is measured by the company’s current business portfolio and is not influenced by future launches of new products etc. (FitzRoy, et al., 2012). According to FitzRoy’s, et al., (2012) study of large firms, market share performance generally represents 21% of the contribution to growth. Conclusively, market share performance is the element that generally contributes least to the total growth of firms (since M&A represents 33% as seen in the section below).

The advantages from organic growth are that it’s often less expensive than conducting inorganic growth, as well as involves less risk (Koller, et al., 2010). It also tends to be easier to plan and control, while also the maintaining of the existing company culture and management tend to be easier (Koller, et al., 2010). On the other hand, organic growth is often slower than inorganic growth (Koller, et al., 2010). The total growth a firm can achieve by growing organic also tend to be limited (Koller, et al., 2010).

**Inorganic growth**

The third element that can grow a company is referred to as inorganic growth. Inorganic growth treats firms that grow by conducting mergers and acquisitions (M&A) or divestments (Baghal, et al., 2007). In essence, inorganic growth arises from M&As rather than increased business activity in the company (Baghal, et al., 2007). In conclusion, by conducting M&As, a firm can grow by gaining new market shares, customers or ideas etc. (FitzRoy, et al., 2012). However, inorganic growth also includes potential revenue increases due to other means of an increased business portfolio, as for instance partnerships, alliances, joint ventures or other types of networks (FitzRoy, et al., 2012). According to the study by FitzRoy, et al. (2012), growth via M&As generally accounts for around 33% of the contribution to growth.
Inorganic growth is, essentially, excess profits which are not generated within the company (Baghal, et al., 2007). As Baghal, et al. (2007) conclude, inorganic growth is often a generally faster way to grow compared to organic growth. The benefits of inorganic growth are also that it immediately increases the firm’s total assets, as well as the total income (Ferrer, et al., 2013). The general market presence also tend to increase (Ferrer, et al., 2013). By growing inorganically, the pool of skills and experiences that the company can offer its customers also increases (Ferrer, et al., 2013). In case there is a competitor that has been acquired, M&As can also lead to less competition in the market (Ferrer, et al., 2013). However, inorganic growth is normally more expensive compared to organic growth and also connected with higher levels of risk (Perry & Herd, 2004). The integration of a new company is generally taking both time and resources, while also different organisational cultures and management styles are hard to combine in one entity (Perry & Herd, 2004).

3.2 Ownership and Corporate Strategy
There could be various different types ownership for a firm, ranging from a sole proprietorship to complex special forms of ownership (Villalonga & Demsetz, 2001). However, in this thesis, the companies that will be investigated are either owned by the founding family (i.e. partner owned) or owned by external investors. The companies will also be privately owned. Therefore, this subchapter will focus on the family ownership and the external investor ownership.

3.2.1 Family Ownership
A family-owned company is in general equivalent to a firm owned via a partnership (Westhead & Howorth, 2006). This is also a definition that will be used in this thesis. In general, a partnership is an ownership structure where two or more persons, who are having common interests in a business, cooperate to align and control the business after their mutual interest (Westhead & Howorth, 2006). Similarly, the partners who own the firm together are also sharing both profits and losses in relation to the business of the company (Westhead & Howorth, 2006). Therefore, a partnership is also entailed with a relatively high amount of risk for the partners since it is they who are ultimately losing if the businesses does not go well (Villalonga & Demsetz, 2001).

A partnership structure often offers a high degree of managerial flexibility and control in a firm, especially if the partners themselves act as managers (Villalonga & Demsetz, 2001). However, it is also normal that partner-owned companies hire an external CEO to handle their daily operations, thus divide the managerial responsibilities to the hired managers (Villalonga & Demsetz, 2001). Nevertheless, this type of managerial structure is indeed connected to a rather high degree of managerial flexibility for the CEO (Villalonga & Demsetz, 2001). Yet, an external CEO often needs final approval from the BoD if the decisions involve larger strategical changes or if large amount of capital is needed. Examples of this could be major changes of the corporate strategy or major investments such as an acquisition (Villalonga & Demsetz, 2001). Thus, the total amount of available capital within a company can establish managerial boundaries for the management and CEO (Villalonga & Demsetz, 2001).

3.2.2 Companies Owned by External Investors
A company could also be owned by an external investor who have invested in them and, thus, acquired the ownership of the company (Bialowolski & Weziak-Bialowolska, 2013). The main benefit of having an external part investing and taking control of the firm is the increased capital availability (Bialowolski & Weziak-Bialowolska, 2013). For instance, if the company is acquired by a private equity company, that normally leads to large amounts of funding, which can be used for investments and other important changes in strategy or hirelings etc. (Bialowolski & Weziak-Bialowolska, 2013). This normally leads to a higher financial flexibility for the management who now have more access to new capital (Bialowolski & Weziak-Bialowolska, 2013). As Bialowolski and Weziak-Bialowolska (2013) conclude, this typically
leads to less capital boundaries, thus, the company be more flexible when for instance forming a new corporate strategy (Bialowolski & Weziak-Bialowolska, 2013).

Moreover, the external investors also tend to be involved in the company’s businesses more than just as an external party (Bialowolski & Weziak-Bialowolska, 2013). For instance, they typically bring new knowledge, expertise and other useful resources, such as a strong network or new customers (Bialowolski & Weziak-Bialowolska, 2013). The investors can also help re-evaluate the business and help in forming a potentially more suitable strategy (Bialowolski & Weziak-Bialowolska, 2013).

However, being owned by an external investor is also connected with less management control for larger decisions as the investors are normally represented in the BoD (Bialowolski & Weziak-Bialowolska, 2013; Villalonga & Demsetz, 2001). If, for instance, the CEO wants to conduct an acquisition entailing larger investments, the owners tend to be highly involved in those decisions and normally take the final decisions, which is not always in line with the CEO’s interest (Bialowolski & Weziak-Bialowolska, 2013; Villalonga & Demsetz, 2001). Another problem can be that the investor’s representatives do not fully understand every aspect of the business they have invested in, thus do not have the required knowledge to be a useful tool for the management to reflect and share their ideas with (Villalonga & Demsetz, 2001). This phenomenon is one of the main reasons for why some companies tend to avoid external investors, as they simply see them as an obstacle with a representative involved who does not fully understand their businesses (Villalonga & Demsetz, 2001).

 Nonetheless, regardless of chosen strategy and type of ownership, a company always needs funding:

### 3.3 Capital Structure

A company’s capital structure defines how a firm finances its operations with different sources of funding and boosts its value creation (Berk & DeMarzo, 2014; Modigliani & Miller, 1958). More specifically, the capital structure consists of the mix of a firm’s equity (e.g. common stock, preferred stock and retained earnings) and debt (e.g. long-term debt and short-term debt) (Berk & DeMarzo, 2014). Thus, the capital structure is the ratio level of debt and equity, often referred to as debt-to-equity ratio (Berk & DeMarzo, 2014). The capital structure also gives a first insight in how much risk the company possesses in terms of capitalization (Berk & DeMarzo, 2014). The general rule is that the more debt the company is financed by, the higher is their financial risk (Berk & DeMarzo, 2014). A high amount of debt is generally referred to as “highly leveraged”; where the financial leverage, or just simply leverage, is the exact degree the firm can utilize debt within its capital structure (Lang, et al., 1996). The leverage of a firm is often measured by a ratio of the amount of debt the firms has by its total enterprise value (Koller, et al., 2010).

According to Modigliani and Miller (1958), the value of a firm is not affected by financial decisions in a perfect and efficient market. However, this is a theoretical case as there are no such thing as perfectly efficient markets in practice (Bender & Ward, 2013). There will always be market imperfections involved, as for instance taxes, information asymmetry and transaction costs, leading to irrational decisions (Bender & Ward, 2013). Nevertheless, Modigliani’s and Miller’s (1958) theories can still be used in order to gain an understanding of capital structure decisions (Vidhan & Murray, 2007). Vidhan and Murray (2007) further argue for that there are two theories that are in particular crucial to understand in order to examine the drivers of the capital structure in imperfect markets. These two theories are referred to as the trade-off theory and the pecking order theory (Vidhan & Murray, 2007). As a result, these two theories are seen as highly relevant for this thesis and the following two subchapters will present more detailed descriptions of them:
3.4 Trade-Off Theory

The usage of leverage is both connected with advantages as well as risks (Berk & DeMarzo, 2014). The trade-off theory captures, and combines, the benefits of debt (e.g. tax shields) with the costs of debt (e.g. costs related to financial distress) (Berk & DeMarzo, 2014). According to the trade-off theory, the value of the firm with leverage \( V^L \) equals the firm’s value without leverage \( V^U \), plus its present value of the tax shield gained from debt, minus the present value of its distress costs due to the debt (Berk & DeMarzo, 2014). This formula is written below and derived from Berk and DeMarzo (2014):

\[
V^L = V^U + PV(\text{Interest Tax Shield}) - PV(\text{Financial Distress Cost})
\]

The tax savings from the interest shield come originates from that interest charges on debt are tax deductible while for instance dividends and repurchases of shares are not (Berk & DeMarzo, 2014). Thus, by using debt instead of equity in order to finance a company, the firm’s total taxable income is reduced, hence also raises the value of the firm (Koller, et al., 2010). However, it is important to bear in mind that this benefit is not scalable in infinity: Increased debt levels may lower the overall corporate taxes, but at the same time, they can also entail higher taxes for the investors depending on whether or not the investors’ taxes are higher for capital gains on shares/dividends or on the interest income (Berk & DeMarzo, 2014; Koller et al., 2010; Miller, 1977). If their taxes are higher for the interest income, financing by equity would then potentially be more profitable, depending on the tax levels for the investors and the corporations (Miller, 1977). Moreover, in a study by MacKie-Mason (1989), the author concludes that firms in general are considering the benefits of debt (e.g. tax shields) when they are choosing of issuing a substantial level of either new equity or new debt. Conclusively, tax shields and other benefits with debt will be further investigated in this thesis.

Moreover, increased leverage could also benefit the company by helping it reduce potential corporate overinvestments and excessive risks (Koller, et al., 2010). Considering a mature company with strong cash flows, while at the same time quite few growth opportunities, an increased level of leverage may lure managers to increase corporate spending on certain opportunities (Richardson, 2006). An example of this could be potential acquisitions or other investment projects, which then potentially would increase the growth of the company, but often at the expense of its total enterprise value (Koller, et al., 2010; Richardson, 2006). In general, overinvestments refer to how managers of a firm are investing too much in different projects, both with positive and negative net present values (NPVs), in order to boost the overall growth (Richardson, 2006). This further signifies that they do not act in the best interest of the financial stakeholders of a firm (Richardson, 2006). Richardson (2006) further concludes that overinvestments are often a result of bad usage of the financial resources of the firm, such as available free cash flows.

Furthermore, increased leverage could also benefit the company by helping them reduce these potential corporate overinvestments and excessive risks, hence restrain the use of cash flow for inefficient purposes (Koller, et al., 2010). This benefit comes due to the fact that increased leverage may restrain managers and make them more reluctant to overinvestment due to the debt obligations that arise with the issuance of debt (Richardson, 2006). Therefore, increased leverage limits those types of managerial overinvestments: It constrains the firm to pay out their free cash flow as interest expenses and other debt obligations before they are able to conduct further investments (Richardson, 2006). However, an increased level of leverage may also imply costs in terms of financial distress and potential bankruptcy (Koller, et al., 2010; Opler & Titman, 1994; Teresa, 1993). The reason for this is because firms that are highly leveraged are often prone to pay their debts, thus may overlook potential investment opportunities and cut budgets for R&Ds etc., which actually could increase their profits in the future (Opler & Titman, 1994; Teresa, 1993). Hence, substantial openings are lost, which would increase the firm’s value and
increase the risk of being outreval (Opler & Titman, 1994). This phenomenon is usually referred to as underinvestment problems (Opler & Titman, 1994). According to Rocca, et al. (2008), these problems tend to stem from a management that is rather risk-averse. These managers tend to avoid projects that may entail a significant risk, despite that the projects may also have a potentially huge upside (Rocca, et al., 2008). A typical behaviour for these types of managements is that they are focusing on selling additional products in order to grow instead of investing for growth, since that type of growth entails a higher level of risk (John & Brito, 2001).

In essence, Myers (1977) argue for that a firm’s value originates in the total assets and the possible growth opportunities the firm has, thus bases the valuation on the future ability of the firm to make investments resulting in positive NPVs. As a result of this, the firm’s capital structure influences how well a company can take advantage of upcoming growth opportunities, findings that are also in line with the conclusions by Goedhart, et al. (2006). Conclusively, the quality of the managerial decisions regarding growth opportunities must be high (Rocca, et al., 2008). In essence, from the theories described in the sections above, it can be concluded that companies which are generally having good financing could indirectly be encouraged to underinvest and, thus, avoid risks (Rocca, et al., 2008). Hence, these companies might undertake a risk-averse behaviour, something that ultimately may lead to a decreased enterprise value (Rocca, et al., 2008). Contrary, companies that generally are having low growth prospect, and often are highly leveraged, are instead indirectly encouraged to (over)invest in riskier projects (Rocca, et al., 2008).

However, another consequence with high leverage could also be lost employees, suppliers or even customers due to their fear of the company’s potential financial distress caused by their high leverage (Rocca, et al., 2008). To overcome this fear, e.g. suppliers tend to sometimes demand up-front payments from firms that are highly leveraged in order to lower their own risks (Rocca, et al., 2008). Consequently, this creates a negative spiral of lowered stocks, which leads to lowered sales, which further on leads to an increased difficulty to meet debt obligations, hence forces the company closer to financial distress (Koller, et al., 2010; Opler & Titman, 1994). Ultimately, financial distress may lead the company to a bankruptcy, implying further legal and other administrative costs for the liquidation of the company, or potentially the restructuring of it (Hotchkiss, et al., 2008).

To conclude, high leverage leads to tax savings and a potential managerial disciplining tool, meanwhile too much leverage increases the risk of default and implies financial distress costs. Thus, in order to achieve a so-called optimal capital structure in accordance with the trade-off theory, a company needs to balance the trade-off between benefits of debt, e.g. tax shields, and the cost of debt. In a perfect and efficient market, Modigliani’s and Miller’s (1958) irrelevance proposition concludes that the decision of finance with debt or equity is irrelevant. However, Modigliani’s and Miller’s updated and corrected the irrelevance proposition from 1963 and suggested that with corporate taxation, a firm should be fully financed with debt due to the tax benefits coming with it in terms of tax shields (Modigliani & Miller, 1963). Nonetheless, when bankruptcy costs are added to the model, the optimal capital structure is, in fact, a trade-off between the tax benefits of using debt and the additional costs which are oblique with the costs of bankruptcy (Vidhan & Murray, 2007; Myers & Majluf, 1984). With this in mind, it is possible to argue for that firms setting a target leverage ratio are in compliance with the trade-off theory, and vice versa (Myers & Majluf, 1984). A general target leverage ratio is objectified in Figure 3 below where the net effect of the benefits/costs related to leverage is objectified:
Figure 3. Leverage ratio target, derived from Berk and DeMarzo (2014).

\( V_U \) is the firm value without debt (to the left in the Figure 3 above) and \( V_L \) is the value of the firm with leverage (orange line in the graph). Hence, with an increased value of debt, \( D \), the enterprise value increases at start due to the tax savings and restrained risk taking, which implies lowered risk of potential overinvestments (Berk & DeMarzo, 2014). The present value of the tax shield (\( \tau^*D \)) is objectified with the blue line. However, the increased leverage gradually starts to entail less benefits. This phenomenon is due to the fact that the interest of the debt eventually starts to exceed the firm’s EBIT\(^3\) (Berk & DeMarzo, 2014). Similarly, the expectations of a financial distress increase, while also potential conflicts of interest among financial stakeholders become more likely (Berk & DeMarzo, 2014). As a result, there is a trade-off between too little leverage and too much leverage in order to find the optimal level of debt: \( D^* \). However, beyond the level of \( D^* \), the enterprise value starts to decrease due to the excess interests and financial distress costs, while also the risk taking increases or potential under-investments become more likely (Berk & DeMarzo, 2014; Koller, et al., 2010).

Nonetheless, finding the actual optimal leverage ratio is easier said than done and many researchers argue that different companies have different optimal leverage that is highly dependent on their characteristics (Koller, et al., 2010). However, in general, companies could be relatively high leveraged if they have high returns, low growth, low overall business risk and with relatively fungible assets (Koller, et al., 2010). These types of companies tend to benefit more from high leverage and the beneficial tax savings since their low-growth prospect implies that the costs of overinvestments are high (Koller, et al., 2010). This is a result of that their fungible assets also imply that the company could have a significant value also after a potential bankruptcy, ultimately lowering the overall cost of financial distress (Koller, et al., 2010). In contrast to this, companies that have lower returns and high growth potential with very specific assets should instead have a low level of leverage (Koller, et al., 2010). Their potential tax savings as a result of debt are generally lower since their overall taxable profits are low. These types of companies often want to grow substantially, thus needs financial freedom, something that debt does not entail due to the financial obligations (Koller, et al., 2010). Hence, high leverage would restrain the growth opportunities of those companies (Koller, et al., 2010). Very specific assets, which often are connected to growth companies, also imply higher costs of financial distress in terms of

\(^3\) EBIT is an acronym for “Earnings Before Interest and Tax” and is an indicator of profitability and measured by the total revenues minus the operating expenses (Berk & DeMarzo, 2014).
a bankruptcy since those assets have rather low value for a third party (Berk & DeMarzo, 2014; Koller, et al., 2010).

3.5 Pecking Order Theory

The pecking order theory is an alternative theory to the trade-off theory that also explains the capital structure and how it should be formed (Koller, et al., 2010). The concept of the pecking order is that the cost of finance operations is increasing with asymmetric information which may often occur between owners/managers and outside investors/stakeholders (Berk & DeMarzo, 2014; Koller, et al., 2010). In short, asymmetric information is the theory within economics that comprehends the circumstance when one party has more/better information than another party, thus creates an imbalance in a potential transaction between them (Myers & Majluf, 1984). One example of information asymmetry would be regarding the firm’s true value, where owners/managers have quite good knowledge of the true value. In opposite, outside investors have relatively limited knowledge of the true value of the firm, hence creating an asymmetric information gap between them. For this reason, managers would generally use equity in a case of an overvalued company, implicitly leading to questioned motives from outside investors/stakeholders since they have limited information about the true value (Koller, et al., 2010). Conclusively, asymmetric information is affecting the decisions of whether internal or external funding is best, as well as the choice between issuance of new debt or equity. More precisely, asymmetric information could be said to favour the issuance of new debt instead of equity since that will give the market a signal that the company has confidence regarding an investment and its profitability, as well as a signal that the current stock price may be undervalued. On the contrary, issuing new equity would instead send a signal of lack of confidence from the board of directors and give the market a belief that the share is instead over-priced, most likely leading to a decrease in share price (Myers & Majluf, 1984). Therefore, as financing generally comes from either internal funds, new equity or debt, the pecking order theory implies that a firm should prioritize their source of financing in the following order (Myers & Majluf, 1984):

1) Internal financing (e.g. use retained earnings)
2) Issuance of new debt
3) Raise new equity from external investors

According to Berk and DeMarzo (2014), it is indeed more common to finance operations with internal funding over debt and new equity. Historically, retained earnings have financed an average of 75% of capital expenditures (Berk & DeMarzo, 2014). This pattern was also found by Lawellen and Lawellen (2006), who concluded that internally generated equity (e.g. retained earnings) are indeed always less costly than external capital, thus more beneficial to use for companies.

By being aligned with the pecking order theory, a company’s financial and managerial flexibility is also enriched (Byoun, 2011). A company that is less dependent on external parties, such as external investors (external equity) or the bank (external debt), are generally having a high level of financial and managerial flexibility (Byoun, 2011). The financial flexibility is enhanced since the company basically can spend their money on whatever they like (Byoun, 2011). The managerial flexibility is enhanced since the company does not need any approvals from external parties regarding managerial decisions (Byoun, 2011).

Lastly, by referring back to the trade-off theory, a firm that is compliant with the pecking order theory does not have a target debt-equity ratio, nor a target leverage rate (Goyal & Frank, 2005). This leads to that the ratio between debt and equity reflects the cumulative need of external funding, and a firm indirectly following the pecking order theory should therefore not have a specific target capital structure.
(Goyal & Frank, 2005). In essence, a firm is often either compliant with the pecking order theory or the trade-off theory (Goyal & Frank, 2005).

3.6 Optimal and Effective Capital Structure

According to the two main theories presented above, it is clear that there are both benefits as well as costs with using leverage in the capital structure. Thus, it is questionable whether or not it is possible for a firm to achieve a so-called optimal capital structure, which is defined as the mix of debt and equity that is maximizing the value of the firm (Berk & DeMarzo, 2014). Conclusively, the optimal capital structure is also the capital structure that balances the debt-equity ratio while at the same time also minimizes the company’s cost of capital, hence lowers the capital that is required in order to stay profitable (Berk & DeMarzo, 2014). Debt financing is generally more pertinent in this sense due to the tax deductibility; e.g. tax shields (Berk & DeMarzo, 2014). Nevertheless, the optimal capital structure seems to be hard to find for a company since the risks are also increasing in correlation with increased leverage (Koller, et al., 2010). For that reason, a firm normally strives to attain an “effective capital structure” instead (Berk & DeMarzo, 2014). An effective capital structure is a capital structure that is “perfected” in terms of the creation of shareholder value (Koller, et al., 2010).

3.7 Capital Structure Determinants

Market imperfections, such as the information asymmetry, play an essential role in a firm’s choice of its capital structure (Berk & DeMarzo, 2014; Titman & Wessels, 1988). However, firm characteristics such as profitability and company size may also affect a company’s alignment of capital structure (Attar, 2014). According to earlier studies, these attributes have proven to be significant for the determination of the capital structure, hence a reason to believe that they may have high importance also for Swedish firms in this research:

3.7.1 Profitability

According to the pecking order theory derived by Myers and Majluf (1984), firms that are highly profitable compared to their competitors tend to be contingent on more internal funding. This is a result of their efforts of elude being dependent on external funding, as well as diminishing information asymmetries in the market (Attar, 2014). Therefore, it could be argued that the relationship between a firm’s profitability and leverage rate should be negative (Attar, 2014). Myers and Majluf (1984) also argue for that companies that are able to generate relatively high earnings also tend to use their excess in free cash flow to fund other projects, conclusively leading to a negative relationship between leverage and earnings of the company.

On the other hand, the trade-off theory suggests that it should be a positive relationship between leverage and profitability (Attar, 2014). The reason for this argument is that highly profitable firms have more earnings to protect from taxes, which can be done by using tax shields (Berk & DeMarzo, 2014). Thus, these companies could better utilize the advantages of being highly leveraged (Attar, 2014). These findings could also be connected to the agency theory. The agency theory advocates that debt can be used as a way to control the managers of a firm, eventually leading to a positive relationship between leverage and profitability (Hiwt & Smart, 1994). However, this will only be a scenario if a significant part of a company’s earnings are in terms of free cash flows (Attar, 2014).

Several studies, i.e. Attar (2014), Chen (2004) and Cassar and Holmes (2003), conclude that it indeed is a negative relationship between leverage and profitability. However, considering the fact that firms with low profits generally have more trouble accessing debt financing, other studies, such as Green, et al. (2001), suggest that it indeed can also be a positive relationship between leverage and profitability.
3.7.2 Size

There is an overall ambiguity regarding the relationship between capital structure and company size. According to the pecking order theory, the information asymmetry decreases with the increased size of a firm, thus leads to that large companies are able to issue new equity and conclusively would lead to that equity is more favourable than debt and increased leverage (Brealey, et al., 2013; Myers & Majluf, 1984). As Attar (2014) also concludes, this would then directly lead to that firm size and leverage would be negatively correlated. On the other hand, large companies tend to have more tangible assets which then can be used as collateral, something banks in general tend to focus on when providing loans (Cassar & Holmes, 2003). Therefore, large firms with more tangible assets tend to have more access to the credit market and conclusively tend to also have a higher level of leverage according to Li, et al. (2014). A noteworthy finding from both Chen (2004) and Awan, et al. (2010) is that there should be a positive relationship between a firm’s growth opportunities and leverage rate. According to these findings, it is possible to argue for that a firm that seeks to grow also tends to have more leverage (Awan, et al., 2010; Chen, 2014).

Many financial theories have suggested that there is a negative correlation between company size and the probability of bankruptcy (Lopez, 2004). For that reason, Rajan and Zingales (1995) argued for that a potential scenario is that large firms tend to have more leverage due to the fact that their probability of default is lower compared to smaller competitors. As Attar (2014) also concludes, larger firms have better access to the debt and equity marketplaces. Conclusively, larger firms could incorporate a higher level of debt in their capital structure (Attar, 2014).

3.8 Growth and Corporate Leverage

Many studies show that growth opportunities are significant determinants for the design of a firm’s capital structure (Awan, et al., 2010). However, whether it is a positive or negative relationship between growth and leverage has been discussed in several articles and there is a general ambiguity regarding this among financial researchers (Awan, et al., 2010). Modigliani and Miller (1958) found that there is a positive relationship between leverage and growth. The argument for this conclusion is that firms and their shareholders in general dislike financing growth-investments with common stock (Modigliani & Miller, 1958). Therefore, Modigliani and Miller (1958) argue for that it is a positive relationship since the common stocks’ ruling price may risk decreasing a growth opportunity’s full potential due to increased costs. Therefore, Modigliani and Miller (1958) argue for that firms should initially finance investment projects with debt. If the project then turns out to be profitable and increase the investing company’s actual earnings, the company could simply pay back the borrowed money by either using their increased retained earnings gained from the investment, or issuing equity at a better price than before the investment (Awan, et al., 2010). Also, this matches Bender’s and Ward’s (2013) findings about the ultimate goal of a company, i.e. an increase of shareholder value, which they state can only be conducted with the right amounts of investments generating positive NPVs. Conclusively, it will increase their actual rate of return compared to the company’s required rate of return (Bender & Ward, 2013; Awan, et al., 2010).

In Pandey’s (2001) findings, the author concludes that firms that are gaining a swift growth in sales naturally also need to invest and expand their fixed assets. According to Pandey (2001), these types of firms tend retain more earnings compared to their competitors. In accordance with the pecking order theory, these types of firms tend to issue more debt in order to be able to maintain their set leverage ratio (Pandey, 2001). Therefore, Pandey (2001) argues for that it is indeed a positive relationship between growth and leverage. According to the pecking order theory, this should then ultimately lead to that the growth is forcing those companies to change their general funding from new issuance of equity to debt in order to minimize the agency problem (Pandey, 2001).
On the other hand, Myers (1977) discusses that it is instead a negative relationship between leverage and growth opportunities. In his study, Myers (1977) concludes that companies that are facing valuable opportunities for growth would never issue any type of “risky debt”. Myers (1977) also mentions that companies that already are financed with risky debt will most likely “pass up valuable investment opportunities”. Conclusively, these companies would therefore also miss out on opportunities that could make a positive impact to the value of the firm (Myers, 1977). Myers (1977) further argues that the reason for this type of behaviour is that the lenders normally do not receive any additional valuable security with a growth opportunity for the borrowing firm. Decisively, this makes an equity financing option more preferred in those terms, leading to a conclusion of a negative relationship between leverage and growth (Myers, 1977).

Similarly, Titman and Wessels (1988) also argue for a negative linkage between leverage and growth opportunities. The authors base their arguments on the fact that investments in growth opportunities can be seen as capital assets that should increase the value of the firm. Yet, the investments cannot be used as collateral, thus, will most likely lead to a decrease of the firm’s leverage levels (Titman & Wessels, 1988).

In order to counter declining growth opportunities, a firm can grow via M&As (more details about inorganic growth can be found in subchapter 3.1.1). In M&As, both the assets and liabilities of the two firms are merged and the probability of default decreases (Cook & Martin, 1991). Particularly, the risky debt is diversified over the new entity’s balance sheet and operations, which therefore lowers the default-risk and is often referred to as the coinsurance effect (Cook & Martin, 1991). As a result, the new entity can raise new debt cheaper and more easily since it normally has less operation risk in its balance sheet due to the diversified leverage over different operations (Cook & Martin, 1991). Cook and Martin (1991) further conclude that the coinsurance effect can be said to reduce the overall operating risk in a company as an effect of different diversified cash-flows. For that reason, firms that are establishing uncorrelated and diversified strategies can in theory issue larger levels of debt as a result of the decorrelation between its different business areas (Cook & Martin, 1991).

Therefore, the case-companies of this study will be further analysed in regards to their growth prospects. This analysis will further aid in the examination of the overall relationship between the corporate strategy and the capital structure and examine how growth may play a central part in this.

### 3.9 Corporate Strategy & Capital Structure

According to Koller, Goedhart and Wessels (2010), there are generally three important steps for every managerial decision within a company in order to aid the management to determine a proper capital structure:

The first step involves a strategic decision and is in regard of the amount of financing the firm needs in order to fund their operations and strategic plans. When managers are making a decision within this level, it is of importance to enrich the flexibility of the company. The firm must be able to both have funding for new investment opportunities which may arise, as well as provide stability in terms of a potential economic downturn or an unstable business cycle (Koller, et al., 2010).

The second step in deciding the capital structure is normally done through setting a target capital structure. This is a decision that requires a deep understanding of the company in order to determine which debt-equity mix that best suits the firm in order to enrich its flexibility and stability described in the first strategic level (Koller, et al., 2010).

Lastly, the third step of making a decision is a purely tactical level which mainly concerns the decision of short-term choices which are required in order to adjust the firm’s capital structure so it is appropriate
for achieving long-term goals. One of these decisions may be whether or not the firm should hold on to excess cash or repay it to shareholders by increased dividends or repurchasing of outstanding shares (Koller, et al., 2010).

However, in a historical perspective, little thought has been put into the actual corporate strategy in terms of different financial decisions and even today, many decisions are taken on an ad-hoc basis in terms of this (Rocca, et al., 2008).

3.10 Capital Structure, Corporate Strategy and Competitors
The firms leverage strongly influences its operational flexibility in terms of assets, acquisitions, investments in different projects and other financial opportunities (Berk & DeMarzo, 2014; Grinblatt, et al., 2011; Koller, et al., 2010). The presence of debt is also important in terms of preventing the firm from being misused and signalling to stakeholders that the firm can meet cash obligations from banks and creditors (Attar, 2014; Rocca, et al., 2008).

However, the amount of leverage the firm should have in its capital structure is part of its corporate strategy and could therefore change depending on current market and industry conditions etc. One clear example would be competitors who increase their investment rates, thus eventually force the management of the firm to increase the leverage in order to invest in the same phase and stay competitive (Attar, 2014). Accordingly, empirical studies have shown that managers do take competitors investment strategies into account and adjust its capital structure and own investment strategy accordingly (Koller, et al., 2010; Rocca, et al., 2008). The effect of competitors is also investigated in a research made by Grinblatt, et al., (2011), who argued that the leverage ratio of a firm often indirectly affects competitors’ strategies. In relation to this, Campello (2003) and Chu (2012) argue that today’s “pricing wars” in many industries stem from the capability of highly leveraged firms to intentionally lower prices to such low levels that competitors can’t keep up with these low margins. As a result, their competitors will sooner or later have to file for bankruptcy or leave the market.

3.11 Summary of the Literature Review
At the present moment, the few studies that have been conducted with focus solely on the relationship between the corporate strategy and the capital structure, i.e. the studies by Attar (2008) and Rocca, et al. (2008), have had highly theoretical approaches. Thus, the literature review has made the knowledge gap clearer, which is what this research is partly trying to attain by incorporating an empirical research approach. Moreover, most researchers further conclude that finance and strategy are moving towards each other (Attar, 2014; Rocca, et al., 2008; Hitt & Kochhar, 1998). The two areas are affecting each other in one way or another, leading to that they need be analysed both separately and together. The two main theories that seem to affect the relationship is the trade-off theory and the pecking order theory. However, looking into more detail, it can be concluded that these two theories are not pointing towards the same conclusion regarding the relationship between the corporate strategy and the capital structure:

The trade-off theory captures the trade-off between benefits and risks with using leverage in the capital structure in order to finance operations in the strategy as well as investments. Thus, the trade-off theory suggests that there is an optimal leverage rate in a company which maximizes the value. On the other hand, the pecking order theory proposes the prioritization a company should have in terms of funding: Internally generated equity (e.g. retained earnings) should be prioritized over external debt and lastly external equity.

In order to further analyse the capital structure and its relation to the corporate strategy, financial theory suggests that e.g. size and ownership are key-parameters that should be investigated more closely.
However, there is a general ambiguity of how these parameters are affected, as well as how they affect the leverage of a company and whether or not there is a positive or negative correlation. The profitability and size of a company are in the long term indirectly influenced by the company’s choice of corporate strategy, hence could be said to connect the bridge between corporate strategy and capital structure. These two parameters are also to a large extent affected by a company’s growth opportunities and how well the company can utilize these opportunities. The utilization of these opportunities tends to depend on how effective the capital structure and the company’s financial flexibility are.

Moreover, the actual corporate strategy tends to depend on several different parameters such as the current market landscape, global economy and competitors etc. Competitors are also a non-financials stakeholder that will be investigated further on in this thesis, and is expected to affect the corporate strategy of a firm, hence the relationship between corporate strategy and capital structure. What is also a potential scenario for the competitor’s effect on this relationship is if the specific company chooses to grow inorganically. In other words, if the firm acquires a competitor. This scenario is expected to affect both the capital structure (raise capital for the acquisition) as well as the corporate strategy. Conclusively, it may also affect the relationship between the corporate strategy and the capital structure.

In essence, it can be concluded that it is indeed a very complex relationship between the corporate strategy and the capital structure according to earlier researchers and literature. This complex linkage is exactly what this research focuses on, thus contributing to the current knowledge with empirical evidence.

To conclude, the main themes that emerged during the literature and theoretical review, which are considered helpful in order to prepare the interviews further analyse the data, are presented below:

- Corporate Strategy and growth
- Determinants of Capital Structure (i.e. Pecking order theory and Trade-off theory)
- Corporate Ownership
4 The Interview and Questionnaire Design

The following chapter will present the interview questions as well as questionnaire questions that will be used for this study. The questions are formulated as a result of the literature and theoretical review found in chapter 3, as well as the pilot test. The chapter will start by presenting the findings from the pilot test followed by the formulated questions.

4.1 The Pilot Test

As described in subchapter 2.4, a pilot test was held in order to test the interview questions before they will be used on the case-interviews. The aims of the pilot test were to ensure that the interview questions were clear and that an interviewee would not have any problems with understanding the questions. The pilot test was conducted in collaboration with Per Björklund, current CEO of Brann (a full-service IP law firm) and former Board of Directors representative of Alten Sweden (Global IT and engineering consultancy company). Conclusively, the pilot test was conducted in collaboration with a CEO in a different company and different industry outside the defined scope of the thesis. This was intentionally chosen due to the access issues with senior persons in this thesis. Therefore, after an assessment, it was decided to not waste any interview opportunities with representatives in the manufacturing segment for the pilot test.

In essence, the pilot test revealed valuable insight and information on how the different questions could be interpreted by interviewees and which questions that might be hard to understand at first. The most important insight from the pilot test was that before an interview, the concept “corporate strategy” had to be defined and explained how it was used in the thesis (Björklund, 2016). The usage of the concept tends to vary depending on specific company and specific industry the company is operating in. Conclusively, interview questions related to the concept may be interpreted differently depending on which company that is interviewed. The pilot test aided the overall alignment and design of the interview and questionnaire questions, before they will be used on the case companies of this study. The final questions that have been formulated are presented below.

4.2 The Questions used for the Study

The following interview questions and questionnaire questions are formulated for the qualitative research approach of this study. These have been derived from the literature and theoretical review in chapter 3, as well as the pilot study described above.

**Interview Question 1:** Would you say that your current corporate strategy drives your choice of capital structure, or how would you describe the relationship between them? Would you rather say that your capital structure drives your choice of corporate strategy?

**Questionnaire Question 1a:** To what extent would you say that your corporate strategy drives your choice of capital structure?

**Questionnaire Question 1b:** To what extent would you say that your chosen capital structure drives your choice of corporate strategy?

The topic of this question is directly related to the research question of this thesis. The interview question will be asked since its answers will give indications of how aware the respondent is of the relationship between the corporate strategy and the capital structure. As it seems to be a general ambiguity in financial theory whether or not the corporate strategy drives the capital structure or the opposite, this question will aid in clarifying this contingency. The question will also serve as a guideline to whether or not there exists a linkage between the corporate strategy and the capital structure. Ultimately, the
answer to the question will give indications of whether the proposition, i.e. the corporate strategy drives the capital structure, holds or not.

**Interview Question 2: In short, how would you describe your current main corporate strategy?**

**Questionnaire question 2: How likely is it that your current main corporate strategy will change radically during the next five years?**

This question will be asked for several purposes. The answer to the interview question will provide an early understanding of the company’s current corporate strategy, something that will make it easier to ask suitable probes during the remaining interview. In terms of the questionnaire question, it will give an indication of how mature the company is and an indication of how suitable their current strategy is in relation to the market, competitors and overall company objectives etc. If the answer will be that it is likely that the company will change their corporate strategy, that could be an indication of mainly three things: 1) The company is not fully satisfied with their current position in the market; 2) The company is mature enough to change strategy to a more long-term sustainable strategy. This scenario is in particular likely if the company has been growing rapidly in the past years; 3) The company might want to focus on growth and increase in market share. Nonetheless, regardless of what the exact purpose is for why the company might want to change their strategy, the answer to the question will be interesting to analyse further and connect to other interview questions.

**Interview Question 3: How are the owners of the company affecting its corporate strategy, for instance in terms of investments?**

**Questionnaire Question 3: None**

This question will be asked in order to gain more information of how involved the owners of a company are in terms of formulating the corporate strategy. The answer to the question will especially be interesting to analyse since the literature brought up in chapter 3 indicate that there might be differences depending on whether the company is owned by external investors or by partners (i.e. founding families). Ultimately, the interviewee’s answer will also give indications of how much managerial flexibility the CEO has within his/her company. This information will further be useful when the exact relationship between the corporate strategy and the capital structure will be analysed.

No questionnaire question is devoted to this interview question.

**Interview Question 4: How is your company’s owner affecting the capital structure?**

**Questionnaire Question 4: None**

Similar to question three, the purpose of this question is to gain more knowledge regarding how the owners, their effect on the company and to what extent they are involved and interacts. Contrary to the previous question, this interview question will focus on the owners and the capital structure. In essence, the question will examine to what extent the owners are involved in terms of the capital structure and related areas.

No questionnaire question is devoted to this interview question.
Interview Question 5: Is there any project, investment etc. you once wanted to do that might have failed due to lack of funding and capital?

Questionnaire Question 5: None

The purpose of this question is to examine whether the different ownerships of a company that can affect its ability to conduct and execute investments. The results of this question will also reveal how much risk the company is willing to take in terms of investments. Eventually, those results will give further indications of how the ownership might affect the relationship between the corporate strategy and capital structure.

No questionnaire question is devoted to this interview question.

Interview Question 6: Given equal access to external debt and external equity, which source of financing would you prefer in terms of for instance an investment?

Questionnaire Question 6: Given equal access to external equity as well as external debt, is external debt preferred when for instance doing an investment?

These two connected questions are highly related to financial theories about the pecking order theory. Thus, the purpose of these questions is to examine and verify to what extent the pecking order theory could explain the behaviour of the companies when they are choosing between equity and debt. Results that would indicate that the companies are aligned with the pecking order theory should be that they prefer to raise capital through debt before external equity. Thus, the results of these questions will give information about the companies’ preferences in terms of external funding. The findings can thereafter be used to analyse the relationship this thesis intends to investigate. Conclusively, the answers will be excellent keys in order to understand the full relationship between the corporate strategy and the capital structure.

Interview Question 7: When available, would you say that internally generated capital is preferred over external financing (i.e. debt and external equity)?

Questionnaire Question 7: When you are financing e.g. investments, is internally generated capital (e.g. retained earnings) preferred over external financing?

These questions are further connected to the pecking order theory and aims to clarify if the companies prefer to use internal capital over external financing. Indeed, the results from this interview question will give further indications of whether the companies, in fact, prefer to use internally generated capital, e.g. retained earnings, over external debt and external equity, as the pecking order theory advocates they should.

Interview Question 8: Does your company have a target capital structure?

Questionnaire Question 8: To what extent would you say that you have achieved your potential target capital structure?

This interview question will be asked in order to verify whether a company has a target capital structure and, thus, potentially is compliant with the trade-off theory. According to the trade-off theory, a firm that acts in accordance with it should have a target capital structure that they aim to establish.

The connected questionnaire question will be asked in order to examine to what extent the companies have achieved a potential target capital structure.
In essence, these questions will be complements to question six and seven (which are dealing with the pecking order theory). The theories brought up during the literature review indicate that a company normally is either compliant with the pecking order theory or the trade-off theory.

**Interview Question 9: What are your growth prospects? How do you think your growth prospects are affecting your leverage ratio and overall capital structure? Will your capital structure and financing look different depending on if your company would grow organic or inorganic?**

**Questionnaire Question 9: None**

The theories brought up in the literature review strongly indicate that growth may affect the capital structure and eventually its relationship with the corporate strategy. Therefore, this question will be asked in order to examine the selected companies’ growth prospects. This question also incorporates the different growth methods as well as related questions about financing and growth. Therefore, this question serves as an important tool in order to further analyse and determine the relationship between the corporate strategy and the capital structure and examine how growth may affect it.

No questionnaire question is devoted to this interview question.

**Interview Question 10: How important are tax benefits (e.g. tax shields) coming with the usage of debt in your capital structure?**

**Questionnaire Question 10: How important are tax benefits (e.g. tax shields) coming with debt in your choice of capital structure?**

The purpose of this interview question is to gain more insight into what might affect the choice of capital structure. Moreover, this question is also highly related to the trade-off theory, which advocates that a firm sets a target capital structure in order to find the most suitable leverage rate. The leverage rate should maximize the tax benefits at the most suitable cost of debt and manageable risk for financial distress. In essence, the question will determine if tax shields are important for companies, thus could be directly related to the trade-off theory.

**Interview Question 11: Do you believe there is a certain optimal “industry specific” capital structure?**

**Questionnaire Question 11: None**

The purpose of this question is to further analyse how a company’s capital structure has been initially set. Moreover, the question will also provide information regarding a potential optimal capital structure and whether that is something the industry has formed, or if it is rather something that is highly company specific.

No questionnaire question is devoted to this interview question.

**Interview Question 12: What kind of bank relation do you have and do you think that affects your choice of financing?**

**Questionnaire Question 12: None**

The purpose of this question is to understand more of how the bank relation affect the capital structure and how important it is with a good bank relationship. Moreover, this question will also be asked in order to examine if a company with a good bank relation potentially would embrace a higher leverage rate.
Interview Question 13: How is the currently low interest rate environment, current economic condition and market and competitors overall in your specific industry affecting you?

Questionnaire Question 13a: How large is the effect from the current economic environment and competitors in your choice of corporate strategy and capital structure?

Questionnaire Question 13b: To what extent would you say that the cost of debt and interest/amortization payments affect your choice of capital structure?

This interview question serves as a concluding question with objective of examining whether there are any other external factors, e.g. the low interest rates, that might affect the investigated relationship. In particular, competitors are something that has been brought up during the literature review and has proven to be of importance for the relationship as it tends to affect the companies’ corporate strategies as well as capital structures. In essence, the purpose of the question is to examine how factors that the company can’t affect themselves might affect them.

The two connected questionnaire questions further examine how external factors may affect the corporate strategy and the capital structure, thus eventually can affect the relationship between them.

Interview Question 14: Does your company partly use debt as any sort of disciplining tool for the management of the company?

Questionnaire Question 14: None

The purpose of this question is mainly to examine whether a company’s uses their leverage as a disciplining tool for the management. Therefore, the findings from this question could further aid in examining how a corporate strategy may drive the choice of capital structure.

No questionnaire question is devoted to this interview question.
5 The Interviewed Companies

The chapter will start with a brief presentation summary of the results from the pre-study with Mats Juhl, which aided in the process of targeting companies for the study. The chapter will thereafter present the companies that are included in this study. The information has mainly been gathered from the companies’ respective homepages and annual reports. It is noteworthy to mention that two of the interviewees specifically asked to keep their companies undisclosed. Therefore, these two companies and their representatives have been given acronyms (“Company 1” and “CEO:1” etc.) in order to keep them anonymous. In order to minimize the possibility of identifying them, the two companies have been given a range of revenues and EBITDA-margin instead of the exact number, as well as slightly less information retrieval around them.

5.1 Results of Pre-Study

Before the interview with Juhl was conducted, it was not yet set that it was only SMEs that should be targeted and the researcher was still looking for suitable companies to investigate. However, after presenting for Juhl that the Swedish manufacturing industry was chosen, Juhl (2016) agreed that the research should indeed be limited to the Small-Medium Enterprises (SME) segment. Juhl (2016) emphasized that this segment could be highly interesting to analyse, since there is a lot of “movement” currently taking place in that segment. This is also besides the fact that large cap companies would most certainly be very hard to gain access to. According to Juhl (2016), SMEs are especially interesting to study as the ownership of these companies tend to vary. Differences in ownership was also something that the literature review proved to be an important factor to investigate. Therefore, the decision was taken to limit this study to the SME segment.

Moreover, Juhl (2016) also pointed out that the manufacturing industry indeed was a good industry to investigate, as these companies tend to have solid balance sheets with tangible and fungible assets. This is something that for instance a consulting company within the business services industry is often lacking. It is normally harder for a company with no tangible assets to issue new debt since they have less collateral (Juhl, 2016). Furthermore, those types of companies also tend not to focus too much on their capital structure, leading to difficulties when doing this type of research (Juhl, 2016).

Below are the five companies chosen for this study presented:

5.2 Company 1 - Anonymous

The first company asked to be anonymous in this research and is therefore named “Company 1”. The CEO that was interviewed will be referred to as “CEO:1”.

- **Company name**: “Company 1”
- **Interviewee**: “CEO:1”
- **Position of interviewee**: CEO
- **Company’s business focus**: Manufacturing of analysis instruments
- **Revenues**: Between SEK 200 and 300 million in 2014
- **EBITDA-margin**: Between 10 and 20 %
- **Ownership**: External investor - Owned by a Swedish Private Equity company

Company 1 is a Swedish manufacturing company that is manufacturing advanced analysis instruments ranging from SEK 100.000 per piece to SEK 10 million per piece. Their customers are mainly active within pharmaceuticals, energy and chemicals, as well as different research institutes. The company is seen as the Nordic leader in this segment and is owned and controlled by a Swedish Private Equity firm.
The capital structure is objectified in Figure 4 below, where the ratio between equity and debt is shown for the period 2005 to 2014.

![Graph showing capital structure ratio between equity and debt from 2005 to 2014]

**Figure 4. Company 1’s capital structure from a historical perspective.**

CEO:1 has had several roles during his/her career and has been both CEO, Financial Advisor and COO in several different large corporations. Also, the interviewee has experience from private equity and has also been a corporate finance director at one of Sweden’s largest banks. Therefore, the conclusion that could be made prior to the interview was that the interviewee had highly relevant experiences for this thesis. Thus, the interviewee should be highly able to discuss both the corporate strategy and the capital structure of Company 1, as well as reflect on the relationship between them.

### 5.3 Company 2 – Swereco

- **Company name:** Swereco
- **Interviewee:** Ulf Groth
- **Position of interviewee:** CEO
- **Company’s business focus:** Manufacturing of medical equipment
- **Revenues:** SEK 150 million in 2014
- **EBITDA-margin:** 6.7% in 2014
- **Ownership:** External investor - Owned by Karo Bio AB who bought them from CapMan (Private Equity) and “Svenskt Företagskapital i Stockholm AB” (Swedish venture capital company) in October 2015 for SEK 250 million

Swereco is a Swedish manufacturer of medical devices, e.g. crutches, products for people with disabilities and common “feel-good-products”. The company is manufacturing the products themselves, as well as selling and marketing them. The company’s products vary in prices from hundreds of SEKs to thousands of SEKs. Swereco is focusing on volume more than quality and customization. The company’s customers are mainly within two categories: The first category is “Official Contractors” (e.g. Swedish counties), where the focus is on hospitals and similar businesses. The second category is the common retail industry for medical devices, where the company is selling their products to private individuals via pharmacies and equivalent businesses. The company is mainly focusing on Sweden and the Nordic countries but has sales distributors in over 10 countries. In terms of the company’s capital structure, it can be concluded that it has been rather stable for the last 5 years. Their level of equity has
increased slightly each year. Swereco’s capital structure for the period 2009-2014 is shown in the Figure 5 below.

![Swereco's capital structure from a historical perspective.](image)

The interview was conducted with Swereco’s CEO, Ulf Groth. Groth was a co-owner and founder of the venture capital company called Svenskt Företagskapital, which in 2009 acquired Swereco. Groth has been CEO of Swereco since it was founded, thus, a highly suitable company representative to interview.

5.4 Company 3 – Westermo

- **Company name:** Westermo
- **Interviewee:** Lars-Ola Lundkvist
- **Position of interviewee:** CEO
- **Company’s business focus:** Production of industrial communication devices
- **Revenues:** SEK 292 million in 2014
- **EBITDA-margin:** 11.4 % in 2014
- **Ownership:** External investor - Subsidiary of Beijer Electronics which is owned by Stena Sessan

Westermo is a fast growing Swedish company that is manufacturing data communication devices for business-critical systems in physically demanding environments. Some of their focus industries are energy, oil and gas, mining, commodity production, transportation, maritime and offshore. Targeting highly demanding industries also entail that the quality demand of their communication devices is very high. Conclusively, quality and customization are two very important parameters for the company. Also, their solutions differ from normal IT purposes such as business networks. Since their target industrial environments are very demanding, their product must have a lifetime for at least 10 years and potential recession could lead to disastrous costly consequences. However, the market for these types of products is growing rapidly. This has led to that Westermo has to focus on R&D and growth in order to remain competitive.

In terms of their capital structure, Westermo’s mix of debt and equity has changed quite a lot since its foundation. In Figure 6 below, it can be seen that their capital structure change radically between 2007...
This phenomenon is a result of the acquisition by Beijer Electronics who acquired Westermo in late 2007. By acquiring Westermo, Beijer Electronics could transfer a lot of their debt to Westermo’s balance sheet instead, resulting in a changed capital structure for Westermo. Figure 6 below presents Westermo’s capital structure for the period 2005 to 2014.

Figure 6. Westermo’s capital structure from a historical perspective.

The interview was conducted with Westermo’s CEO, Lars-Ola Lundkvist. Lundkvist has been CEO of Westermo since 2007. Lundkvist has also been CEO of Deva Mecaneyes and has worked several years in ABB prior to his role at Westermo. Therefore, Lundkvist was seen as a suitable representative of Westermo for this study.

5.5 Company 4 – Roslagsglas
- **Company name:** Roslagsglas
- **Interviewee:** Johan Waern
- **Position of interviewee:** CEO/founder/owner
- **Company’s business focus:** Production of glass (e.g. for windows) and special glass (e.g. glass with prints)
- **Revenues:** SEK 25 million in 2014
- **EBITDA-margin:** 12.6% in 2014
- **Ownership:** Family-owned

Roslagsglas is a family-owned company with three owners that is located in northern Stockholm. The company was founded 1994 by Johan Waern who still is active as CEO and owner of the company. The company manufactures and sells different types of glass solutions for all types of customers. Customers can be found throughout Sweden but mainly in the Stockholm area. Their glass solutions vary from standard glass windows (for houses etc.) to very advanced plate glasses, energy glasses and isolation glasses. The company also used to manufacture car windows, which at the time represented 25% of their businesses. However, Roslagsglas sold this division in 2012 in order to better focus on their core business, i.e. flat plate glass. Their revenues were SEK 25 million in 2014, making them the smallest company in this study. As a result of being relatively small, part of Roslagsglas’s strategy is also to make sure that they never sign up for too large projects in order to minimize their risks.
In essence, the focus of the company is to do what they do best and not to establish sub-divisions with related, or unrelated, services within the glass manufacturing industry. Conclusively, Roslagsglas’ strategy is not to become the largest glass manufacturing company in Sweden, but rather the most profitable. Indeed, the company has an objective of becoming one of the ten most profitable glass manufacturers in Sweden within the next five years. Figure 7 below shows Roslagsglas’ capital structure between the years 2005 and 2014.

The interview was conducted with the founder, owner and CEO of Roslagsglas, Johan Waern. As Waern has been CEO since the foundation of the company he founded himself, he was seen as a perfect representative of Roslagsglas for interview in this study.

5.6 Company 5 – Anonymous

The fifth company in this study requested to be anonymous and is therefore named “Company 5”. The interviewed CEO of this company will be referred to as “CEO:5”.

- **Company name**: “Company 5”  
- **Interviewee**: “CEO:5”  
- **Position of interviewee**: CEO  
- **Company’s business focus**: Production of plastic components  
- **Revenues**: Between SEK 100 and 200 million  
- **EBITDA-margin**: Between 5 and 10%  
- **Ownership**: Family-owned

Company 5 is a manufacturer of plastic components for various industries and machines. The company’s machines have a capacity ranging from 25 to 350 tons and they can produce components ranging from as small as 0.01 gram up to 1 kilogram. The company mainly works with autonomous moulding machines. Company 5 is currently focusing on inorganic growth, yet, the company will never sacrifice the stable profitability. There are four owners of the company, all from the same family, owning 25% each. The owners are all active in the company as employees. The company’s capital structure for the period 2006 to 2015 is objectified in Figure 8 below.
Figure 8. Company 5’s capital structure from a historical perspective.

CEO:5 has been the CEO of the company for several years and has prior to this role had several other managerial roles in other companies. Therefore, CEO:5 was seen as a suitable interviewee for this study.
6 Results and Analysis

In this chapter, the answers from the semi-structured interviews as well as the connected questionnaire will be presented. Due to the reason that the questionnaire is highly related to the interview questions, the results will be presented together instead of separately. The results will be presented in the same order as the interview questions were asked during the interviews. Two major themes emerged during the interviews: Companies owned by external investors and companies owned by the founding families.

6.1 Structure of the Presented Results and Analysis

The structure of the following sections will be as following:

1) Presentation of the specific interview question:
   The specific interview questions are stated and marked in bold

2) Identified key themes in relation to the answers provided by the interviewees:
   A bullet list will present a summary of the key themes from the results that were identified related to a specific interview question

3) If existing, the related questionnaire question with graph of results (questionnaire question stated in the title of the graph):
   Along with some of the interview questions, one or two related questionnaire questions were also asked as stated in subchapter 2.4.1 in the methodology. These results will be presented in a graph where the title of the graph will present the specific questionnaire question, and the graph itself will show the answers from the interviewees.

4) Analysis of the specific results:
   The actual results will be presented more accurately below the graph. There will be quotes from the interviewees, as well as more accurately analysed results. Conclusively, the thesis incorporates an intertwined presentation of the results and analysis, where the results are analysed directly in relation to them, instead of in a separate chapter.
6.2 Empirical Results and Analysis

1. Would you say that your current corporate strategy drives your choice of capital structure, or how would you describe the relationship between them? Would you rather say that your capital structure drives your choice of corporate strategy?

- For companies owned by external equity investors: The strategy is the driving factor to a large extent as they have a large pool of available equity, as well as easily available debt.
- For family-owned companies: The capital structure tends to be the driving factor as the CEO is restrained by the amount of capital available since the companies do not want to involve external equity investors, while the companies also tend to aiming for decreasing their leverage rate.
- The relationship between the corporate strategy and the capital structure is most likely more important and traceable for large companies, where the corporate strategy would most likely be the driver as they have more capital available already.

1a. To what extent would you say that your current corporate strategy drives your choice of capital structure?

1b. To what extent would you say that your current capital structure drives your choice of corporate strategy?

Figure 9. Results from questionnaire question 1a and 1b.

This question was the key-question of the entire empirical data collection and is seen as central for this thesis. The overall main theme of this key question was that this is not a relationship the companies have been expressively thinking of due to the fact that a lot of decisions regarding strategy and financing tend to be on ad-hoc basis.
It was further identified during the interviews that the answers depended on what type of ownership the companies had. On the one hand, companies owned by the founding families tended to be more aligned towards a relationship driven by the capital structure. On the other hand, companies owned by external investors tended to have a relationship driven by the corporate strategy. Therefore, these results are in line with theories about family-owned and external investor-owned companies, where for instance Bialowolski and Weziak-Bialowolska (2013) argue that companies owned by external investors tend to have more managerial flexibility due to the fact that they are owned by financially strong investors. Similarly, Villalonga and Demsetz (2001) argue that family-owned companies also have a rather high managerial flexibility, yet, they tend to be restricted to the amount of capital available. This is a reason for why the capital structure drives the corporate strategy among these types of companies.

Based on the results from the two questionnaire-questions, it can further be concluded that there was no significant result in any direction. Therefore, it can be argued that the found relationship between the corporate strategy and the capital structure indeed exists, but is rather insignificant. However, as stated above, as well as identified during the interviews, this relationship would eventually become stronger and more significant if we had investigated larger companies rather than the SME segment. CEO:1 exemplified this by mentioning Volvo as a good example for further studies (CEO:1, 2016). All investigated companies indirectly agreed that this would indeed be a very important relationship to consider if they would have been larger to size, i.e. a large cap company for instance.

Therefore, additional questions related to this relationship were asked in order to further analyse the relationship between the corporate strategy and the capital structure. These questions and results are presented below:

2. In short, how would you describe your current main corporate strategy?
   - Strong focus on core businesses
   - High quality and customized solutions
   - Focus on identifying and targeting the right clientele
   - Growth but without decreasing profitability was a priority among the family-owned companies
   - Strong focus on pure growth among the investor-owned companies

2. How likely is it that your main corporate strategy will change radically in the next 5 years?

![Figure 10. Results from questionnaire question 2.](image)

From the interviews, it could be concluded that the investigated companies had rather different strategies and there were some significant differences despite the fact that they were all within the SME segment in the Swedish manufacturing industry. These results were however expected, since they were all manufacturing different types of goods for different industries with different competitors and different market conditions. Thus, the companies have to formulate different specific strategies best suited for
their particular industry. However, a significant parity among the interviewed companies was that they were all focusing on growth and had that as a high priority within their overall corporate strategy.

For externally owned companies, it was easily perceptible that their external investors wanted their companies to grow and increase in profitability. These objectives stem from their investor’s long-term goals of eventually sell them in the future with a profit. This is also in line with the theories from Musso and Schiavo (2008) as well as Penrose (1995) who argue that in order to create long-term value for the company, a firm need to grow gradually. As earlier studies also have shown, companies that outperform the market in terms of growth tend to enhance their overall revenues and profitability more (Musso & Schiavo, 2008; Penrose, 1995). It can also be concluded that focusing on growth is beneficial for the owning companies (Baghal, et al., 2007). As Rappaport (2006) also states, increased revenues are one of the main factors for increased shareholder value. Conclusively, the interviewed companies and their owners are aligned with this theory and by focusing on growth, the companies will most likely increase in value. Ultimately, these objectives will increase the shareholder value for their owners as well.

In terms of the family-owned companies, they were indeed focusing on growth within their corporate strategy. However, they also had a strong focus on profitability. Indeed, CEO:5 stated that Company 5 will expand and grow their business, but never on the cost of sacrificing the profitability (CEO:5, 2016). Similarly, Waern (2016) stated that one of Roslagsglas’ main targets was to become one of the ten most profitable glass manufacturers within five years. Both Waern (2016) and CEO:5 (2016) emphasized that it in order to achieve these objectives, it was of high priority to always adapt to the customers’ demands and, thus, have flexible operations and machines.

Moreover, four of the investigated companies were also very satisfied with their current strategies meanwhile one, in accordance with Figure 10 figure above, will most likely change their corporate strategy within the next five years. As Dransfield (2001) and Koller, et., al (2010) emphasize, the corporate strategy is the alignment of a firm’s businesses and operations in order to meet long-term plans. Thus, it can be concluded that the chosen companies were suitable targets for this research. However, as one company was actually indicating that it was highly likely for them to change their strategy, it could be questioned whether this company was suitable to include in this research or not. It could be concluded from the interviews that the company that would most likely change their strategy radically was one of the companies owned by external equity investors since both CEO:5 (2016) and Waern (2016) emphasized that they were satisfied with their current strategy. Therefore, a likely conclusion is that the company that will change their core corporate strategy will do that in combination with decisions of their owner. This is not out of the ordinary when an outside investor, e.g. private equity company, initiates a restructuring processes etc. in order to increase profitability or eliminate parts that are inefficient. However, as the research and interview questions were mostly backwards-looking, this was not seen as a problem. Instead, it was seen as something interesting to investigate further, in regard to how that may influence the answers and relationship between corporate strategy and capital structure.

3. How are the owners of the company affecting its corporate strategy, for instance in terms of investments?

- Companies owned by external investors tend to be affected to a high degree by the owners. The owners are to a large extent involved in the decision making progress, leading to a limited managerial flexibility for the CEO depending on situation
- CEOs of companies owned by external investors present suggestions of how to run the businesses and operations of the company to the BoD, including representatives from the external investors. The BoD often takes the final decisions for approval or decline
• External management of family-owned companies have more flexibility in their work, and the families tend to be more of “entrepreneurial spirit” and leave strategic and operational decisions to the CEO
• When family-owned companies are solely run by the family, the strategic and financial flexibility are almost unlimited

It can be concluded from the interviews that companies owned by external investors are indeed affected to a high degree by their owners and have a limited managerial flexibility. All interviewed CEOs described that they were reporting to a Board of Directors (BoD) where the owners were represented in all cases. Indeed, all respondents said that they were in charge of the operative management and businesses of the company, but that all larger decisions had to be approved and go through the BoD. However, as CEO:1 stated, there is always a very open dialogue between the operating management and the BoD (CEO:1, 2016). Even though the external owners were indeed very involved in the decisions regarding the strategy, the CEOs had a relatively large managerial freedom, mostly restricted by capital needs or large-scale decisions (CEO:1, 2016; Lundkvist, 2016). The procedure for the decisions was on an aggregating level identical between the three externally owned companies, where the normal procedure was that the CEO together with management had the responsibility for the operative part of the business. However, if the CEO wanted to conduct a larger strategic change/investment, he or she had to present it in front of the BoD, who would then have the final verdict regarding the decision. Conclusively, the CEOs had a relatively large managerial freedom regarding investments to a certain capital level. If the investment requires more than a certain level, it would require the approval from the BoD. These findings are therefore in line with the findings by Bialowolski & Weziak-Bialowolska (2013) and Villalonga and Demsetz (2001) who emphasize that capital strong companies, owned by external investors, have indeed a high degree of managerial flexibility for their CEO. However, the CEO does have some restrictions where he needs approval from the BoD, such as strategic decisions or large investments (Bialowolski & Weziak-Bialowolska, 2013). Nonetheless, the owners could eventually also set the entire strategy themselves and ask the CEO to implement it, something that normally happened in the first phase of a take-over where the new owner set the new strategic alignment which they believe would be more beneficial for the company (CEO:1, 2016).

On the contrary, the owners of family founded companies generally give more managerial control to the CEO. This enhances the managerial flexibility, leading to that the CEO of those companies tend to have more decision-making flexibility. However, since Waern is CEO of Roslagsglas, as well as the main shareholder and founder, it could potentially affect the decision-making progress of the company. Nevertheless, during the interview, Waern (2016) emphasized that there were no conflicts of interests at all for him being both CEO and main-owner and that he always puts the company’s best before his own interest. For instance, he has a habit of re-investing retained earnings in the company instead of paying them as dividends. Waern (2016) further emphasized that being both CEO and main shareholder gave him almost “unlimited managerial freedom”. Therefore, these findings could be connected to Villalonga’s and Demsetz’ (2001) research of owning partners who also have the role of CEO. Villalonga and Demsetz (2001) emphasized that companies owned by partners, i.e. partners in terms of founding family in this research, have a higher degree of financial and strategic flexibility since it is their own money and initial investments that are financing and partly running the company.

Indeed, CEO:5 also highlighted that the owners of Company 5 give him/her a lot of managerial freedom and always put the company’s best before their own interest, thus acting in accordance with the theories of Villalonga and Demsetz (2001). When asking more specifically how the owners of Company 5 interact in terms of the core strategy of the company, CEO:5 described that they are not significantly involved in the operational activities of the company and daily/weekly plan. Thus, the owners of
Company 5 have hired him/her to take care of daily operations and overall managerial decisions, which was something Villalonga and Demsetz (2001) also found was normal in partner-owned companies. However, in terms of for instance a larger investment, the owners, as representatives in the BoD, are highly involved and are the ones who have to approve the investment. Nonetheless, as long as the planned investment has a good estimated ROIC (return on invested capital), the owners normally approve the suggestion (CEO:5, 2016). CEO:5 further described the owners of Company 5 as “entrepreneurs instead of strategists”, which is why he/she has been given the operative responsibility of the company and also a large managerial freedom. Indeed, this was actually something Waern (2016) emphasized on and he described that founders and managerial founders of smaller SMEs within different manufacturing industries tend to be rather bad strategists but instead very good entrepreneurs. For that reason, the founders often tend to hire an external CEO to run the operative part of the company, which also was concluded in Villalonga’s and Demsetz’ (2001) findings. However, when asked why Roslagsglas had not adapted to that approach, Waern (2016) stated that as long as the company keeps increasing their profitability and “is the company being the challenger and the company that the competitors are afraid of”, he does not see any reason to implement any managerial or strategic changes.

Moreover, when talking about Roslagsglas’ new factory they are currently building, Waern (2016) also mentioned that, as a small family-owned manufacturer of glass products, he believes it is highly important to remain focused on their core businesses. According to Waern (2016); the company could potentially build 5000 square meters of factory instead of the planned 3000 square meters and rent out the additional 2000 m² of space to another company. Conclusively, the company could make additional profits on that, something the company has also been considering when planning this new factory. However, Waern emphasized that since they are family-owned and still rather small in size, that would be a large risk to take without external investors involved (something they never would consider of involving, but will me more thoroughly described below) (Waern, 2016). Waern even stated that “The company is a glass manufacturing company, not a service company or rental company, this is what we are good at and what has made us profitable” (Waern, 2016). Similarly, the company has also large unused areas where they could for instance let boat owners store their boats during the winter and make an additional profit on that. However, once again, he states that they indeed have been considering that, but their philosophy is to remain focused on their core business – glass manufacturing (Waern, 2016).

Furthermore, both Waern (2016) and CEO:5 (2016) stated that, in a case where it would be impossible to finance an ongoing investment or the companies’ operations, it would be more likely that the whole company would be sold than that they would involve an external equity investor. Both CEOs seemed very reluctant to external investors and saw it solely as a problem. Quoting CEO:5: “Having an external actor who has no relevant experience or knowledge in the area we are working in and can solely contribute with cash is only a problem for us which will slow us down and make us inefficient”. Therefore, it is possible to connect these statements to the model by Dransfield (2001), in the stage of understanding. Indeed, Dransfield (2001) argues that understanding the firm’s current strategic situation and market environment is crucial in order to set an appropriate and efficient strategy. Conclusively, this is the stage which Waern and CEO:5 believe may be inefficient and problematic by involving an external owner who eventually lacks the required business knowledge of their industry.

Conclusively, the overall results of this question are in line with theories about ownership and strategy and it can be concluded that it is already possible to identify that there are indeed some significant differences between companies owned by external investors respective companies owned by the founding families. Indeed, this was also something also Juhl (2016) emphasized as a potential scenario during the pre-study. Therefore, the results of this question indicate that it is highly likely that there will
be significant differences depending on the ownership type in regards to the relationship between the corporate strategy and the capital structure.

4. **How is your company’s owner affecting the capital structure?**
   - In terms of external owners, they are highly involved in the decision-making process for the capital structure and capital allocation
   - For family-owned companies, the families are also controlling the capital structure
   - The CEOs of family-owned companies have rather high financial flexibility and are involved in decisions regarding capital allocation

Similar to how external investors are significantly affecting the corporate strategy of a firm, the results of this question indicate that they are also to a high degree affecting the company’s capital structure, thus further in line with the theories by Bialowolski and Weziak-Bialowolska (2013). One example for how the owners are affecting the capital structure is in the stages when they are acquiring the company: A common phenomenon when for instance a private equity company is acquiring a firm is that they are taking on a lot of debt in order to buy the company, debt that is thereafter transferred into the acquired company’s balance sheet (Lundkvist, 2016). Another example of the owners’ effect on the capital structure, which was also emphasized on during the interviews, was that when the management would ask the owners for an approval and capital for of an investment, they could be directed to go to the bank for money instead of receiving equity from the owners (CEO:1, 2016; Lundkvist, 2016). This pattern was especially significant in situations when the external investors were caught up in other large projects or acquisitions that were of a higher priority (CEO:1, 2016). Another example was stated by Groth (2016) and is when Swereco’s owner requires the company to issue parts of the required capital from the bank, solely in order to transfer and share some of the risks with the bank. Conclusively, these are all different methods used by owners to control the capital structure and also their risk exposure in relation to, for instance, an investment (CEO:1, 2016; Groth, 2016; Lundkvist, 2016).

In terms of family-owned companies, the owning family (Waern himself in terms of Roslagsglas) is also to a high degree involved in the capital structure and had initially set the debt-equity ratio with their initial investment when they were establishing their companies (CEO:5, 2016; Waern, 2016). Moreover, in terms of Company 5, CEO:5 has a high flexibility due to the families’ nature of often be “entrepreneurial” instead of “managerial” as stated by CEO:5 (2016). These findings are further in line with the findings by Villalong and Demsetz (2001) who emphasize that the management of family-owned companies tend to have rather high managerial flexibility in all directions, both strategic and financial. CEO:5 (2016) also emphasized that in terms of larger decisions, such as an investment or an acquisition, he/she needs approval from the founding family in the BoD. Yet, it seems that many financial decisions within smaller firms are taken on an ad-hoc basis, leading to that the effect from the owners varies depending on situation and amount of capital needed, as well as current strategic alignment (CEO:5, 2016).

Moreover, in terms of potential external equity investors, both the investigated family-owned companies were very clear with that they absolutely did not want any external investors within their company as they wanted to retain the control within the family and retain their managerial as well as financial flexibility. CEO:5 even stated: “The family’s control of the company is an essential part of our business and will never change. There will never be any angels or financiers other than the family and the bank” (CEO:5, 2016).

Both Waern (2016) and CEO:5 (2016) highlighted the importance of the choice of securities and financing within their companies. They also believed that this would be similar for the majority of
family-owned SME companies: The initial financing of the company originates from the founding family, while also retained earnings could be paid as dividends instead of being reinvested. Conclusively, the owners are taking a rather high risk with their own money if they, for instance, want to invest for growth by acquire another company. This is a significant difference compared to the companies owned by external inventors, as the external investors are the one taking most of the risk in terms of investments etc. For family-owned companies, it is the family who takes the risk. It has been found that they are more risk averse, something that was also identified in the interviews with Roslagsglas and Company.5. These findings are also in line with the findings by John and Brito (2001), who argue that a firm that is more exposed of being acquired, such as a family-owned business, often tends to be more risk averse.

5. Is there any project, investment etc. you once wanted to do that might have failed due to lack of funding and capital?
- If owned by external investors: No
- If family-owned: Yes

The family-owned companies are taking a relatively large risk with a potential investment since it is indirectly the family’s money that is financing the investment; money that could instead have been paid as dividends for instance. Therefore, due to their limited capital and resources, the family-owned companies tend to dislike being prone to risk, and therefore try to avoid it. Both the family-owned companies in this study emphasized that it is a possible scenario that a project may be cancelled before fully executed if the company identifies it as too risky or costlier than earlier expected (CEO:5, 2016; Waern, 2016). Conclusively, that may lead to that an investment may be cancelled due to insufficient amount of capital or costly delays. This is a significant difference compared to the externally owned companies who stated that the chance of cancelling an ongoing project was really low due to their backup of capital from their owners (CEO:1, 2016; Groth, 2016; Lundkvist, 2016). Indeed, these companies can bear more risk due to their higher access of capital through the investors and banks. Therefore, these companies can potentially conduct a project that could be highly profitable in a couple of years but costly until then, whereas, the family-owned company can’t afford this type of strategy.

The conclusion that can be drawn from this question is that main benefit of having external equity investors is that there are in general more access to capital, leading to that investments tend to have a higher success rate of going through. This is further in line with the theories by Bialowolski and Weziak-Bialowolska (2013), who conclude that one large benefit of having external equity investors is indeed that they can provide the company with additional capital. Thus, due to their high access to capital and resources, these companies can be rather risk-loving and can invest in projects that might not be profitable until several years forward.
Given equal access to external debt and external equity, which source of financing would you prefer in terms of for instance an investment?

- Debt is almost always preferred over external equity
- Additional external equity may be considered over external debt only if it would entail some additional intangible value such as new knowledge, extended network, new clients/customers etc.

6. Given equal access to external equity as well as external debt, external debt is preferable in terms of for instance an investment

The purpose of the question was to investigate how compliant the companies were in terms of the pecking order theory. As seen in Figure 11 above, the results indicate that the companies are indeed aligned with the pecking order theory in accordance with the theories by Koller, et al (2010) and Myers and Majluf (1984). The authors concluded that cost of debt is in general cheaper than cost of equity, thus should overall be more preferred. Using debt also retains the ownership and managerial flexibility of the company compared to external equity which also was found in the research by Byoun (2011), something the two family-owned companies in particular emphasized as key arguments for them to use debt solely instead of external equity. Indeed, both Roslagsglas and Company 5 emphasized that they had no plans at all of bringing in an external investor as stated above (CEO:5, 2016; Waern, 2016). Waern (2016) even stated that it was more likely that he would sell the entire company before bringing in an external equity investor; “I do not want anyone around my table who does not know exactly what we are doing in every step in this business” (Waern, 2016). Indeed, the new factory Roslagsglas is currently building will actually be financed entirely with internally generated cash in accordance with the pecking order theory. Company 5 is also currently building a new factory, and exactly like Roslagsglas, no external equity investors are assisting in financing it. Contrary to Roslagsglas though, Company 5 will to some extent finance the new factory with debt as well, although the majority will be financed with internally generated equity (CEO:5, 2016).

However, as seen in the graph above, one company, Swereco, actually stated that external debt and equity were equally preferred. Even though Groth (2016) definitely agreed that external debt was overall preferred over external equity, he also emphasized that there could be potential scenarios where external equity is preferred. Such a scenario could be if the equity investor would add something more than just cash, as for instance valuable knowledge or a powerful network (Groth, 2016). Thus, Swereco is considering external equity in situations where it entails additional value and fits along with their current strategy, despite the fact that external equity normally is more expensive. In all other cases, Groth (2016) concurred that external debt was always preferred over external equity. Similarly, Company 1 and Westermo also stated that external equity is sometimes preferred in situations where it entails some other value in accordance with the statement by Groth (2016). Lundkvist (2016) and CEO:1 (2016) also...
emphasized that going to the bank for external debt normally was time and resource consuming, thus sometimes easier to request external equity from their owners, especially in time critical investment opportunities. Nevertheless, they still emphasized that they mostly preferred external debt as it gave them more managerial freedom (CEO:1, 2016; Lundkvist, 2016). Thus, it could be concluded that these companies are adjusting their capital structure in accordance with their current strategy and needs of capital. Conclusively, this is also an indication that their corporate strategy is driving their choice of financing.

Therefore, this is a significant difference to the family-owned companies and stems from the fact that the investor-owned companies are very capital strong companies. They have relatively high EBITDA-margins and are comparably large compared to the family-owned companies. Thus, by being a relatively large and profitable company, it entails that they can easier utilize somewhat costlier intangible benefits following external equity, instead of always prioritize cheap capital in terms of debt.

7. When available, would you say that internally generated capital is preferred over external financing (i.e. debt and external equity)?

- Internally generated capital is almost always preferred over external financing

![Figure 12: Results from questionnaire question 7.](image)

Partly contrary to the previous graph, the results for this question were that all investigated companies were fully aligned with the pecking order theory, by always preferring internal financing over external financing. CEO:1 captured the results well by stating “retained earnings are wonderful”, indicating that internal financing is preferred over external equity and external debt (CEO:1, 2016). Groth (2016) also emphasized on this fact and stated that using internal financing is “always preferred since it will help remain in control of the company” and that it is “better to use the retained earnings to grow instead of pay as dividends for instance”.

As partly stated above, the two family-owned companies were always preferring internal capital firstly, as they had objectives of lowering their leverage rates. At the same time, they would never approve that an external equity investor would invest in their companies (CEO:5, 2016; Waern, 2016). Thus, these findings could be said to be contradictory to Awan, et al., (2010) findings, which concluded that a firm should initially finance investments with debt. Instead, they are aligned with Myers (1977) findings regarding the pecking order theory, stating that there is a negative relationship between leverage and investments in growth opportunities in particular. Moreover, these results are also strongly in line with the theories by Lawellen and Lawellen (2016) who state that a company should always prefer to use
internally generated capital (e.g. retained earnings) over external capital since it is generally less costly. Furthermore, it retains the ownership and managerial flexibility in accordance with Byoun’s (2011) findings, something the companies were aiming at.

8. **Does your company have a target capital structure?**
- Swereco, Roslagsglas and Company 5 had a target capital structure; Westermo and Company 1 did not
- A sub-objective for the family-owned companies is to finance their companies with as little debt as possible without involving external investors, thus increasing the rate of internally generated equity in their capital structure
- Companies owned by external investors tend to often vary their source of financing depending on situation and specific project, thus tend to not having a target capital structure
- For companies with external equity owners, they tend to sometimes utilize their external investors and use their equity since debt financing is seen as “boring, time and resource consuming”

8. **To what extent would you say that you have achieved a potential target capital structure?**

![Figure 13. Results from questionnaire question 8.](image)

As identified in the two previous questions, all companies but one seems to be aligned with the pecking order theory, although the investor-owned companies tend to sometimes prefer external equity over external debt. Therefore, this question was asked in order to investigate the companies’ potential alignment with the trade-off theory and whether the companies have a target capital structure. When linking this question to the results from the previous questions that were investigating the pecking order theory, the initial assumption should be that the companies should not have a target capital structure. This assumption is based on the theories by Frank and Goyal (2005), who state that the pecking order may often be at odds with the trade-off theory. Conclusively, companies that are fully aligned with the pecking order do not have any debt-equity ratio, thus not a target capital structure.

However, as seen in the Figure 13 above, three companies were actually answering that they partly had a target capital structure. This is interesting and gives a first indication that they might in fact be somewhat aligned with the trade-off theory as well after all, thus would contradict the findings by Frank and Goyal (2005). From the interviews, it was further identified that Swereco answered that they had achieved a target capital structure “to a high degree” as Groth (2016) clearly stated that they indeed had a target capital structure which they also had met. In particular, Groth (2016) stated that their target capital structure had been designed in collaboration with their former owners and the bank, in order to make it as efficient as possible to provide the best support for their chosen corporate strategy. Groth (2016) further stated that he did not believe that there was any specific “optimal capital structure” in
Swereco’s industry (more thoroughly described in question 11 below). Instead, Groth (2016) emphasized that their capital structure was formed rather as an “efficient capital structure”, forged from the market environment and banks. It was perfected in terms of shareholder value creation and suitability for the chosen strategy, thus in line with the theories about optimal vs. efficient capital structure by Koller, et al (2010). Moreover, this further explains why Swereco’s capital structure has been rather stable in a historical perspective, objectified in subchapter 5.3 above. It is their belief that they have found an efficient capital structure that supports their corporate strategy and maximizes value creation (Groth, 2016). Indeed, Groth (2016) specifically stated that their capital structure has been forged and designed to support their chosen corporate strategy as good as possible in order to maximize the value creation. Therefore, it is possible to conclude that even though Swereco has a target capital structure, it is their corporate strategy that is driving the relationship between them, as they have been adjusting its capital structure in accordance with the corporate strategy.

Moreover, the two companies which answered that they had achieved a target capital structure “to some extent” were further identified as the two family-owned companies, Company 5 and Roslagsglas: Both Waern (2016) and CEO:5 (2016) emphasized that they are trying to lower their company’s leverage rate gradually without sacrificing profitability. At the same time, they are trying not raise any external equity by being very resistant to external investors. Indeed, both Waern (2016) and CEO:5 (2016) specifically stated that they partly had a target capital structure as they were aiming to finance themselves with internally generated equity to the greatest possible extent. Waern (2016) even stated that his “dream scenario” would be that their capital structure consisted of 100 % internally generated equity, although he also stated that this was not a practical scenario. The two CEOs highlighted that their target capital structures were set in order to enhance their managerial flexibility (CEO:5, 2016; Waern, 2016). Conclusively, these findings and company objectives are in line with the theories by Byoun (2011), who concludes that managerial flexibility increases with the amount of internally generated equity in the capital structure.

However, as these companies did not focus on tax shields and other benefits of leverage in accordance with question 10 below, the conclusion is that they are not aligned with the trade-off theory more than the pecking order theory. The findings from this question should instead be seen as an indication that these companies are working towards a target capital structure. This is due to the fact that they believe it is more beneficial for them to have a great majority of internally generated equity within their capital structure in order to maximize their managerial flexibility and ownership control. This analysis and conclusions are also supported by the theories by Byoun (2011) as described above. The other argument for them to increase the level of internal capital within their capital structure is due to the fact that it is cheaper than debt in accordance with the theories by Koller, et al. (2010). This is beneficial for them as they are not as capital strong as the investor-owned companies. Thus, these results are further proving that the family-owned companies are aligning their strategies after their capital structure: They do not want to have any external equity investors while at the same time keep their debt-level low in order to retain ownership control and minimize the cost of debt. Conclusively, the two companies will not set a strategy that requires external equity and preferably not a strategy that requires any debt either. Rather, they would set a corporate strategy that to a large extent can be financed solely by internally generated earnings. Both Waern (2016) and CEO:1 (2016) specifically stated that it was highly unlikely that they implement a strategy that they couldn’t finance themselves with their own generated capital. However, if it is of utmost importance, they would use debt. Thus, this further evidences that smaller family-owned companies are more restrained by their capital availability and sources of financing. Indeed, they are not, and would not like to be, backed-up and owned by capital strong external investors, such as the three other investigated companies are.
These findings are significantly differing compared to the results from the externally owned companies. The CEOs of the externally owned companies specifically stated that they might formulate a corporate strategy that they can’t solely finance with internally generated capital, and may finance it with both external capital from the investors, as well as debt (CEO:1, 2016; Groth, 2016; Lundkvist; 2016).

Moreover, Westermo and Company 1 emphasized that they will adjust their source of capital depending on situation and project. In addition, they will also look at what is currently the most beneficial for them in terms of the trade-off between cheap capital and other potential intangible benefits followed by external equity (CEO:1, 2016; Lundkvist, 2016). Conclusively, Westermo and Company 1 were the companies that replied that they did not have a target capital structure, something which they also emphasized during the two interviews. This gives further proof that the corporate strategy can be the driving factor for these types of financially strong companies owned by external investors. Indeed, CEO:1 (2016) and Lundkvist (2016) both talked about that it was the market and their owners that to a large extent had formed their capital structure to what it was today.

Furthermore, since both Company 1 and Westermo are owned by investment companies (a private equity company and Stena Sessna), it can be concluded that these owners are adjusting the companies’ capital structures to suitable structures that are maximizing the profits in an efficient way. Similarly, they are also adjusting the capital structures so they are not sacrificing the companies’ possibilities to operate effectively and grow. This was also something CEO:1 emphasized on during the interview, by stating that from a managerial point of view, he/she would actually prefer more equity in the capital structure (CEO:1, 2016). Yet, due to the fact that they were quite recently acquired by a private equity company, they are still relatively high leveraged (as seen in Figure 4 in subchapter 5.2 above). The reason for this stems from the core activity of private equity (PE) companies in general: Their operation consists of acquiring a company by adding on debt, which will then be reflected in the acquired company’s balance sheet. This process is the so-called Leveraged Buy-Out (LBO). Thereafter, the PE company will ensure that the leveraged company’s operations are optimized on a profitable level. A significant part of these profits will then be utilized to repay part of the debt the PE company raised to buy the company, since the debt is on the acquired company’s balance sheet. The value of the company is expected to increase due to increasing profitability, while at the same time the value of total debt is expected to decline due to the pay back generated by the strong profitability of the company. Further, the equity value of the company will increase⁴. Therefore, since a PE company aims at exiting the acquired company and making a profit on it, they expect to increase their return on equity. Consequently, the owners align the acquired companies with increased debt. Looking at a historical perspective, this phenomenon is also possible to conclude from both Company 1’s and Westermo’s capital structures, objectified in Figure 4 and Figure 6 in chapter 5 above. Thus, it can be concluded that their capital structures are heavily affected by their owners, as well as affected by the management’s common objective of repaying the increased debt in order to enhance managerial and financial flexibility. Conclusively, the capital structure could be said to be driven by corporate strategy decisions and it further evidences that the corporate strategy drives the choice of capital structure within companies owned by external investors. Lundkvist further stated: “Westermo does not have a target capital structure currently. However, as a wholly owned subsidiary of Beijer Electronics and Stena Sessna, that can absolutely become a future BoD-question depending on what strategy we will set now with Beijer’s new CEO. Thus, we might set a target capital structure that might be more suitable and supportive to a

⁴ Enterprise value = Equity Value + Net Debt => Equity Value = Enterprise Value – Net Debt in accordance with the theories by Koller, et al. (2010)
potential new corporate strategy.” (Lundkvist, 2016). Conclusively, this statement could be said to support the analysis of that the corporate strategy drives the capital structure within these companies.

Looking at the capital structure in Figure 4 and 6 for Company 1 and Westermo, it is also possible to identify the pattern of debt-repayment, where Company 1 has started paying back their debt in 2014 whereas Westermo started to repay their debt in 2009. As Westermo was acquired in 2007 whereas Company 1 was acquired in 2011, the analysis and results above are correlated with their capital structures in a historical perspective.

9. **What are your growth prospects? How do you think your growth prospects are affecting your leverage ratio and overall capital structure? Will your capital structure and financing look different depending on if your company would grow organic or inorganic?**

- Strong focus on organic growth that can be financed with internally generated funds to the greatest possible extent, and/or external capital if the company is owned by an external investor
- In the case of family-owned companies, they will always avoid external investors and rather abandon a growth opportunity than find an external equity investor
- Despite that the focus may be solely on organic growth, the companies are always open for utilizing a good opportunity for inorganic growth
- Opportunities for inorganic growth will be financed with internal funding if possible, otherwise from the bank for family-owned companies, and/or external equity in the case of investor-owned companies

It can be concluded that the companies are indeed interpreting growth as an important element in their strategies, something that was also concluded in question 2. The companies are also having different prospects for growth, including both inorganic and organic growth or just solely one of them. For instance, Lundkvist (2016) stated that Westermo is currently in a period of investments and has an objective of investing SEK 175 million over a three-year period in order to achieve growth. According to him, these investments would mainly entail investments on an organic level in order to expand and improve the organisation and modernise the mechanical equipment and machinery (Lundkvist, 2016).

Therefore, the company could be said to attain a growth-strategy by market share performance, defined by Baghal, et al., (2007) as an improvement relative the market the company is currently in. This a possible scenario if Westermo manages to successfully improve the overall organisation with new efficient and cost-effective equipment and machinery. Similarly, as stated in question 6 above, Roslagsglas and Company 5 were also focusing on this type of growth by building new factories. Roslagsglas is financing it with 100% retained earnings whereas Company 5 finances the investment with partly retained earnings and partly bank loans (CEO:5, 2016; Waern, 2016). Moreover, both Waern (2016) and CEO:5 (2016) highlighted that they rather prefer to omit a growth opportunity than to issue new debt, and more importantly, involving an external equity investor. However, in terms of Company 5, their new factory serves as an exceptional case due to the large investment, thus forcing them to partly pay it with debt. Nonetheless, even though they were all mainly focusing on organic growth, the three CEOs specifically stated that if suitable opportunities for inorganic growth would emerge, they would definitely investigate them and possibly seize them (CEO:5, 2016; Lundkvist, 2016; Waern, 2016).

Likewise, Company 1 stated that they will mainly focus on organic growth by developing and selling new products. Thus, on the contrary to the three companies above, Company A plans to grow by portfolio momentum, defined by Baghal, et al., (2007) as growth achieved by progression in new and existing segments by for instance introducing new products. However, if inorganic growth opportunities would emerge, the company would seize these opportunities if they would suit the company’s strategy and maturity (CEO:1, 2016). CEO:1 (2016) further stated that “the company is a small player, yet they
have operations and businesses globally, thus creates a demand to reach a critical mass before conducting acquisitions actively”.

Swereco also has a conveyed growth-strategy which has been developed after the acquisition by Karo Bio according to Groth (2016). However, in contrast to the four other companies, Groth (2016) stated that Swereco will mainly focus on inorganic growth by acquisitions of companies and product groups. Indeed, as financial theory shows, such as the findings by Perry and Herd (2004) and FitzRoy, et al. (2012), growing by acquisitions is riskier but also more efficient if conducted properly, something Groth (2016) also emphasized on during the interview. However, due to the fact that Swereco has had stable profits over the recent years and recently changed ownership, Groth (2016) stated that the company now was in a phase when inorganic growth was “more suitable than ever” as the company had achieved critical mass. Their former owners, CapMan and Svenskt Företagskapital i Stockholm, had very different views on risk and acquisitions overall due to their significant differences in available capital, thus leading to a relatively restricted growth strategy in terms of inorganic growth (Groth, 2016). With their new sole owners, Swereco is better able to align themselves towards a common goal with Karo Bio, which is in this case to grow significantly. Still, if opportunities for organic growth present themselves, they will be considered according to Groth (2016).

Moreover, it can be argued that the companies are indirectly incorporating the theories by Myers (1977), who argues that the value of a firm increases with their growth opportunities and ability to seize them. Koller’s, et al. (2010) theories of the importance of growth are further evidenced within these companies, as it is identified that the companies are indeed focusing on growing in order to become more competitive. Conclusively, by working towards their growth target, the companies are indirectly strategically aligned with the theories by Baghal, et al., (2007) who state that firms that are achieving their growth targets tend to outperform the revenues of firms that are not focusing on growth and conclusively become more competitive. As Rappaport (2006) further states that growth may be a way to increase shareholder value by increased revenues, it can also be argued that the found themes regarding growth are indeed expected.

Since three of the companies are owned by external investors, these investors want higher shareholder value, i.e. an incentive to support growth. Similarly, the family-owned companies have incentive to grow in order to increase shareholder value for the owning family, thus also compliant with Rappaport’s (2006) theories about shareholder value and growth. However, from the interviews conducted, it was concluded that the companies were compliant with the pecking order theory regardless of inorganic or organic growth: When available, all companies stated that they preferred financing growth by reinvesting the retained earnings. In terms of the family-owned companies, they were more aligned to omit the growth opportunity than to issue new debt or raise external equity, whereas the investor-owned companies varied their source of financing depending on situation. CEO:1 (2016) captured this well by stating: “As long as everyone [the company and the owners] is agreeing on the company’s alignment and strategy, and the company continues to increase profitability, an investment will just be seen as positive. There is always money available. Sometimes from the owners, sometimes from the bank. Nonetheless, if the investment is considered good, it will be conducted”. Conclusively, it is arguable that the strategy tends to be driving the choice of financing for the investor-owned companies. Thus, this is further evidencing the conclusion of that the corporate strategy is driving the alignment of the capital structure for investor-owned companies.

However, all companies in this research were already focusing on growth, consequently, they were already taking advantage of growth opportunities by following the pecking order theory. As a result of this, it is not possible to support the theories by Goedhart, et al., (2006) who state that a firm’s capital
structure indirectly determines how well the firm can take advantage of upcoming growth opportunities. Nevertheless, the theories might still have been applicable for these companies, yet, not possible to determine in this research as the investigated companies were already involved in their growth processes.

10. How important are tax benefits (e.g. tax shields) coming with the usage of debt in your capital structure?

- Not important at all and not a topic any of the companies are talking about or incorporating in their strategies and capital structures

This question was asked in order to determine the importance of tax advantages (i.e. tax shields) followed by debt interest deductibility, while it also was asked in order to further verify potential application of the trade-off theory. According to the trade-off theory, tax shields are something companies tend to perceive as important and incorporate in their financial strategy (Koller, et al., 2010). As also three companies stated that they had a target capital structure (the two family-owned companies and Swereco), this question could potentially evidence that they might be compliant with the trade-off theory. However, looking at the empirical answers from the investigated companies, it is clear that they are not focusing on tax shields at all. Conclusively, the findings by MacKie-Mason (1989), who concludes that companies in general are considering tax shields as highly important, were not found among the companies in this study.

Moreover, these results further evidence that the investigated companies indeed do not have a target capital structure in accordance with the trade-off theory. Therefore, it supports the argument that the investigated companies are more aligned with the pecking order theory than the trade-off theory. Therefore, these results further evidence that the three companies stating that they have a target capital structure, i.e. Swereco, Roslagsglas and Company 5, mainly have a target capital structure in order to enhance ownership control. Furthermore, in the case of Roslagsglas and Company 5, the companies are having a target capital structure in order to lower their debt expenses by decreasing the amount of total debt.
11. Do you believe there is a certain optimal “industry specific” capital structure?

- No, the capital structure is highly company specific
- In a benchmarking of the largest companies in the respective industries, there might be some similarities, but not for SMEs

Most companies interpreted the capital structure as something highly company specific and also not as something that had significant importance in their specific industries. Therefore, this further evidences that the companies are more compliant with the pecking order theory and their strategies are indeed financed by securities in accordance with this theory.

All investor-owned companies agreed that it does not exists any optimal capital structure in their specific industries and that a company’s capital structure is highly company specific. A capital structure seems to depended on a company’s specific strategy as well as historical events in the market and within the company (CEO:1, 2016; Groth, 2016; Lundkvist, 2016). These findings further evidence the fact that the companies have historically adjusted their capital structure after their corporate strategy, thus further evidences that the corporate strategy drives their choice of capital structure.

The family-owned companies also concurred that the capital structure was highly company specific. However, as their sources and amount of capital distinguished how they could set up their strategy, it was still seen as important (CEO:5, 2016; Waern, 2016).

Moreover, another significant theme that emerged during the interviews, related to the capital structure and target capital structure, was that all respondents stated that the size of a company is a factor that probably affects the capital structure significantly. Indeed, both Groth (2016) and Lundkvist (2016) stated that they believed tax benefits from debt are much more important factors to consider in large global corporations due to their large size and larger profits. Therefore, both interviewees believed that an appropriate and well-developed capital structure is even more important for larger companies, as those companies probably tend to incorporate the theories about the trade-off theory to a larger extent (Groth, 2016; Lundkvist, 2016). CEO:1 concurred with the statement and took Volvo as an example and stated that their capital structure is probably well aligned with the trade-off theory, whereas it most likely is also similar to Scania’s (CEO:1, 2016).

12. What kind of bank relation do you have and do you think that affects your choice of financing?

- Important in order to have fast access to loans if needed
- Important in order to be able to clarify unexpected circumstances which might have had a negative effect on the income statement, leading to unfulfilled covenants

The interview question showed that the companies consider their bank contact important. However, it was not seen as important in order to negotiate debt-terms and covenants. The bank relation was rather important in order to clarify for instance why a company has not fulfilled a certain covenant due to unexpected circumstances (Groth, 2016; Lundkvist, 2016; Waern, 2016). It was further important in order to have quick access to debt if needed, as for instance in terms of a quickly emerging and suitable growth opportunity, where the retained earnings had already been invested in other projects (CEO:1, 2016; Lundkvist, 2016).
13. **How is the currently low interest rate environment, current economic condition and market and competitors overall in your specific industry affecting you?**

- The low interest rate environment is not affecting the companies at all, just seen as a “**bonus**” leading to lower interest payments
- Current economic environment is not affecting companies significantly, especially not companies aligned towards the healthcare industry such as Company 1 and Swereco
- Competitors are being actively tracked, yet, they are not directly affecting the companies in this study in terms of for instance strategies

![13a. How large is the effect from the current economic environment and competitors in your choice of corporate strategy and capital structure?](image)

![13b. To what extent would you say that the cost of debt and interest/amortization payments affect your choice of capital structure?](image)

**Figure 15. Results from questionnaire question 13a and 13b.**

The investigated companies did not consider the current economic environment with extremely low interest rates as a reason to change strategy or sources of funding. Instead, the companies saw the low interest rates as a “**bonus**” leading to lower interest payments, rather than something to push them to add more debt to their capital structure (CEO:1, 2016; CEO:5, 2016; Groth, 2016; Lundkvist, 2016; Waern, 2016). These findings could also be connected to the questionnaire results where there was a closely related question regarding cost of debt and interest/amortization payments. The results for that question indicate that the cost of debt and interest rate are not seen as important parameters when choosing a capital structure, nor when choosing the strategy. Indeed, the companies indirectly agreed that the currently low interest rate environment was not anything that affected their decision making process at all, nor their choice of funding for investments and operations (CEO:1, 2016; CEO:5, 2016; Groth, 2016; Lundkvist, 2016; Waern, 2016). Lastly, this results further evidences that the pecking order theory is more important for the investigated companies than the trade-off theory, as a company aligned with the trade-off theory should be more aware of benefits and cost of using debt according to the theories by (Koller, et al., 2010) and (Goyal & Frank, 2005).
Moreover, Attar (2014) concludes in his findings that companies that are facing competitors that are increasing their investment rate in a certain division or product area tend to sometimes increase the leverage rate in order to be able to also increase their investment rate simultaneously with the competitor for the same division/product area. However, the results of this research show that the interviewed companies are rather unaffected by competitors’ different strategic moves and did not align or change their capital structure in accordance with this. Although, they were indeed actively tracking them. Conclusively, Rocca’s, et al., (2008) and Koller’s, et al., (2010) findings regarding managers that are taking competitors’ investment strategies into account and adjusting their specific company’s capital structure in accordance with this, were not applicable for this study. Reasons for why the investigated companies did not comply with these theories may be that they are firstly very much focusing on growth already, thus, are perceived as the companies that competitors instead have to adjust for. This was actually something Lundkvist (2016) specifically stressed during the interview. Moreover, most of the investigated companies are focusing on quality and customization rather than volume, with exception of Swereco. Therefore, it can also be argued that they are not forced into a price war with their competitors, which Campello (2003) and Chu (2012) both conclude could affect the leverage ratio and strategy of a firm. The only possible risk a competitor could pose would be if a large market leading competitor invested heavily in a specific product line. This would then eventually lead to that the companies of this study may not continue to focus on that product line, and rather increase their focus on other products (CEO:1, 2016; CEO:5, 2016; Groth, 2016; Lundkvist, 2016; Waern; 2016). However, this was very depending on how much focus and how well-established the companies already were in that specific product line.

Lastly, all interviewees concurred that, once again, if they would have been larger to size, parameters such as interest rates, macroeconomic conditions, the cost of debt, competitors etc. would have been much more significant and affected them to a larger scale (CEO:1, 2016; CEO:5, 2016; Groth, 2016; Lundkvist, 2016; Waern; 2016). In particular, the family-owned companies would probably interpret debt as more attractive if they would have been larger in size as they may then increase their leverage to invest more aggressively in growth (CEO:5, 2016; Waern, 2016).

14. Does your company partly use debt as any sort of disciplining tool for the management of the company?

- Not at all
- Not disciplining but maybe partly as a tool to enhance quality of decisions and accounting etc.

This question was asked in order to find further patterns of how the capital structure and the corporate strategy, and in particular the CEOs financial flexibility, may have been interlinked. However, as seen in the summary of the results above, all companies indirectly agreed that debt is not used as a disciplining tool within their companies. Koller, et al., (2010) state that highly leveraged firms have the benefit of reducing potential overinvestments leading to a reduction of excessive risks. Conclusively, the theories by Richardson (2006), who states that companies may use high leverage as a strategic tool to in order to increase managerial disciplining within a company, are rejected in this research. One reason for this rejection may be because the investigated firms already were investing in growth as seen in question 9. As Richardson (2006) and Koller, et al., (2010) conclude, firms that have quite a few growth opportunities are more exposed to managerial overinvestments when attempting to boost growth, while companies with many growth opportunities are less exposed. Therefore, as the investigated companies already had set growth targets and growth strategies, it can be argued that their growth opportunities were rather strong. As a result, they are not exposed to potential managerial overinvestments, leading to that debt does not have to be used as a disciplining tool.
### 6.3 Summary of Results

Two themes that emerged from the findings that had significant differences in terms of the results were: 1) Companies owned by external equity investors and 2) Companies that were owned by the founders and family controlled. Therefore, the following table captures the main differences and main similarities between the two groups:

Table 1. Summary of the differences and similarities between the externally owned and the family-owned companies.

<table>
<thead>
<tr>
<th>Priorities in current corporate strategy</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Growth</td>
<td>- Growth but not sacrificing profitability</td>
<td></td>
</tr>
<tr>
<td>- Focus on core businesses</td>
<td>- Focus on core businesses and customized solutions</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Owners involvement in corporate strategy decisions</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Owners highly involved in many decisions</td>
<td>- Owners involvement limited to important/expense decisions</td>
<td></td>
</tr>
<tr>
<td>- The CEO presents suggestions that the BoD have to approve</td>
<td>- High managerial flexibility; presents suggestions for larger decisions/investments which the BoD have to approve</td>
<td></td>
</tr>
<tr>
<td>- The CEOs managerial flexibility is limited to smaller operative decisions and in-expensive decisions/investments</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Owners involvement in capital structure decisions</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Owners highly involved in both capital structure and capital allocation</td>
<td>- Owning family sets up and controlling the capital structure</td>
<td></td>
</tr>
<tr>
<td>- The CEO presents suggestions for where he/she wants money for an investment for instance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Failed project due to lack of funding</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- No</td>
<td>- Yes</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Compliance with pecking order theory</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Internally generated funds are preferred</td>
<td>- Internally generated funds are preferred</td>
<td></td>
</tr>
<tr>
<td>- External debt often more preferred over external equity, yet, external equity sometimes preferred over external debt in some situations depending on what other benefits comes with equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- External debt in &quot;worst case&quot;, objective of decreasing the leverage rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- External equity never an option</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trade-off theory and target capital structures</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Swerco has an achieved target capital structure</td>
<td>- Both companies have target capital structures with objective of enhancing managerial flexibility and lower the debt level, thus lower the interest payments from loans</td>
<td></td>
</tr>
<tr>
<td>- Westermo and Company 1 have no target capital structures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- None of the companies consider e.g. tax shields important</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Not aligned with trade-off theory</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Growth by inorganic or organic</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Company 1 and Westermo: Mainly organic growth</td>
<td>- Both companies: Mainly organic growth</td>
<td></td>
</tr>
<tr>
<td>- Swerco: Mainly inorganic growth</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financing differ whether organic or inorganic growth</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Internally generated capital always preferred firstly regardless of growth type</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Depending on situation and specific project, external equity and external debt are similarly preferred</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Growth will be conducted regardless of source of capital as long as the opportunity is considered good</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- The investment in growth is more likely to be omitted if it means raising external equity or issuing more debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Debt can in some situations be used in a &quot;worst case scenario&quot;</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Industry specific &quot;optimal capital structure&quot;?</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- No; highly company specific</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Why is your bank relation important?</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Quick access to new debt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Easier to explain if debt covenants were not fulfilled due to unexpected circumstances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Easier to explain of debt covenants were not fulfilled due to unexpected circumstances</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current economic environment and competitors</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Low interest rates are just seen as a &quot;bonus&quot;; they are not affecting strategy/capital structure decisions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Competitors are tracked but are not affecting corporate strategy</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debt as a disciplining tool</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>- No</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Driver between corporate strategy and capital structure</th>
<th>Companies owned by External Investors</th>
<th>Family-owned Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate strategy</td>
<td>Capital structure</td>
<td></td>
</tr>
</tbody>
</table>
7 Discussion

This chapter presents a discussion of chosen methods. This chapter also contains a discussion of the research results as well as the analysis linked to the results with focus on the reliability, validity and generalizability.

7.1 Discussion of Methods Used

This subchapter presents a general discussion of the choices of methods for this thesis and potential implications they might have had on the findings and results.

As the thesis subject was relatively unexplored, especially in terms of empirical studies, with mainly contributions only from Attar (2014) and Rocca, et al., (2008), setting up appropriate methods for this research required thorough and accurate review of existing academic literature, published papers as well as the two studies mentioned above. Thus, the literature review was a crucial part of this thesis in order to set a foundation to continue on. However, even though the literature and theoretical review were thoroughly conducted, it does not guarantee that all relevant areas have been covered. Indeed, some relatively important areas, such as taxes, had to be excluded due to time limitations. Therefore, the risk of having excluded or missed important key theories might have influenced the results and conclusions drawn from this research. However, the impact of the theoretical limitations was reduced by including and combining different types of sources. By combining the results from the interviews with the information gathered in the literature review, including both academic journals, books as well as reports and articles published by recognizable associations, the results could be triangulated in the analysis. Therefore, the impact of the theoretical limitations was reduced.

Moreover, the chosen method was to conduct interviews as well as distribute a questionnaire to the respondents in the interviews. Target groups for the interviews were companies in the Swedish SME segment within the manufacturing industry. Due to limited time, as well as highly limited accessibility of top executives within these firms, only five interviews were conducted; three companies owned by external investors and two family-owned companies. However, as the results indicate that ownership seems to affect the relationship between the corporate strategy and the capital structure significantly, it would have been of interest to also include other types of ownerships such as publicly owned companies listed on the Swedish stock exchange. Thus, this might have affected the results.

Furthermore, as the five interviewees are representing five different types of manufacturing companies within the Swedish manufacturing industry, that might have influenced the results of the thesis. Indeed, by only including one company for each specific industry limits the strength of the conclusions that can be drawn, as the results might have been different if more companies within the same manufacturing segment had been included.

7.2 Discussion of Results and Analysis

This subchapter contains a discussion about the results of the thesis with the focus on the reliability, validity and generalizability.

7.2.1 Reliability and Validity

The research approach of this thesis has mainly been a qualitative research approach. However, a qualitative approach relies on the researcher’s own observations during the empirical data collection, while it also relies on the researcher’s own interpretations during the analysis of the findings (Collis & Hussey, 2013). Therefore, a qualitative research tends to have a rather low reliability since such a study has rather low replicability as it to a large extent depends on the researcher (Madill, et al., 2010). Furthermore, replicate interviews with following discussions are impossible since humans tend to not
replicate the same answer despite the same question would be asked (Madill, et al., 2010). For that particular reason, the reliability tends to be relatively low for studies that are constituted of mainly interviews (Collis & Hussey, 2013). However, in order to counter this issue, some interview questions had connected questionnaire questions. A questionnaire is easier to replicate, thus not reliant on the researcher’s interpretation to the same degree as the interview results. As a consequence, these types of questions partly counterbalanced the reliability issue with interviews, thus increased the general reliability of the research.

In order to further enhance the reliability of the research, the answers provided by the interviewees had to be captured accurately. Therefore, the approach during the interviews was to both record it as well as take notes during it. Prior to the interviews, all respondents were asked if they approved that the interview would be recorded, which they all permitted. The notes and recordings were thereafter transcribed and reviewed in order to make sure that all answers were accurately captured. All transcriptions were thereafter sent to the interviewees in order for them to approve and verify the transcriptions. All transcriptions were confirmed and approved by respective interviewee, although, it is not possible to determine to what level of detail they actually read it. Nonetheless, as a whole, this further enhanced the reliability of the research. Lastly, in order to further increase the reliability of the study, all interview and questionnaire documents are presented in Appendix 10.1 and 10.2.

In terms of validity, the validity of a research paper deals with that the right subject is studied in regards to the research question (Collis & Hussey, 2013). Also, the research question should be answered with valid and reliable sources of information and data (Collis & Hussey, 2013). Therefore, the literature and theoretical review of this study have been conducted with reliable sources; ranging from academic journals and books, as well as reports and articles published by recognizable associations. The review of these sources of information was conducted with a source critical mindset in order to further be able to verify them, thus enhance the validity of the research. However, there is no guarantee that some of the sources have been influenced by for instance a supporting company or government, which would lead to potentially biased reports which may decrease the validity of the report.

In terms of validity, the validity would have decreased if the interviewees would not have been prepared for the questions. Therefore, in order to tackle this potential decline of validity, the interview questions, as well as the questionnaire, were always sent to the interviewees in advance. Thus, the respondents could prepare and provide better and more thoughtful answers. In order to further increase the validity, the background and purpose of the study were always declared before an interview. According to Collis and Hussey (2013), declaring the purpose of a study before interviews do not only increasing the reliability, but also the validity, since the answers provided by the respondents will then be more correlated to the purpose of the study. However, the concept corporate strategy can be defined and used in various ways depending on the specific company, interviewee’s position and the specific industry the company is operating in. Therefore, in order to further increase the validity, the definition of the concept in this thesis was always properly declared prior to an interview. In essence, this led to that the interviewees interpreted the concept corporate strategy in a similar way, conclusively leading to enhanced validity. Additionally, the continuous use of the so-called probes further increased the validity of the study. Probes were used in order to ensure that the interviewee answered the intended question, as well as used for asking clarifying questions in relation to an answer to an interview question.

Lastly, another potential issue that might have decreased the validity of the research paper was that fact that the interviewees were all active CEOs of operative companies. To clarify, the answers a CEO provided were also representing his/her company. Therefore, an interviewee might sometimes have answered what is expected by him/her from the company. Conclusively, this might therefore lead to that
the provided information were not entirely true, but rather something that reflected the best side of the company. However, in order to counter this potential decrease of validity, all interviewees were given the opportunity to conduct the interview anonymously. By answering anonymously, the interviewees could provide the most truthful answers while not sacrificing any potentially confidential company related information. Indeed, two interviewees also took this opportunity and requested to be anonymous (i.e. CEO:1 and CEO:5). Therefore, it is arguable that these two interviews increased the validity of the report. However, noteworthy to mention is that even though the anonymous interviewees increased the validity of the report, they simultaneously lowered the reliability. Having two anonymous interviewees imply that it will be harder for a new researcher to replicate the results of the thesis, thus lower the reliability. Moreover, as three interviewees declined the offer of being anonym, the validity of their answers could be somewhat questioned. Nonetheless, the interview questions could be answered without providing any potentially confidential information. The interviewees also had the opportunity to skip an interview question if they wanted. Therefore, the assumption is that the three CEOs who were not anonymous, i.e. Groth, Lundkvist and Waern, also provided truthful and unbiased answers. Conclusively, these three interviews neither enhanced or decreased the validity of the study significantly.

7.2.2 Generalizability
The general purpose of this thesis was to investigate the relationship between a company’s corporate strategy and capital structure, as well as determine if the proposition that the corporate strategy drives the choice of capital structure could be verified.

As described in chapter 2, in order to investigate the thesis subject, five case studies with five different companies were conducted. However, conducting case studies implies that the generalizability of a study decreases (Collis & Hussey, 2013). Collis and Hussey (2013) further argue that case studies can never fully be generalizable, even though the findings from them are intended to be extrapolated to a larger scale. Therefore, the generalizability of this study is considered rather low. Yet, the generalizability is higher for a study with five case companies than a study with only one or two cases etc. The fact that the five case companies are active in different manufacturing industries further increases the generalizability since more than one segment in the manufacturing industry was targeted. As a result, more general conclusions could be drawn. Nevertheless, the study would have had higher generalizability if more companies had been investigated; including other industries, other company sizes and other types of ownerships, e.g. publicly listed companies. Conclusively, in order to draw more general conclusions, recommendations for future studies are to conduct even more case studies and/or studies with quantitative approaches in regards to the thesis subject.
8 Conclusions, Implications and Future Studies

This chapter presents and discusses the conclusions of the study, the answer to the research question as well as implications of the study. The chapter also contains suggestions and recommendations for future studies.

The purpose of this thesis was to investigate the relationship between the corporate strategy and the capital structure within companies in the SME segment in the Swedish manufacturing industry. In order to fulfill this purpose, the following research questions was formulated:

“How is a firm’s corporate strategy affecting its choice of capital structure for SMEs in the Swedish manufacturing industry?”

This research question was addressed by conducting five case studies with five different manufacturing companies. Three of the companies represented companies owned by external investors, whereas two companies represented family ownership. In order to answer the research question, the overall research methodology was to conduct semi-structured interviews with the CEOs of the five companies. A questionnaire was also provided in order to easier enable benchmarking of the results from the companies.

8.1 Key Findings

The key findings of this study have been categorized under the two main themes that were derived: Companies owned by external investors and companies owned by the founding families.

8.1.1 Companies owned by external investors

In terms of the companies owned by external investors, i.e. Company 1, Swereco and Westermo, the key finding was that they normally had easy access to new capital. As a result, the companies could easily conduct investments, as for instance investments in growth. Additionally, all three companies stated that they always preferred using internally generated funding (e.g. retained earnings), over the usage of external capital.

In essence, manufacturing companies within the SME segment that are owned by external investors can more easily choose an appropriate corporate strategy without having to incorporate too much thought of the financing. This is a result of that they are owned by financially strong companies who want them to excel, leading to easy and quick access to new financing via the owners. Therefore, these companies can invest heavily regardless of their available amount of internal capital, as their external investors often support them with cash if needed. Being owned by an external investor also enriches the possibility of issuing debt, especially in situations where the equity investor puts in capital in combination with debt that is issued from the bank. A scenario where the external owner invests new equity in the company together with the issuance of debt from the bank, the risk is shared between them. Conclusively, the bank would not be the only party taking a risk and therefore could have a higher risk appetite, leading to a greater pool of external capital the company has available. Having an external investor also decreases the risk of defaulting, hence makes the bank more willing to issue new debt. Consequently, companies owned by external investors have indeed a high availability to both external debt and external equity, thus, can choose aggressive strategies and adapt their capital structure in accordance with these.

Therefore, it is possible conclude that the corporate strategy is driving the capital structure within the firms owned by external investors, as they are adding and adjusting their financing in order to meet the required capital for chosen strategy. By looking into more detail by analyzing Interview Question 1 together with the two related questionnaire questions, it can be concluded that the Swereco and Company
I answered that the corporate strategy is driving the capital structure “to some extent”. Meanwhile, Lundkvist (2016) clearly stated in his interview that the choice of corporate strategy is driving the capital structure “to a large extent” within Westermo.

Conclusively, the initial proposition, i.e. the corporate strategy is driving the capital structure, holds in regards to companies owned by external investors. Figure 16 below shows a schematic model of the concluded relationship between the corporate strategy and the capital structure for these types of SMEs within the Swedish manufacturing industry:

Figure 16. Schematic model of the relationship and sources of capital for firms owned by external investors.

The model shows that a lot of decisions are indeed going through the external owners and BoD, represented by solid arrow from the CEO to the BoD in the top of the model. In more detail, this arrow represents that the CEOs are giving their inputs and suggestions etc., whereas the actual decision-making power belongs to the owners, thus leading to that most final large-scale decisions are taken via them. Therefore, also the arrow going between the box for the external owners and the box for corporate strategy decisions (central position in the model) is solid. This further represents that many final decisions are taken via the owners, thus indirectly affecting the corporate strategy. As seen in the top left of the model, a dotted arrow extends from the CEO to the box for corporate strategy decisions. The dotted arrow represents that some decisions within the company, which are affecting the corporate
strategy, are taken directly by the CEO without owners and BoD involved. However, these types of decisions tend to be smaller in terms of magnitude and capital requirements. Moreover, the two central boxes in the model show the conclusion of the relationship between the corporate strategy and the capital structure for investor-owned companies. Indeed, as seen in the model, decisions regarding the corporate strategy are driving the secondary choice of capital structure.

Lastly, the model also objectifies information about the investor-owned companies’ preferences regarding sources of capital, where they are indeed compliant with the pecking order theory. This is symbolized with a solid arrow from internal capital, whereas the arrows from external debt and external equity are dotted.

8.1.2 Companies owned by founding families
Contrary to the companies owned by external investors, the relationship between the corporate strategy and the capital structure was not that significant among the companies owned by the founding families (i.e. Roslagsglas and Company 5). On the one hand, Roslagsglas and Company 5 were focusing on growth, similarly with the external investor-owned companies. However, on the other hand, they clearly stated that if they couldn’t fund the investments solely with internal capital, it was more likely that they cancelled the investment and changed strategy than asked for external financing. This evidences that the corporate strategy is not driving the capital structure, but rather the opposite: The current amount of available capital drives the choice of strategy, as the amount of capital restrains the company and its management. Conclusively, the companies have to align their strategies in accordance with their current available capital. The current available capital also limits the number of possible alignments their corporate strategy could potentially attain. This further evidence that the amount and sources of capital drive the possible strategies the company can attain, thus indicates of a conclusion that their choice of funding and capital structure drive the choice of corporate strategy.

Moreover, both companies also stated that they had a theoretical target capital structure. The companies’ target capital structures implied the objectives of lowering the leverage rate and increasing the share of internally generated equity. The ultimate goals of these targets were a decrease of their cost of debt, as well as an enhancement of the managerial freedom in their companies. The results further indicate that the family-owned companies were indeed aligning their corporate strategies in accordance with these objectives. As a result, it is further possible to argue for the conclusion that the capital structure drives the choice of corporate strategy for the family-owned companies.

Furthermore, the two CEOs stressed that they would never let external equity investors invest in their companies. Even in a potential scenario where they desperately need cash, they both stated that it was a more likely that they would sell their entire companies or abandon an investment, than involve an external equity investor. Simultaneously, by also gradually lowering their levels of debt, it put fewer pressure on the company. Conclusively, as external equity investors were ignored, while pressure from the bank will decline due to lowered debt levels, the companies were enhancing their overall managerial freedom. Therefore, these objectives were seen as more important than increasing their total amount of capital, something they could eventually do by for instance letting an external party invest in them. In essence, these objectives were driven by the main objective of enhancing the level of internally generated capital in their capital structures. By aligning their corporate strategies accordingly, the companies were supporting this objective.

Indeed, the findings also indicate that the two companies did not align themselves with a corporate strategy that demanded external equity or issuance of new debt. Similarly, the findings also indicate that they did not conduct investments that couldn’t be afforded with mainly internally generated capital.
Consequently, these results further evidence the conclusion that the capital structure actually drives the choice of corporate strategy within the family-owned companies.

Conclusively, the initial proposition, i.e. the choice of corporate strategy is driving the choice of capital structure, is rejected in regards to companies owned by the founding families. The findings rather indicate that the relationship is inverted, where their capital structure rather drives their choice of corporate strategy. Figure 17 below shows a schematic model of the concluded relationship in regards to family-owned companies:

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**Figure 17. Schematic model of the relationship and sources of capital for firms owned by the founding families**

The model shows how the CEO and BoD (including the founding family) are taking decisions together to a high degree, symbolized with the dotted double-headed arrow between them. Moreover, the model also objectifies the CEOs’ ability to take their own decisions to a quite high degree (symbolized with the solid arrow towards the box for capital structure decisions). However, as the founding family also are represented in the BoD and owns the company, they have the ability to take whichever decisions they want without incorporating an external CEO’s will. This is symbolized with the solid arrow between the box for owning family and BoD to the box for capital structure decisions. In essence, the model shows that the decisions regarding capital structure and overall financing are driving the choice...
of corporate strategy. This is symbolized with the large arrow from the box of capital structure to the box of corporate strategy in the center of the model.

The model also shows the family-owned companies’ preferences of capital, where it can be seen that they are compliant with the pecking order theory. This is symbolized with the solid arrow from the green box, representing internally generated capital. Similarly, the arrow from the red box (external debt) is dotted, thus, indicating that this is indeed their secondary choice of funding. Unlike the model for companies owned by external investors in Figure 16, this model does not have a box that is representing external equity. This was intentionally chosen since the family-owned companies are never considering external equity as an option.

8.1.3 Answer of Research Question

By combining the findings from companies owned by external investors and companies owned by founding families, the research question of this thesis can be answered. Indeed, it can be concluded that the answer differs depending on type of ownership.

The corporate strategy did not always significantly affect the choice of capital structure within the SME segment for the Swedish manufacturing industry. This pattern was identified among the family-owned companies. They proved to rather have an inverted relationship, where their financing and capital structure drove their choice of corporate strategy. However, in terms of companies that were owned by financially strong external equity investors, it was identified that they were adjusting their capital structure in accordance with their chosen corporate strategy. Therefore, the relationship between the corporate strategy and the capital structure for these companies was indeed as the initial proposition of the thesis: The choice of corporate strategy drives their capital structure.

To conclude, the answers to the research question, “How is a firm’s corporate strategy affecting its choice of capital structure for SMEs in the Swedish manufacturing industry?”, are:

- Companies that are owned by external investors tend to adjust their capital structure in accordance with their chosen corporate strategy. Capital that is needed for the chosen strategy is easily available. Yet, the companies always prefer using internally generated capital (e.g. retained earnings) before external debt and external equity, which is their secondary choice of funding and varies depending on situation and strategy. Nonetheless, when capital is needed to support the chosen strategy, the companies obtain it, regardless of its source. Conclusively, their capital structure becomes rather dynamic and adjusted to their current corporate strategy.

- For companies owned by the founding family, the corporate strategy is not significantly affecting the capital structure. Instead, the corporate strategy is strictly financed with capital in accordance with the pecking order theory. Moreover, the family-owned companies are aiming to reduce their level of debt in their capital structure and are aligning their corporate strategy in accordance with this objective. Furthermore, the family-owned companies are also refusing all types of potential approaches from external equity investors, and their corporate strategy is set so they would never need any external equity. Therefore, the relationship between the corporate strategy and the capital structure is instead rather inverted, where the capital structure seems to aligns the corporate strategy of the company.
8.2 Contribution to Academic Literature
This thesis contributes with more knowledge to the rather unexplored area of the relationship between the corporate strategy and the capital structure, which so far has been investigated thoroughly by mainly Attar (2014) and Rocca, et al. (2008). Thus, this study contributes with empirical data and evidence from the Swedish SME manufacturing industry, a segment that has not yet been investigated in terms of this subject. The thesis further contributes with more knowledge of how different ownership types may affect the corporate strategy and the capital structure, and in particular the relationship between them.

Furthermore, the findings of the thesis evidenced that manufacturing companies within the SME segment tend to be more aligned with the pecking order theory than the trade-off theory. However, the findings also indicated that this conclusion may change in a scenario where the companies are larger to size. The results also showed that smaller family-owned companies tend to be more aligned with the pecking order theory than the externally owned. Instead, the investor-owned companies tend to vary between using external equity and external debt depending on strategy and situation.

8.3 Contribution to Managers
The contributions of this thesis provide insight of strategic considerations for managers in terms of funding and decisions regarding the capital structure in particular. The findings indicated that interest rates, market conditions and competitors are rather unimportant factors in terms of capital structure decisions for SMEs in the Swedish manufacturing industry. However, competitors may be of interest to monitor for strategic purposes.

The results of the thesis also provide important knowledge of what a manager can expect in terms of the corporate strategy and the capital structure in a company, as well as their relationship. In particular, this knowledge would be valuable if a manager joins a new company as senior executive. Depending on the size of the company and whether it is a family-owned business or a company owned by external investors, the manager can expect a different relationship regarding strategy and capital. Furthermore, the thesis provides insight of how the managerial flexibility changes depending on company ownership. In particular, the thesis provides insight of the managerial flexibility regarding capital structure decisions as well as strategic alignments of the firm. Lastly, the thesis also provides information of factors that are often seen as rather unimportant for companies in the SME segment, such as tax shields. Conclusively, the findings of the thesis can serve as important tools for a manager in order to prepare him or her for what he or she can expect in a new company depending on the company’s ownership.

8.4 Future Research Recommendations
Due to time limitations of this thesis, interviews were conducted with five different SMEs in the Swedish manufacturing industry. Thus, future research of this topic should incorporate more companies of various sizes. Indeed, as all interviewees emphasized, this relationship would most likely become more significant if larger companies were investigated. A likely scenario is then that the corporate strategy would be even more dominating in regards to the relationship with the capital structure, something that was also emphasized on during the interviews. Therefore, a recommendation for future research is to start with larger companies and investigate whether the findings of this thesis could be extrapolated to those companies as well. Similarly, as emphasized by the interviewees, tax-shields are most likely also of higher importance for those types of companies, ultimately leading to different patterns in regards to the pecking order theory and the trade-off theory.

Moreover, a related recommendation for future research is also to investigate companies outside the manufacturing industry. As an example, a consulting company typically does not have physical assets to the same extent as a manufacturing company. Conclusively, it is most likely harder for them to issue
large amounts of new debt as they have less collateral, leading to potentially different conclusions in regards to the relationship between the corporate strategy and the capital structure. Ultimately, patterns in regards to the pecking order theory and trade-off theory would then potentially also differ for those types of companies.

Furthermore, as only private companies have been investigated in this thesis, a recommendation for future studies is also to include public companies in the research. The findings clearly indicate that different types of ownership affect the relationship differently. By including publicly traded companies, an additional type of ownership would also be incorporated, eventually leading to other patterns and conclusions. By including public companies, factors such as risk could also be included in the study, as the systematic risk could easily be derived by looking at their betas.

The last recommendation for future studies is to investigate other important theories that may affect the relationship between the corporate strategy and the capital structure. Some examples of relevant theories to include are the agency theory, the transaction cost theory and the coinsurance effect theory. Lastly, taxes are overall a relevant and important topic that should be of high relevance to further investigate in future studies.
9 References


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10 Appendix

10.1 Appendix 1 – Interview Guide

Name – Company – Position – Date

Short introduction and purpose of study

[Jacob Björklund, final year student at the Royal Institute of Technology. Bachelor in Mechanical Engineering and Master thesis student in Industrial Engineering and Management. The master thesis is conducted at the department of Master in Industrial Engineering and Management. The purpose of the study is to analyse and understand the relationship between a company’s corporate strategy and capital structure within Swedish SME manufacturing firms. The goal of the interview is to understand more of this relationship, as well as the corporate strategy and the capital structure as separate elements within a company.]

Interview Questions

1. Would you say that your current corporate strategy drives your choice of capital structure, or how would you describe the relationship between them? Would you rather say that your capital structure drives your choice of corporate strategy?
2. In short, how would you describe your current main corporate strategy?
3. How are the owners of the company affecting its corporate strategy, for instance in terms of investments?
4. How is your company’s owner affecting the capital structure?
5. Is there any project, investment etc. you once wanted to do that might have failed due to lack of funding and capital?
6. Given equal access to external debt and external equity, which source of financing would you prefer in terms of for instance an investment?
7. When available, would you say that internally generated capital is preferred over external financing (i.e. debt and external equity)?
8. Does your company have a target capital structure?
9. What are your growth prospects? How do you think your growth prospects are affecting your leverage ratio and overall capital structure? Will your capital structure and financing look different depending on if your company would grow organic or inorganic?
10. How important are tax benefits (e.g. tax shields) coming with the usage of debt in your capital structure?
11. Do you believe there is a certain optimal “industry specific” capital structure?
12. What kind of bank relation do you have and do you think that affects your choice of financing?
13. How is the currently low interest rate environment, current economic condition and market and competitors overall in your specific industry affecting you?
14. Does your company partly use debt as any sort of disciplining tool for the management of the company?]
Appendix 2 – Questionnaire

Introduction
This questionnaire is part of my Master Thesis study at the Royal Institute of Technology, where I am writing about the relationship between a company’s corporate strategy and capital structure. The purpose of this questionnaire is to gain more knowledge of this relationship, as well as knowledge about your company’s corporate strategy and capital structure as separate units. This information will be highly valuable for me when analysing the relationship between the corporate strategy and the capital structure.

Answering the survey is optional and the results of the questions will be used in aggregated form. The answers will be anonymous. Your inputs for this questionnaire are greatly appreciated and will be used in this research. The questionnaire takes approximately 5 minutes to answer. If you have any questions, please do not hesitate to contact me at jacobbjo@kth.se.

Thank you in advance and I am looking forward to meet you for the actual interview.

1. To what extent would you say that your current corporate strategy drives your choice of capital structure?
   - They are independent of each other
   - Not at all; the choice of capital structure drives the choice of corporate strategy
   - To a low extent
   - To some extent
   - To a high extent

2. To what extent would you say that your current capital structure drives your choice of corporate strategy?
   - They are independent of each other
   - Not at all; the choice of corporate strategy drives the choice of capital structure
   - To a low extent
   - To some extent
   - To a high extent

3. How likely is it that your main corporate strategy will change radically in the next 5 years?
   - Not likely at all
   - Low likelihood
   - Quite likely
   - Likely
   - Very Likely

4. Given equal access to external equity as well as external debt, external debt is preferable in terms of for instance an investment
   - Strongly disagree, equity is always preferred over debt
   - Disagree, equity is often more preferred over debt
   - Debt and equity are equally preferred
   - Agree, external debt is preferred
   - Strongly agree, debt is always preferred over equity
5. When you are financing e.g. investments, internal generated financing (e.g. retained earnings) is preferred over external financing
   - Strongly disagree, external financing is always preferred
   - Disagree
   - Internally and externally generated funds are equally preferred
   - Agree
   - Strongly agree, internal financing is always preferred

6. To what extent would you say that you have achieved a potential target capital structure?
   - We do not have a target capital structure
   - Not at all
   - To a low extent
   - To some extent
   - To a high extent

7. How important are tax benefits (e.g. tax shields) coming with debt in your choice of capital structure?
   - Unimportant
   - Almost unimportant
   - Slightly important
   - Important
   - Very important

8. How large is the effect from the current economic environment and competitors in your choice of corporate strategy and capital structure?
   - No effect at all
   - A very small effect
   - Small effect
   - Some effect
   - A large effect

9. To what extent would you say that the cost of debt and interest/amortization payments affect your choice of capital structure?
   - We do not have any debt
   - Not at all
   - To a low extent
   - To some extent
   - To a high extent

Thank you!