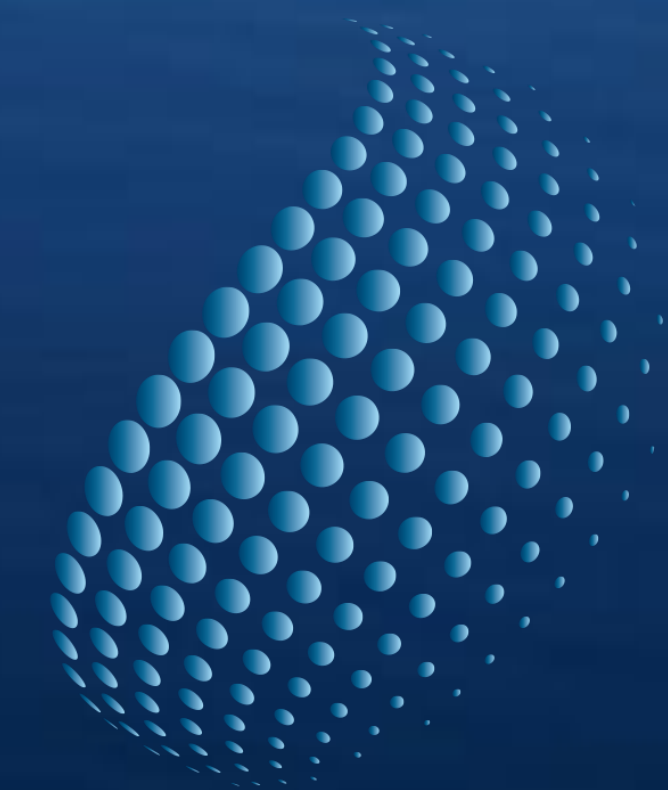


# The Swedish legacy of decentralization



**REQ CAPITAL**

INVESTING WITH INSIGHT

Our investment philosophy is built on three key pillars: capital allocation, decentralization, and people. We strive to identify exceptional capital allocators who decentralize their operations and embody true ownership. This approach is fundamental for securing superior long-term investment returns.

Decentralization is an organizational structure where management delegates responsibility down in the organization. This organizational structure is based on the belief that top management does not have all the correct answers about how underlying departments and subsidiaries should deal with products, customers, suppliers, and competitors.

With responsibility comes the power of increased motivation, knowledge sharing, and better customer relations because the decision-makers are close to customers. It is a management philosophy of using the carrot rather than the stick. Our companies operate without the anchor of bureaucracy. Our decentralized businesses have lean corporate headquarters by nature.

**We often encounter the question, "Why does Sweden have a significant number of acquisition-driven companies?"**

There isn't a single answer but rather several factors that collectively weave a history explaining why Sweden has successfully fostered numerous companies, many of which have thrived on acquisitions spanning decades.

Sweden's rich industrial heritage dates back to the 19th century, with industrial pioneers such as Sandvik, Atlas Copco, Electrolux, Ericsson, Tetra Pak, Asea, and Trelleborg. As a relatively small and geographically isolated country, Sweden quickly adopted trends in innovation and globalization. Many industrial firms initiated their international journeys through acquisitions in the mid-20th century. Companies such as Bergman & Beving (with its first acquisition being Lagercrantz in 1967), Electrolux, and Atlas Copco, backed by financially robust families (like the Wallenberg family), embarked on acquiring companies to grow their operations.

The 1970s witnessed the rise of a decentralized governance model influenced by Jan Wallander, the former CEO of Handelsbanken, and Hans Werthén, CEO of Electrolux. This decentralized corporate governance model was adopted widely, becoming deeply ingrained in Swedish business practices. Inspired by models like Electrolux, Atlas Copco and Bergman & Beving, companies like Indutrade emerged in 1978, founded on similar decentralized principles. The success of these ventures inspired other Swedish companies to adopt similar models, creating a model that proved to be scalable globally.

By the mid-1970s, Atlas Copco, under the leadership of Tom Wachtmeister, began to embrace the decentralized structure:

*"The role of Atlas Copco AB as a parent company of the Atlas Copco Group was more closely identified in 1976. As a result of a reorganization which was made in the course of the year, the responsibility for a number of operative functions has been transferred to other companies in the group. /.../ As a consequence of this reorganization /.../, the number of employees in group management functions has been reduced to about 200.*

*The decentralization has meant that several service functions have been moved closer to the actual users, cost accountability has been linked directly to needs, and the central corporate management has been relieved of several routine matters in order to allow more time for strategic management questions."<sup>1</sup>*

### **Organizational transformation of Electrolux**

In his book, "You Don't Sell Any Christmas Trees the Day After Christmas – A Book About Hans Werthén,"<sup>2</sup> Carl Ugglä explores the impactful tenure of Hans Werthén as CEO (1967-1974) and Chairman (1974-1991) at Electrolux. Ugglä identifies Werthén as an early advocate for decentralization towards the end of the 1960s, a significant shift from the company's previously bureaucratic and middle manager-heavy structure. Werthén fundamentally transformed Electrolux's culture by implementing a decentralized framework, wherein all operational responsibilities were delegated except for acquiring companies, making large capital expenditures (greater than USD 1 million), and purchasing properties.

When Hans joined Electrolux in 1967, one of his first actions was to sell the fancy office in central Stockholm and move to a more outskirt location, while all unnecessary staff at the time was adjusted to a minimum. Budgeting and forecasts were useless in Hans Werthén's playbook, and unnecessary internal meetings closed down. As stated in the book: "*Forecasts are only interesting when you look at them in the rearview mirror.*"

Leif Johansson, former CEO of Volvo Group, and at that time 28-year-old Head of Motorbikes at Husqvarna, in the book describes Electrolux's decentralization when he called headquarters to ask about advice about restructuring production units, he was answered, "*We have hired you with a high salary – take your own decisions!*" .

In Hans Werthén's decentralized structure, he implemented simple ways to measure profitability as profit before tax, which every manager was measured against. He also implemented the same accounting system and monthly follow-ups, which then was unusual. As we also see today, among many decentralized organizations, managers are given a lot of freedom as long as the business performance is satisfactory. The book also describes how top management thought it was "*poetry to hear the managing directors talk about return on assets.*" Words like corporate culture and delegation were never mentioned; they were embedded in the Electrolux culture.

1 - Source: Directors' Report To the Shareholders, Atlas Copco Annual Report 1976

2 - A translation from the Swedish original title "Man säljer inga julgranar på annandagen – en bok om Hans Werthén."

3 - Translated from Swedish "Här har vi anställt dig för dyra pengar. Fatta dina egna beslut!"

## A management philosophy in accordance with human nature

Dr. Jan Wallander, the long-standing CEO of Svenska Handelsbanken, stands tall among visionary business leaders, earning his place among the influential figures during his tenure at Svenska Handelsbanken. His transformative journey with Svenska Handelsbanken turned the bank into one of the globe's consistently successful banks at the end of the century and redefined the essence of effective management.

In the early 1970s, when corporate empires were built with strategic planning departments and centralized control systems, Dr. Wallander dared to be different. He orchestrated a series of groundbreaking changes, steering Handelsbanken into uncharted territory by adopting controversial measures at the bank. Facing resistance to decentralization, Dr. Wallander acknowledged the time-consuming process, taking about five years to achieve the goal of becoming a decentralized organization.

*"Bringing about decentralization is a very time-consuming process. One has to begin with oneself."*

In his book *"Decentralisation – why and how to make it work: The Handelsbanken Way"*, Jan Wallander states his management philosophy: *"Decentralization is a management philosophy that can release the full potential of the people in any corporation, because it is in accordance with human nature, not against it. People are the only sustainable competitive advantage."*

Wallander abandoned the tradition of bank management when he took over as a CEO. Annual plans and budgets were tossed aside, breaking free from the fixed performance contracts that stifled innovation. Branch employees were bestowed with independent lending authority, embracing autonomy and responsibility. Despite initial skepticism, Handelsbanken's credit risks diminished as decisions were made closer to customers, and the bank abandoned centralized risk assessments.

Dr. Wallander's mantra was clear – decentralize, empower, and trust the frontline. Headquarters' role shifted from control to being a service provider for the front line, emphasizing a customer-centric approach. The head office saw a 33% reduction in employees, challenging the perception of superiority over branch staff. Local branch offices became primary profit centers, challenging the traditional pyramid structure. The marketing department saw a drastic reduction from 40 to just one person, emphasizing efficiency over bureaucracy.

A transparent steering system ensured that every branch's performance was visible, fostering healthy competition. From an incentive point of view, Wallander introduced *"The Octagon,"* a long-term profit-sharing system that prioritized better profitability and return on capital over the company's competitors, while aligning incentives with sustainable success.

In conclusion, Dr. Jan Wallander's legacy at Handelsbanken is a testament to the enduring power of decentralized, human-centric management. By challenging the status quo, he revolutionized a bank and provided a blueprint for success that transcends time. In a world of constant change, Wallander's principles remain a guiding light for leaders seeking a path to sustainable and resilient organizations.

### **A country built upon transparency and trust**

Moreover, Sweden is home to many small and medium-sized businesses, often family-owned, making it fertile hunting grounds for acquirers and small private companies. Sweden is also known for its open society and data accessibility, contributing to high transparency. Annual reports for all companies are open to the public in Sweden, fostering trust and reliability in the companies' financials and decreasing unpleasant surprises post-acquisition.

As acquisition-driven compounders have demonstrated the practical value of their models and maintained an entrepreneurial spirit within the acquired entities, trust between sellers and buyers has flourished over the years. Today, Sweden boasts one of the highest levels of interpersonal trust globally. The country also ranks favorably on international indices measuring parameters such as ease of doing business, global innovation, perceptions of corruption, and human development.

Another crucial factor is that successful acquisition-driven strategies, with small private transactions at the heart of their strategy, have established a simple, efficient, and standardized way of conducting business, employing simplified, short, and concise deal-making and deal documentation over time.

As evidenced by the histories of Electrolux, Atlas Copco, and Svenska Handelsbanken, the decentralized approach to management has a long legacy in Sweden. Building a decentralized culture and harnessing the strong benefits of autonomy and local decision-making takes time. We believe the decentralized approach adopted by the companies we invest in represents a strong competitive advantage in a rapidly changing world.