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*Niina Nummela (toim.)*

***MANY FACES OF  
CROSS-BORDER MERGERS  
AND ACQUISITIONS***

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# PREFACE

In recent years globalisation has become one of the buzzwords that we encounter daily. The broad use of the term sometimes confuses more than clarifies what is meant by it. With a view to increasing our knowledge of the phenomenon, and of the changing business environment and particularly companies' operations in it, a research programme was established at the Turku School of Economics and Business Administration (TSEBA) in spring 2002. The aim of this programme is to review and analyse the strategic adaptation of enterprises to the global environment. It comprises three sub-projects, each of which has its own specific objectives:

- Transition in the globalising environment, particularly in the Baltic Sea region
- Adaptation to the changing environment at the company level, particularly in terms of international growth and innovation management
- Mergers and acquisitions as a response to the changing environment.

This book is an outcome of the third subproject, which is mainly focused on cross-border mergers and acquisitions. Research on this theme is very lively at TSEBA, and is spread across departmental boundaries. We could say that this multidisciplinary approach is one of our major strengths. We should also point out that research is conducted on three levels, the post-doctoral, the doctoral and the undergraduate. This highlights our potential and lays the foundation for the research path of the future, because today's high-quality Master's theses will sow the seeds of forthcoming doctoral dissertations. As evidenced in this publication, researchers on all levels have been very active in 2004. The book would not exist without their efforts, and I would like to thank everybody for their contributions.

This volume aims to address the complexity of cross-border mergers and acquisitions from various angles, starting with their antecedents and consequences. Olli-Pekka Hilmola and Tomi Solakivi analysed recent mergers and acquisitions in an industry that is globally very interesting, contract manufacturing, while Lotta Häkkinen takes another, quite novel perspective in describing the outcomes of international M&As in terms of logistics operations.

Next, the focus turns to the end of the acquisition process, in other words to the challenges of post-acquisition integration. Kaisa Aalto points out how

some of the problems could be solved through communication, and how this might, in fact, effect employee satisfaction. Niina Nummela then describes the integration process from a cultural viewpoint, and Sanna Pennanen brings out the specific features of integrating knowledge-intensive functions such as research and development. All these contributions provide valuable information on the integration process.

The book ends with a discussion of aspects related to the success of international mergers and acquisitions. It is well known that the majority of them either fail or at least do not meet the objectives set. What are the factors that would ensure their success? Crucial elements of the process are considered in these final articles. Mel  nie Raukko focuses on the importance of identifying key employees, and Erkki Vuorenmaa studies the phenomenon in the context of trust and control.

I would also like to extend my thanks to the Turku School of Economics and Business Administration and the Finnish Foundation for Economic Education for their financial support of this research programme. Additionally, our training and research secretary Auli Rahkala has again done valuable work when taking care of the editing process. We are all also indebted to the TSEBA Publications Committee for allowing our contribution to be published in the publications series of the university.

Eagerly waiting for a White Christmas, Turku, December 2004

Niina Nummela  
Editor

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# MERGERS AND ACQUISITIONS IN ELECTRONIC CONTRACT MANUFACTURING

*Tomi Solakivi & Olli-Pekka Hilmola*

## 1 Introduction

Improvement of productivity, the relation of outputs achieved with different invested input items, has been the central issue since the early days of industrial revolution. As Adam Smith argued already over 200 years ago, that dividing of the work to distinct smaller tasks, will alone result to very significant improvements in productivity. However, he did not agree at all that this would justify ever larger manufacturing companies; according to his opinion these bigger companies could not operate in efficient manner at all (Heilbroner 1961, 28-57). Thus, he was wrong. The dividing of the artisan work to smaller parts was only first step in the series of other improvements; as phases were more standardized, labour could be educated more specifically to learn some certain parts and as a result these were handled even better, more efficiently and with higher quality. As the knowledge of specialized areas increased even more, simple machines and later on automation was rather easy to be developed and implemented for different isolated phases; resulting once again to enormous improvements in productivity. As the production process was technically improved, also management innovations were used to improve performance further. Solow's (1957) seminal work in this area has indicated that nearly 90 % from our economic growth has happened due to technological change. This change is rather complicated phenomenon; combination of both soft managerial and hard technical innovations, which together establish opportunities for further improvement.

This paper examines one frequently used productivity improvement technique of strategic management, called Mergers and Acquisitions. Companies are often trying to find out better combinations between different actors to respond increased demands from shareholders; usually synergies are expected to be happen in the form of scale and scope economies. First mentioned item will mean that particular company is, e.g. interested to buy hardest rival away from the markets, and by combining these two new entities together to have steeper learning in production, more efficient distribution,

higher purchasing power towards suppliers and more stable customer base. Scope economies is in contrary used to increase the benefits through higher amount of end products; e.g. company might have a vision that future markets will combine two technologies together in their products, so they are keen to acquire company from second technology to be able to master and provide higher number of selection for their customers. However, it should be noted that scale or scope are not totally distinct items, since they are in real-life available simultaneously. For example, increasing sales and production volumes as well as offering greater selection of end products is one simplified example how to use scale and scope at the same time (e.g. Maital 1994, 122-126).

Research environment of this paper is electronic contract manufacturing, industry which started to appear in the early 1980's to aid Original Equipment Manufacturers (OEMs) to produce their products of consumer electronics. Some of the early examples from outsourcing included such products as Atari videogame as well as standardized IBM PC computer. As this PC revolution was the product of Silicon Valley, even today largest EMS companies come from U.S. After 24 years of development, this industry is nowadays estimated to have a size of \$100 billion, and contract manufacturers are taking increasingly larger responsibility from their client's products. It is not so rare to find out that some strong brand products never flow through their own company's facilities in the value adding process, since they are manufactured, assembled, tested, packaged and distributed by other parties. These other parties are also often taking part in purchasing management as well as product development activities. As contract manufacturers are operating with transaction based contract to fulfill their customer needs, economic downturns will hit their operations most significantly, since OEMs have turned their fixed costs to variable and have avoided to make larger investments. Therefore, the aim in this paper is to examine the merger wave of electronic contract manufacturing during years 2000 and 2001, in the years when current downturn was taking its steepest steps. Numerous mergers were completed in this time, and objective in this paper is to examine, if there exist any indicators which could tell, whether contract manufacturer is going to be acquirer or target. We are using detailed five year quantitative analysis for three most significant mergers happened in this industry during recession years of 2000 and 2001.



## 2 Brief Introduction to Mergers and Acquisitions

Mergers and acquisitions have been a major international business phenomenon since mid 90's and the most recent merger wave seems to continue, as companies tend to shift to compete in global scale (see e.g. Sorensen 2000; Bower 2001; Darnikoff et al 2002). This phenomenon has been around for decades (see e.g. Kitching 1967 and Searby 1969), even if the motives for it have changed during years. For example, in the 60's and 70's a typical motivation for a merger was diversification of business areas. After 90's the opposite seems to be the objective, companies are concentrating to their core competencies and then *horizontal mergers* (buying competitors) has become more popular. This keen interest towards horizontal integration is in some occasions facing troublesome situations with antitrust legislation (e.g. in the markets of USA and Europe); with some respect this development is "nothing new", since in the beginning of last century horizontal integration created so powerful companies that some restrictive actions were more than needed (Livermore 1935). Despite of the increased popularity towards horizontal integration, instead of trying to establish highly vertically integrated multi-industrial conglomerates, synergies have been expected to appear within both of these alternatives in finance, joint purchasing, distribution, marketing, administration, product development and/or production (see e.g. Best and Seger 1989, or Taqi 1991).

Despite the fact that companies are quite often using mergers to fulfil their planned strategic objectives, however, empirical studies do not give a consistent answer whether M&A have been beneficial or not (Lubatkin 1983). While some studies argue that there are many rewards from M&A, many other studies (e.g. Ravenscraft et al 1987; Lichtenberg et al 1987; Chatterjee 1992) show that these benefits are not easily realizable and most often performance before merger is better than after. Thus, we stress that merging will in some rare occasions create very successful and sustainable companies for longer term. For example, the first merger wave (1890-1905) created such well-known companies as Eastman-Kodak, Dupont, American Tobacco, General Electric and Otis Elevator (Livermore 1935).

As was already mentioned, companies emphasize to use mergers to achieve their strategic goals, such as emphasis for high presence in particular business (horizontal merger) or to establish financial hedge through totally different industries (conglomerate structure). Ravenscraft and Scherer (1987) have divided mergers into five different classes, and they use following definitions:

1. *Horizontal mergers*: The merging companies produce one or more of the same, or closely related, products in the same geographic market.

2. *Vertical mergers*: The two companies had a potential buyer-seller relationship prior to the merger.
3. *Product extension*: The acquiring and acquired companies are functionally related in production and/or distribution, but do not compete directly with each other.
4. *Market extension*: Companies manufacture same products, but sell them in different geographic markets.
5. *Other or pure conglomerate*: Companies are essentially unrelated in the products, which they produce and distribute.

Mergers in the latter three categories are all regarded as conglomerate of greater or less purity (Ravenscraft & Scherer 1987, 22-23). These five definitions also have some overlap with each other, since it might be, for example, hard to classify whether merger has been purely horizontal, product extension or market extension. And similarly Anderson et al (2001) further argue that the first four categories concern related businesses, whereas the fifth concerns unrelated businesses of financial character.

The simplest motive for a merger must be that both the buyer and the seller consider themselves to be in better situation with the transaction than without it. The situation must be evaluated from both the acquirers and the targets point of view. Especially when smaller companies are acquired, common motives on the sellers side include the will to diversify investment portfolios, increase liquidity, and to ensure that the company will have a proper chain of managerial succession. (Ravenscraft & Scherer 1987, 2-3)

The motives of the buyers side may include that the buyer is for some reason more optimistic about the prospects of target firms. Another reason might be that acquiring company believes it can run the target company more efficiently and profitably as a part of its organisation than target company could do by staying independent. A third possibility is that those in charge of the acquirer seek prestige and monetary rewards associated with managing a larger company, no matter if the merger is economically valuable. (Ravenscraft & Scherer 1987, 3)

### 3 Business Environment of Electronic Contract Manufacturing

Usually global manufacturers of consumer electronics follow the principles of focused factory, which was the main proposal for productivity improvement of Skinner during 1970's (Skinner 1974). Using the principles of this approach, low amount of manufacturing sites (quite often below 10) will take care of the

entire worldwide production each focusing to a small number of different product families. This focus will foster the local supplier network also to be developed to serve high volume challenges, and tight delivery schedules. However, as responsiveness of the supplier network as well as the focused manufacturing unit increases (which results to significantly lower inventory levels), the management of global distribution becomes quite troublesome. Most often OEMs will experience high changes of demand (including both volume and mix) in different markets due to the demand amplification effect (Lee et al 1997 & 2000), and therefore their efficiency of outbound logistics operations will suffer.

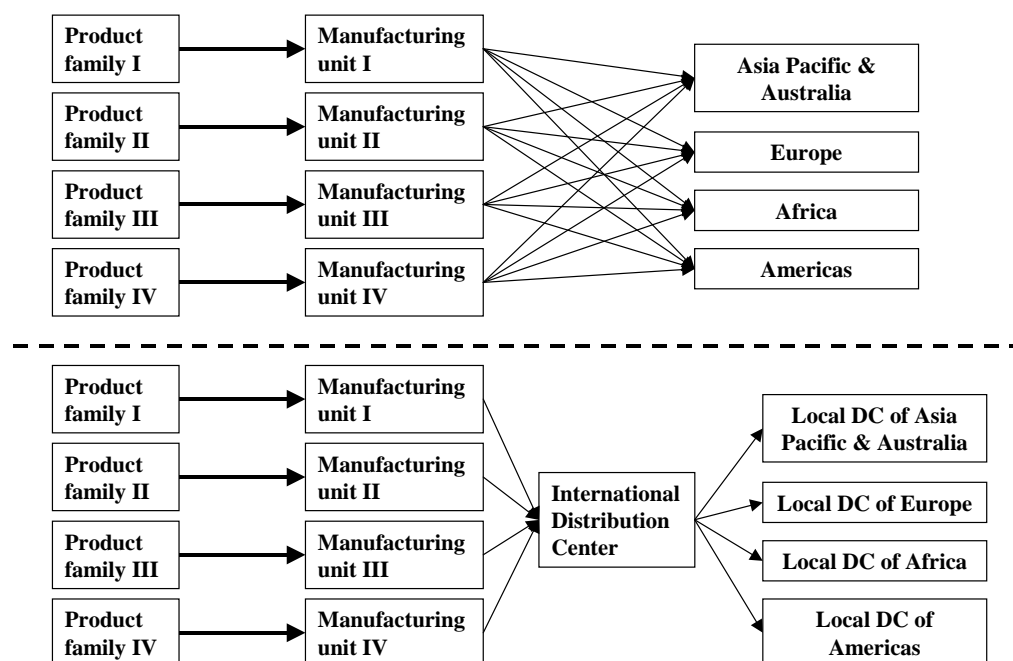


Figure 1. Four different product groups of global OEM, and using focused factory principles (please see Albino & Garavelli 1993 and Garavelli 2001 for the issues related to flexibility, source of this figure: Barros & Hilmola 2003).

Due to the challenges related to distribution, OEMs have started increasingly to favor the use of services offered by Third Party Logistics (TPL) operators. In practice third party solution will contain some kind of integrated logistics service package, which is taking care by external operator (e.g. Bowersox 1990; Laarhoven, Berglund & Peters 2000; Skjoett-Larsen 2000). Most often third parties will have joint responsibility of e.g. inventory management in distribution centers as well as all needed transportation services of distribution. Figure 1 illustrates one quite simplified solution for a global manufacturer; before OEM started to use third party logistics services it

was having most of its end-item inventory in manufacturing sites (upper part of figure), but third party was able to provide its own distribution infrastructure and resources to increase the efficiency even more (lower part of figure). With this kind of arrangement OEM could expect rapid decline in its transportation costs as well as inventory investments. This will result due to the centralization (e.g. Maister 1976; Das & Tyagi 1999) as well as the scale opportunities offered by the third party for inventory management and purchasing of transportation services. It is not so rare to find out that TPL operators will customize products (quite often OEMs are using postponement) in their local distribution centers (near to market areas), and therefore services could also include some amounts of assembly and packaging. For example, Hewlett Packard (e.g. Lee & Billington 1995; Feitzinger & Lee 1997) uses international distribution center to gather all of the end-items (like printers) from different manufacturing units to one center, which then serves needs of local distribution, and often final customization is completed locally. This will enable them to have lower inventory levels in distribution center (due to the pooled less variable demand from different regions), and final customization is then made at latest possible moment regionally. Of course these kinds of supply chain strategies will enable global companies to have local content in their products, and this might be used as marketing criteria as well.

As an OEM is using focused factory principles, its manufacturing operations could also quite easily be outsourced from contract manufacturers (more about contract manufacturing, please see Helo 2001 and Hilmola 2001). Usually OEM in the beginning establishes and owns all the facilities, inventories and needed resources (such as labour and machinery), but after completed outsourcing decision it will sell everything for a contract manufacturer. However, it is not unusual situation either that OEM will not have any manufacturing operations at all – this was the case recently with Palm; their production and purchasing decisions have been taken care by contract manufacturers from the very beginning (this has enabled them to have record high human productivity, this was nearly \$900,000 per person during year 2002). Most often outsourcing decisions are not so extreme as in Palm's case, and contract manufacturers will take care manufacturing of lower margin products in maturity phase of product life-cycle (either locally for some number of countries or having global delivery responsibility), while OEM tries to handle efficiently higher margin products as well as effectively new product introductions.

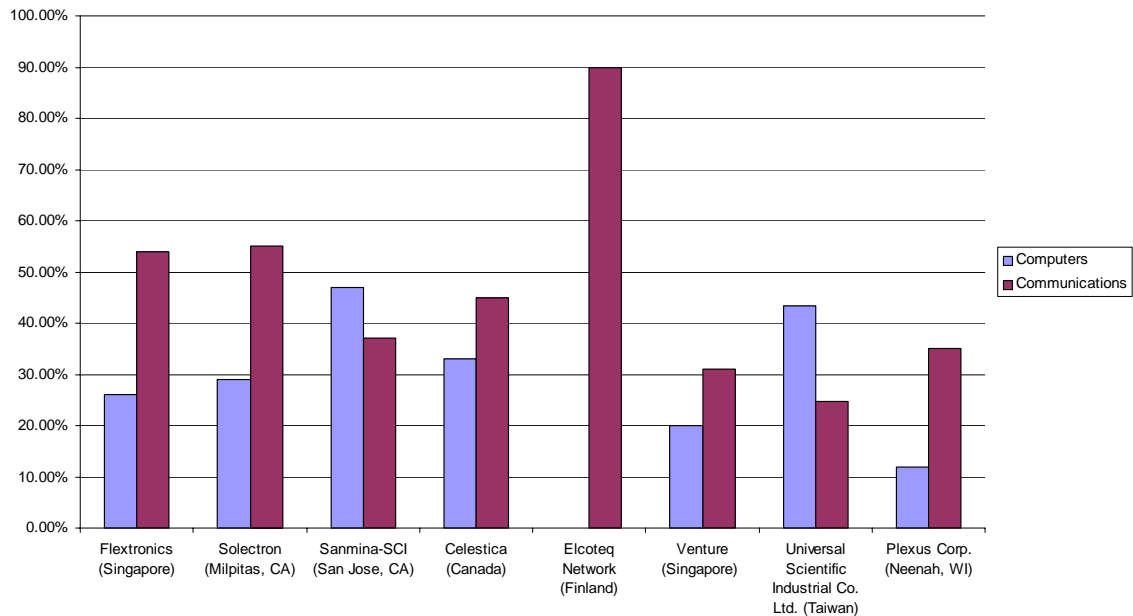


Figure 2. Eight largest contract manufacturers (year 2002) and their two most important customer sectors, computers and communications. Source: Electronic Business Magazine (2003)

Contract manufacturers are usually concentrating to either one in the following two sectors (e.g. Hilmola 2001: 93-95): (1) consumer electronics products (BtoC) or (2) industrial electronics products (BtoB). Both of these sectors have their own characteristics, but it could be concluded that consumer electronics is the primary sector of largest contract manufacturers, where industrial products are often taken care by middle sized regional companies. The largest companies in electronics contract manufacturing are serving computer manufacturers and telecommunication companies as could be noticed from Figure 2. Most often consumer products in these industries are competing in global scale with extremely tight margins, and this will mean even smaller margins for contract manufacturers. For example, contract manufacturer for cell-phone or laptop might have such a cost structure that direct materials solely account 90 percent from total costs. Quite often emphasized base of competitiveness, direct labour, is taking only tiny fraction from total costs (maybe one or two percents). Also depreciation of machinery and factories is having minor role. So, it could be concluded that contract manufacturers are generally operating in very material intensive business, and therefore the successful companies are basing their strategy to the flow materials and information, aiming to have as low working capital as possible. It should be noted that this task is not easy, since customers of contract manufacturers often require delivery time of couple of days from order, while their component and material suppliers are serving contract manufacturers

with lead time of 8 to 16 weeks. Also prices of purchases are developing quite dynamically (price erosion, meaning that prices will e.g. decline with 30 % annually), and therefore large inventory investments are undesired. Price erosion, however, creates contradictions with lead times of suppliers and requirements of own supply process (supply lead time is e.g. 8 weeks, and customer order lead time is couple of days, so safety stocks in purchasing are more than desired, but unprofitable due to price erosion).

#### 4 Analyzing three TOP10 mergers during years 2000 and 2001

In the latter part of 1990's contract manufacturers were experiencing booming demand for their services (revenue of TOP100 companies nearly doubled within one year period, from 1999 to 2000), but the global recession hit very hard this industrial sector during years 2001 and 2002 (sales of top 100 companies decreased from \$85 to below \$70 billion). During this period merger activity was rather high (please see Lane 1993 for traditional development), and in only two years (2000 and 2001) were 14 mergers completed between TOP50 companies of this industry alone (numerous smaller and middle sized contract manufacturers have been bought by larger companies in this time as well). In the following analysis we are concentrating on top three mergers of this industry, and we are completing pair-wise comparisons in their performance with respect of performance measures gained from publicly available data (such as financial statements). We are especially interested in the following analysis to find out, if there exist any common indicator for companies acting as acquirer or target. These used performance measures are further introduced in Appendix I.

As we were interested only in three top mergers of contract manufacturing, are size differences notable even among these largest companies. The primary reason for this is the general concentration trend in this industry; top three manufacturers account approximately 30 % from total sales. From analysed deals, only the first merger completed by Flextronics, could be considered as a merger of equals (Table 1). Both companies, namely Flextronics and DII Group have nearly the same total sales and the number of manufacturing facilities. However, size difference is significant, if the number of employees is used as a measure; Flextronics has its head quarters in Singapore, and notable number of factories are located in China, and therefore workforce is over three times bigger than what is the case with DII Group. The second merger between Sanmina and SCI is very untypical, since Sanmina was able to acquire over six times larger company as measured with sales. Size

differences are notable with two other dimensions as well. The third analysed merger was in contrary quite typical one; sales of acquirer (Solectron) is four times larger as compared to Natsteel. Size difference is notable also as it is measured with number of employees and facilities.

Table 1. Total sales (USD in millions, year 1999), number of employees (year 1999), number of facilities (year 1999) and deal completion date of the companies involved in three most significant contract manufacturing mergers during years 2000-2001. (Source: Electronic Business Magazine 1999)

	Sales	# of employees	# of facilities	Deal completed
Flextronics	1113.1	15000	18	20.4.2000
DII Group Inc.	925.5	4400	12	
Sanmina corp.	823.6	6000	27	6.12.2001
SCI Systems	6583.2	23530	35	
Solectron	6097.1	24857	25	5.1.2001
Natsteel	1510.0	9600	13	

The main focus in the following analysis is to compare companies in period before transaction was realized, in order to find out, if there would exist any indicators e.g. of poor performance, and thus giving a reason for a company to become a target in a merger. This hypothesis is based on the view of some previous authors of this area. For example, Ravenscraft & Scherer (1987, 56) describe the targets to be *“in general a sickly lot”*, and the central motive for the acquirer that it believes it can run the target company more efficiently as a part of its own organisation. Singh & Zollo (1998) have evaluated the issue from the viewpoint of merger success, and have come up with a result that *“the quality of the target has a negative effect on performance”* of the combined entity. In other words, the merger success is easily attainable, when the target company is performing poorly compared to the acquiring part. Lichtenberg and Siegel (1987, 647-648) have concentrated in their research on plant level productivity performance instead of whole companies, but their findings are mutual to the previous ones. They see that *“ownership change is primarily a mechanism for correcting lapses of efficiency”*.

Of course there are other opinions as well. For example, Ansoff et al (1971, 67) state that in fact the acquiring companies are the ones to have poor performance level, and the acquisitions is in fact the only way for them to survive. This finding might be applicable for a situation, where larger company is losing its market share rapidly, and it tries to buy its customer relationships and markets back with hostile, expensive and in rather short-term completed transactions.

*Flextronics International – DII Group, Inc.*

Flextronics international merger with DII Group, Inc (the deal was signed 20.4.2000) was a deal where Flextronics International, the sixth largest contract manufacturer in the world (year 1999), acquired seventh largest contract manufacturer (year 1999), the DII Group Inc.

Total productivity developments of these two companies seem to be compliment with each other (please see Figure 3): Whereas Flextronics has managed to improve its level of total productivity during every year of the period, the total productivity level of DII group has been bouncing back and forth. DII Group has had a total productivity value some 0.08 higher than Flextronics, and has stayed ahead for the first three years of the period, before dropping behind. There is a little fallacy in the data source, and therefore total productivity value of the DII group from the year 1999 is missing.

The total productivity-break even point comparison follows the trend of the total productivity. The acquired company, the DII Group has had a better performance in the beginning of the period in this analysis as well. The company has been on the profit zone or above the break-even point for the whole period, but as was the case in total productivity, the same up and down movement bothers the company in this respect as well. In 1998, the last year of available data for the company, the direction was once again down. At the same time, the acquiring company has first started from the loss zone, but then managed to climb from the loss zone to the profit zone and also managed to keep the improving pace for the rest of the period.

Return on investment development has two trends, the upward trend of Flextronics, and the downward trend of DII Group. The return on investment of Flextronics has had a rapid positive development for the first four years of the follow-up period, beginning with a negative value of -4.3% in 1995 and rising as high as +7.1% in 1998. DII Group has first been able to raise its level of ROI from 9.8 % (1995) to 10.9 % (1996), but since then trend has been downward and with an accelerated pace. ROI value of target company has fallen to 7.7 %; value from 1999 is missing, so any comparison for this particular year is impossible. The development of the ROI value of Flextronics has also turned downwards between 1998 and 1999, which has indeed been a trend for the whole industry at this time.

Labour productivity (thousands dollars per person) measure of these two companies ends up to similar kind of pattern as which was identified in two previous measures. The acquiring company (Flextronics) is constantly improving, while target (DII Group) company is experiencing difficulties in the end of observation period. However, according to Figure 3, there does not exist clear answer, which one of these companies is in the end better. As could



be noted, target company had somewhat higher performance during years 1996-1998, but since data for year 1999 is missing, the superior performance of acquirer could not be compared.

Development of inventory turns of these two companies seems to be quite different. Inventory turns of DII Group has had a steady, positive development during the first four years of the follow-up period, rising from six in the beginning of the period to as high as 11 in 1998. At the same time the inventory turns value of Flextronics, the development has been highly varying. In some years there has been some positive development and in some years the company has suffered some setbacks. In 1998 the inventory turns value of Flextronics is on almost same level as four years before, nearly eight. Only one year after (in 1999) the value has in fact diminished significantly to slightly above four (interestingly having some kind of tradeoff with labour productivity). Unfortunately, the value of the DII group from that year is missing, so there is no point in guessing, what kind of differences there would have been in 1999.

The most significant differences between these companies could be found from market capitalization, total assets and net sales. As could be noticed, acquirer (Flextronics) has been able to grow with respect of these measures within very impressive way (facing exponential growth), while target (DII Group) has only been growing rather slowly and in very predictable manner.

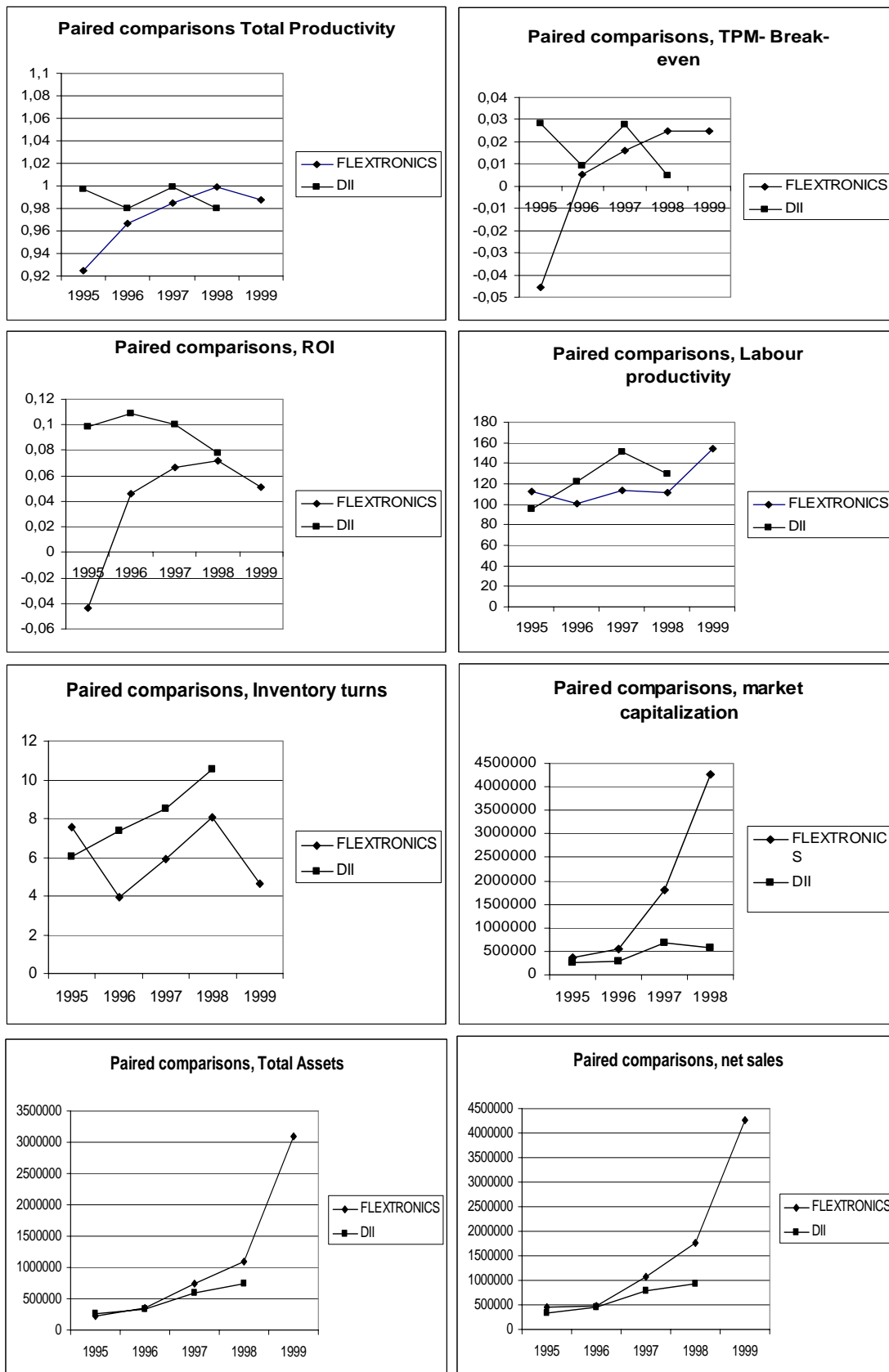


Figure 3. Paired comparison of Flextronics International and DII Group.

#### 4.1 Sanmina Corporation – SCI Systems, Inc

Sanmina Corporation merger with SCI Systems (6.12.2001) has been the largest deal, which this industry has so far experienced. In this merger, 10<sup>th</sup> largest (year 1999) contract manufacturer acquired the number 1 (year 1999) company in the whole industry (as measured with net sales).

The figures of this pair are quite the opposite from previous. Total productivity of acquiring company (Sanmina) has been higher than the target company (SCI Systems) for the whole observation period (Figure 4). The development of the total productivity values is also very interesting. The value of the acquiring company has had a downward trend for the whole period, whereas the target company has managed to maintain its level. Another difference between these two companies is that Sanmina Corporation has started with a much higher level of total productivity. One question arises from these results: What if the follow-up period would have continued longer? The drop in the total productivity of Sanmina has been so rapid throughout the whole period that the shape of the curve would indicate some difficulties to maintain the level of performance.

TPM break-even residual curves follow the trends of total productivity. Opposite from the previous pair both of the companies of this pair have been in the profit zone or above the break-even point for the whole period. The target company (SCI Systems) has had a steady development in the profit zone and it has been able to improve its performance every year. The acquiring company (Sanmina) on the other hand has suffered from a downward trend during the whole period. One has to remember, though that the starting level of the Sanmina Corporation has been so high (e.g. if compared to other companies) that despite of the continuous fall, it is still far above SCI Systems level.

Return on investment of acquiring company (Sanmina) has been higher than the target company (SCI Systems) during the whole observation period. ROI values of Sanmina have had a positive development for the most of the period, rising from 14.3 % (1995) to as high as 23.9% (1998). What seems to be a trend for all the companies of this paper, ROI development of Sanmina has also suffered a setback during last year, when performance has dropped almost ten percentage points to 14.4 %. ROI development of the target company (SCI systems) has been more modest, beginning with a ROI of 9.3 % (1995), rising to as high as 13.2 % and then lowering back to 10.1 %.

Labour productivity level of target company (SCI Systems) has developed in a similar way as was the case with labour productivity of previous target (DII Group). Performance has been rising in the beginning of the period, and then turned downwards closer to the end of the period. Labour productivity of

the acquiring company has developed differently; it has been much steadier, without a any peak in the end of the period.

Shapes and sequence of the curves are the only things in common between these two pairs of companies. As can be seen from Figures 3 and 4, labour productivity levels of the previous pair were between 96 and 155, whereas the same figures for this pair are between 162 and 339. This is a good example how the values vary between different companies, maybe indicating rather different product mix (less variations, and therefore higher volume and higher productivity).

Inventory turns of these two companies follow the shape of the labour productivity curves. Target company (SCI Systems) has a higher value throughout the observation period. The shape of the curve is similar to productivity curves; rapid progress and higher values in the beginning of the period from slightly below six (1995) to as high as ten (1998), and then slight movement downward to nine. The value of the acquiring company (Sanmina Corporation) has behaved just the oppositely: Only very marginal movement downwards between first three years, and then having rapid progress to nearly eight, and in the end facing major setback to four.

As was the case in previous comparison, the most interesting development could be found from three aggregate measures of company size. Interestingly, both of the companies are equally valued with respect of markets, but acquirer has significantly lower net sales as well as total assets. This only highlights how important shareholder value is for these companies – constantly meeting as well as beating market expectations will enable smaller companies to have high market value, due to greater future business expectations.

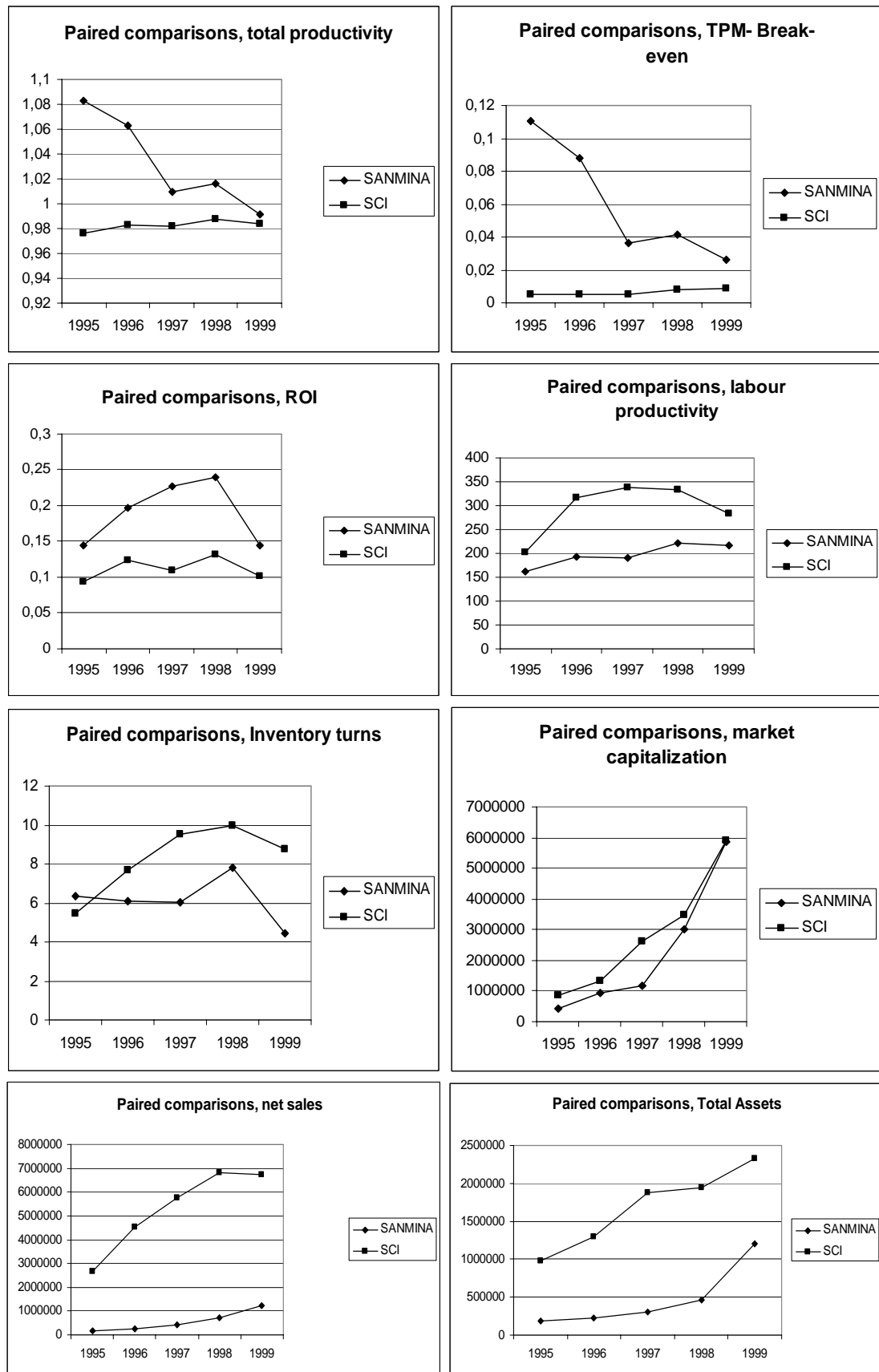


Figure 4. Paired comparison of Sanmina Corporation and SCI Systems, Inc

## 4.2 Soletron Corporation – Natsteel Electronics

Soletron Corporation and Natsteel Electronics deal (5.1.2001) is the third merger of taking place between TOP10 companies during years 2000 and 2001. Acquirer is number two in contract manufacturing list (Soletron Corporation, year 1999), and the target is fourth largest (Natsteel Electronics, year 1999).

Analyzing these two companies is a bit different than the previous two pairs, because the database used didn't contain any data of Natsteel Electronics before 1997. It is therefore quite obvious, that the comparisons are possible only from the year 1997 onward.

Total productivity values of these two companies are having by far the most steadily developed of this analysis (Figure 5). Total productivity of the acquirer (Soletron) has been varying a bit under 1.00 for the whole observation period, the lowest value being 0.988 (1998) and the highest being 0.994 (1997). As mentioned before, data for Natsteel Electronics is available only from 1997 onwards, when Total Productivity value was 0.988. Thereafter total productivity has only very marginally increased. It would most certainly have been interesting to continue analysis a bit further to see, if the development of total productivity would have continued to be as steady and predictable as it was in this observation period. Rather interesting point is that this is the only pair from these three, where total productivity value in the end observation period has been higher in target company.

The curves describing ROI level tell that these two companies follow rather smoothly the shape of industry in total. The only exception is that in the beginning of the period, most of the other companies have had an upward sloping curve, whereas the Soletron's curve first lowers from 13% to 12 %, before taking a leap upward. In the end of the period, ROI (both companies) begins to have some slide downwards; just like as the other analysed companies.

Used database didn't contain any information about the number of employees of Natsteel electronics. Due this lack of information, labour productivity values of this respective company were impossible to have, and thus no comparison with these two companies can be made. However, labour productivity values of the acquiring company, (Soletron) have had a firm, upward trend during the whole observation period, beginning with a value of 187 (1995) and ending to 267 (1999). This reminds quite much of the development of Flextronics during the last year, when labour productivity improvements in this industry were quite rare.

Inventory turns of these two companies follow quite similar pattern with two previously analyzed pairs. Natsteel electronics (target) has had a steady,

upward sloping trend for the whole period beginning with slightly below seven in 1997 and ending up to nearly nine in 1999. At the same time, Solec-tron has first had a little rise between 1995 and 1996, then suffered from some downward movement between 1996 and 1998, but in the end of the period managed to rise its level of inventory turns to seven. When comparing the progress of these two companies with each other, acquiring company (Solec-tron) has experienced somewhat lower performance than target (Natsteel) in observed three years. This was the case in the two other pairs as well.

Three remaining measures related to size were once again showing rather interesting results; Solec-tron has been able to show similar exponential growth, which was found in the case of Flextronics also. At this time too, difference especially in market valuation has been visible between acquirer and target, and one has to remind that target company has not been poor performer either. Natsteel Electronics has been growing like DII Group earlier, linear growth in all respects without visible surprises.

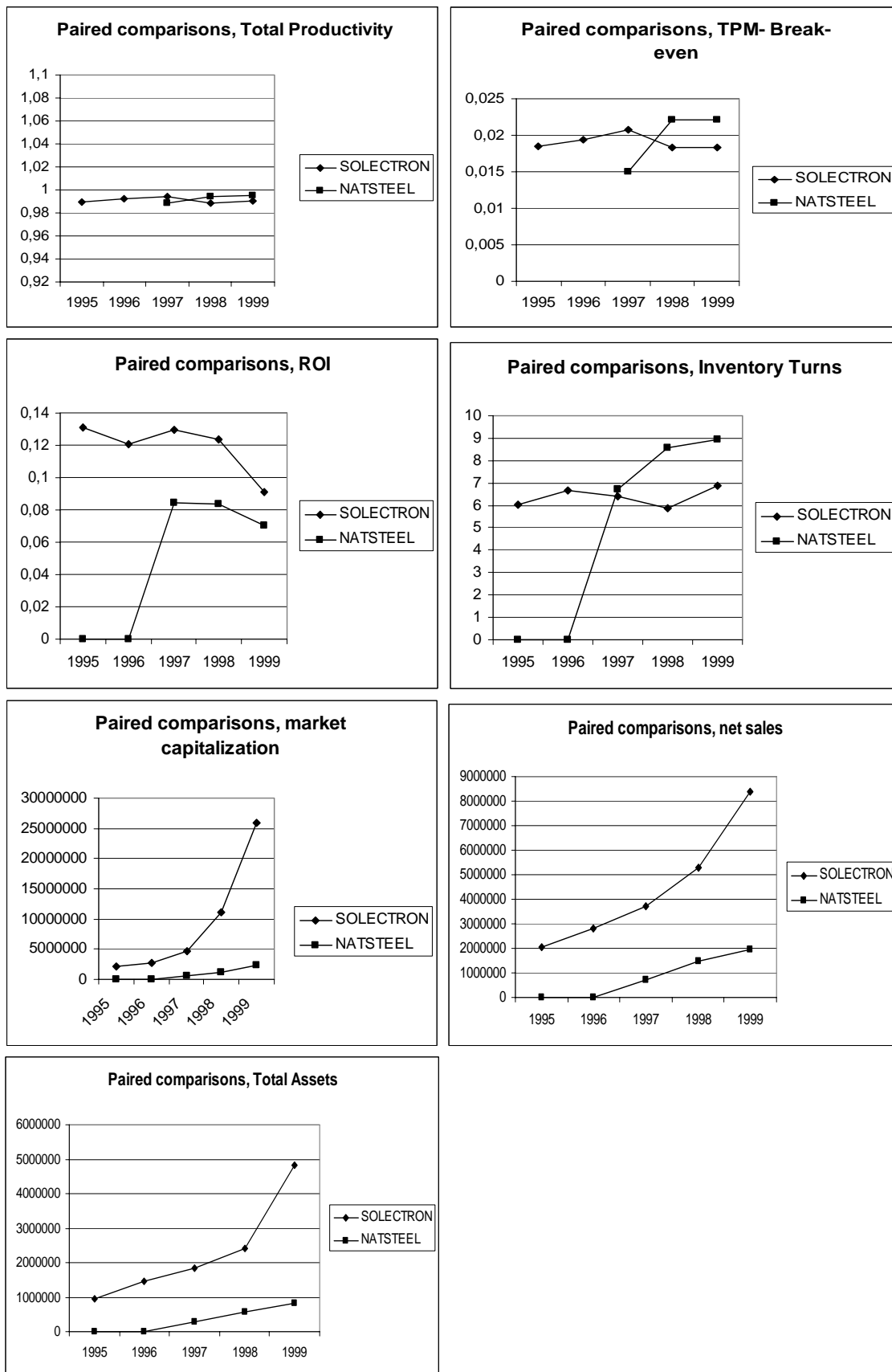


Figure 5. Paired comparison Sollectron Corporation- Natsteel Electronics.



## 5 Conclusions

The objective of this study was to examine mergers of the largest electronic contract manufacturers (TOP10) in order to find out, if there would exist factor(s) that would indicate whether a company would become a target in an acquisition. The main hypothesis was that companies that have become acquired would have performed poorly before the acquisition when compared with the acquiring part. (Ravenscraft & Scherer 1987; Singh & Zollo 1998; Lichtenberg & Siegel 1987).

The paired comparisons seem to support the hypothesis as well. On two cases out of three, acquirer was in fact been performing better than target. The Flextronics-DII Group merger, and especially the Sanmina-SCI Systems merger show higher values of total productivity and 'total productivity less break-even point' values for the acquiring part of the merger. Similar development could be found from ROI measure; both Sanmina and Soletron acting as acquirers have been showing better performance than target companies. Total assets, net sales, and especially market capitalization would seem to follow the same trend. The Sanmina-SCI merger is the most extreme case, where the target company (SCI Systems) is almost seven times as big, when compared with net sales, but the Sanmina Corporation is still just as big, when market values are considered. We could therefore conclude that the most probable enabling factor to complete mergers currently is the valuation of company in stock markets; at the moment most of the transactions are completed with exchange of stocks (e.g. Rappaport & Sirower 1998) between acquirer and target, and therefore higher valuation in markets will mean higher purchasing power.

Unlike all of the efficiency theories and the importance of inventory management, especially in manufacturing industry, we could argue according to completed analysis, that quite often these measures are having higher values in target companies rather than in acquirer's side. Of course this could be assumed to happen, if acquirer is facing exponential growth in its net sales and/or total assets. The generalization of this finding to any other industry is facing troubles, since electronic contract manufacturing has experienced its highest historical growth phase during the observation period.

The future growth of electronic contract manufacturing seems to be the main question, if we speculate whether this merger wave is going to continue or not. Is this three decades old industry going to face another rapid growth phase, when the world economy starts to recover from current downturn? Or has this industry reached its optimal size? A key variable in the future is so-called product architecture used by OEMs (Utterback 1995), and the production strategies directly related to it. These strategies in near future will

most likely aim at combining the cost efficiency of mass production and the higher profitability of customized products. To combine these positive effects, the products will be designed so, that the manufacturing process of the products will be kept as similar as possible, as long as possible, and the modification will be done in the last phases of the production. (Ptak & Schragenheim 2000, 77-79) For example, in the mobile phone industry, the objective is to use the same technical platform in different products and to modify them for example with different software code and cover. Now, the assembly of the platform will most likely be done in specialized production lines operated by the electronic contract manufacturers in the future as well, but who will do the rest? It doesn't take highly specialized production line to program the phones or to put the battery and the cover to the place. Will the electronic contract manufacturers perform these last phases of production or will someone else do? In other words, will someone else, like third party logistics operators take the revenue share of these phases, thus declining the growth of the industry itself? In some of the most developed cases answer to this question has already been gained; third party logistics operators are able to offer attractive packages for OEMs, and therefore final customisation is in some cases completed by them. Therefore, contract manufacturers are trying to find out their place in the value chain by establishing product development services for OEMs, but gaining growth from here would not be easy either. At the moment there exist numerous Original Design Manufacturers (especially in laptop industry of Taiwan), who will with agreed contract complete the whole product development (including proto and 0-series production) for OEMs. Some of the biggest contract manufacturers have solved this problem of product development expertise with acquiring ODMs, and one of the most recent example could be taken from Finland, where Flextronics bought operations of Microcell (ODM for mobile phones) with \$200 million (direct cash \$80 million and liabilities to Flextronics with \$120 million; Flextronics 2003). It is rather interesting to note that during financial year 2001 Microcell was having as a net sales 17.4 million euros, net profit of 1.6 million euros and total assets of 41.6 million euros (Voitto 2003).

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## Appendix I

Used performance indicators in three pair comparisons are presented in more detailed level in the following:

1. Total productivity development (e.g. Sumanth 1998; Hilmola 2001),  
Total productivity is the ratio of all the output and input. In other words all the tangible output of the company divided by all tangible input of the company. In this analysis the Total Productivity value is calculated by using a modified formula.

$$\text{Total Productivity} = \frac{\text{Total Output}}{\text{Total Input}}$$

, where

Total Output = Net Sales or Revenues+ Non- Operating Interest Income+ Income Tax Credits+ Minority Interest+ Extraordinary Credit

Total Input = Cost of Goods Sold+ Depreciation, Depletion & Amortization+ Selling, General & Administrative Expenses+ Other Operating Expenses+ Extraordinary Charge+ Interest Expenses on Debt+ Interest Capitalized+ Income Taxes+ Current Domestic Income Tax+ Current Foreign Income Tax+ Deferred Domestic Income Tax+ Deferred Foreign Income Tax+ Discontinued Operations+ Extraordinary Items & Gain/ Loss Sale of Assets + Working Capital (Total Inventories+ Receivables  $\times$  Prime lending rate+ 2%) (Federal Reserve, 2003)

2. Total Productivity break-even point of Total Productivity (e.g. Sumant 1998): As could be noticed from total productivity equation, for input items is taken account as well working capital from balance sheet. So, in order to tell whether company is profitable with its total productivity level, we need to deduct working capital input factor from input items. As in the following equation is shown, residual value of total productivity break-even is calculated in following manner:

$$\text{Residual value of total productivity} = TP_t - TP_t(BEP)$$

, where

$TP_t$  = Total Productivity performance in period t

$TP_t$  (BEP) = Break-even point of total productivity in period t (1 – (working capital input)/total inputs used)

3. ROI, return on investment,

$$\frac{\text{Operating Income}}{\text{Total Assets}}$$

4. Inventory turns,

$$\frac{\text{Cost Of Goods Sold}}{\text{Total Inventories}}$$

5. Labour productivity development: As the Total Productivity, also the labour productivity has to be calculated by using a modified type of calculation. The labour productivity in this analysis is calculated by using a following formula.

$$\frac{\text{Net Sales Or Revenues}}{\text{Average Amount Of Personnel Each Year}}$$

6. Some other figures to measure the relative size of the companies such as market capitalization, in other words the value of the company in the stock- market at the end of each year of the follow- up period, net sales or turnover of the company, and total assets.





# **IMPACTS OF INTERNATIONAL MERGERS AND ACQUISITIONS ON THE LOGISTICS OPERATIONS OF COMPANIES**

*Lotta Häkkinen*

## **1 Introduction**

During the past decade, several industries have been reshaped as a result of technological and social developments, which have led to high interconnectedness of organisational systems and people. The trends of globalisation, market liberalisation and technologic development have forced companies to re-examine their operations in order to answer to these challenges and growing customer expectations. These new challenges and opportunities have triggered a wave of mergers and acquisitions within a number of industries as companies have sought efficient ways to enhance their business capabilities and to restructure themselves to better adapt to the new business environment.

Although M&A activity, as its research, is by no means a new phenomenon, the phenomenon itself has evolved since the first merger wave, which took place in U.S. during the late 19<sup>th</sup> century. Changes in the business environment and the M&A motives have also changed the requirements for company management to successfully carry out the merger process (Jansen 2002, 1-2). Additionally, the latest merger wave affected European companies much more profoundly than previous ones, which mainly took place within the U.S. (Chapman & Edmond 2000, 753; Garette & Dussauge 2000, 63). Also the share of cross-border M&A has increased substantially reaching 40 % of the total number of transactions worldwide in 2000 (World Investment Report 2001; Jansen 2002, 2-3). This international aspect raises yet new issues for company management to consider.

Despite the increased interest towards M&A also from a scholarly perspective, several research gaps still exist within the research field. Studies are fragmented by nature and often lack a holistic view of the implications of mergers and acquisitions (Larsson & Finkelstein 1999). For example, M&A related synergies and value creation are a much-discussed topic in this field, yet inconclusiveness and general ambiguity often plague research results.

Another overlooked research topic has been the impact of M&A on the logistics operations of companies and related value creation (see Häkkinen 2003, 50; Norrman, Häkkinen, Ojala & Hilmola 2004, 6-11). However, these issues would seem to be central when pursuing contemporary M&A objectives related to increasing market coverage or enhancing the product portfolio. The motivation for conducting this particular study has been to start filling this research gap.

The purpose of this paper is to illustrate the role of logistics resources and capabilities in M&A situations by describing M&A induced changes in the logistics operations of manufacturing companies and to explore the linkage of these actions on value creation. The paper reports on an explorative multiple case study covering six cross-border M&A deals carried out by Finnish manufacturing companies during 1998-2001<sup>1</sup>. The study focuses specifically on horizontal M&A, which involve companies that operate in the same industry and industry level. This M&A type is considered to be the most interesting when focusing on the change aspect from a logistics perspective, as these deals are the most likely to involve the restructuring of logistics resources due to overlapping operations as well as related capability transfer.

## 2 Strategic management literature on M&A

### 2.1 Relation to other streams of M&A research

Due to the ever-growing amount of scientific studies linked to M&A research, scholars have been eager to develop various categorisations to divide research into different streams. This paper focuses on the strategic management stream, which is central when discussing M&A related value creation. This stream has its theoretical background primarily in industrial organisation economics, but recently also resource-based theories have gained ground in this stream (Birkinshaw, Bresman & Håkanson 2000, 397-398). The strategic management stream adopts the perspective of an individual company and discusses the motives for different types of mergers and the effects of M&A on company performance (Larsson & Finkelstein 1999, 2).

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<sup>1</sup> In this study, mergers and acquisitions are referred to as a single business phenomenon as is done frequently within this field despite the slight differences between these two concepts (see e.g. Parvinen 2003, 2-5).

In addition to the strategic management stream of M&A research, at least three others can be identified. The economic stream focuses on the impact of acquisitions based on financial and organisational economic theories. The central research issue is the assessment of M&A activity on the overall economy, a specific industry or on the value creation for company shareholders. (Birkinshaw et al 2000, 397; Baroncelli 1998, 378) The organisational stream studies the M&A integration process on an organisational or individual level. Central topics include organisational fit, cultural clashes and employee resistance (Larsson & Finkelstein 1999, 2; Vaara 1999, 10). As traditional economic, strategic and organisational perspectives haven't been able to explain the large percentage of M&A failures, scholars have started to focus on the impact of post-merger management on M&A performance. This so-called process perspective is in itself also fairly diverse, but has a more applied approach from a managerial perspective (e.g. Jemison & Sitkin 1986).

However, this interest towards post-merger actions cannot be seen as being limited to the process perspective as ideas have diffused also to the other streams. For example, though the primary focus of this study is strategic, post-merger implications are by no means excluded. Therefore the presented streams should not be understood as exclusive, and in practice researchers often combine perspectives from several different streams (e.g. Larsson & Finkelstein 1999).

## 2.2 M&A typologies and strategic fit

Several different typologies have been created over time to categorise M&A<sup>2</sup>. A conventional classification divides M&A into three categories: horizontal, vertical, and diversified or conglomerate deals (e.g. Hodge & Anthony 1988). In horizontal M&A both companies operate in the same sector and level of business<sup>3</sup>. Vertical M&A in turn are defined as deals between firms in buyer-seller, client-supplier and other vertical supply chain linkages. Conglomerate deals involve companies from unrelated businesses.

Basically the main criterion for all typologies is the companies' prior business relationship, which sets certain expectations and boundaries for the

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<sup>2</sup> For a more detailed discussion on M&A typologies see e.g. Larsson (1989, 204-213).

<sup>3</sup> Some classifications require that the companies should be in direct competition with each other, whilst others are not so strict on this condition. Here this restriction is not seen necessary as long as both companies operated under the same SIC code.

type and magnitude of benefits that can be realised from the deal. A central concept for determining this relationship is strategic fit. Strategic fit has traditionally meant the relatedness of the products and markets of the merging companies (e.g. Salter & Weinhold 1979). Figure 1 illustrates the different dimensions of strategic fit through a framework based originally on an M&A classification made by Salter and Weinhold (1979).

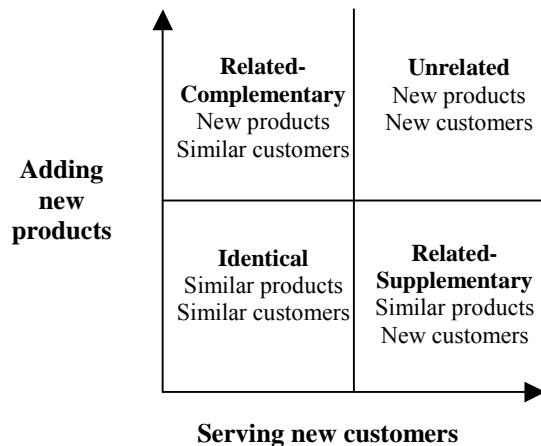


Figure 1. Strategic fits between target and bidder firms (Shelton 1988, 280)

A pure supplementary fit provides access to new markets and customers, which would intuitively seem to be an important objective for international M&A. However, the customer dimension is by no means limited to geographical market segments, and it should also be noted that cross-border M&A can have a variety of motives and fits driving the deal (e.g. Hopkins 1999, 216-220). Complementary targets in turn provide new products, assets or skills for product markets currently served by the acquirer. This can involve the combination of complementary technology, production assets and skills, or distribution channels. By providing improved customer service with new products or improved technology in some segments the companies can potentially create value, typically however most of the assets continue to be used as they were previously. (Shelton 1988) An identical fit provides the most potential for benefiting from economies of scale and from the increase in market power (Seth, Song & Pettit 2002).

According to Shelton (1988, 280-281) a purely related-complementary fit would suggest vertical integration, whereas related-supplementary fit (in addition to identical fit) would point to horizontal integration. However, this largely depends on how the product and customer markets are actually related. This study concentrates on horizontal deals where the strategic fit is primarily identical, complementary or supplementary. Horizontal deals may involve

unrelated features, but a purely unrelated fit would be classified as a conglomerate deal.

### 2.3 M&A and value creation

On a broad level, horizontal M&A can be explained through two main classes of theories: 1) value-maximizing theories, and 2) managerial theories (Capron 1999, see also Seth et al 2002). Value-maximising theories (also referred to as the synergy hypothesis) assume that managers make M&A decisions with the objective of creating economic value. Managerial theories (also called the managerialism motive, conflict-of-interest hypothesis and agency hypothesis) on the other hand suggest that managers embark on M&A to maximise their own benefit at the expense of other stakeholders. In their study, Seth, Song & Pettit (2000) found the synergy hypothesis to be the primary explanation for value-increasing M&A, while value-reducing M&A appear to be driven by managerialism.

This study focuses on the first perspective, which is naturally of more relevance when examining M&A related value creation. In the context of M&A, value creation is understood as a long-term phenomenon that results from managerial actions and interaction between the merging firms. Value creation differs from value capture, which involves shifting value from previous stakeholders to new stakeholders of the acquiring firm and is a one-time event. (Haspeslagh & Jemison 1991)

Previous studies have identified a number of potential sources of value creation in M&A situations (see e.g. Seth 1990). Capron (1999, 988-990) has studied horizontal M&A in particular and divides possible sources of synergy into two groups based on the underlying theoretical perspective, namely:

- Cost-based synergies (derived from economies of scale and scope; cost efficiency theories, economics)
- Revenue-based synergies (derived from resource redeployment; resource-based theory)

Synergies of the first type of are easier to measure and the level of certainty that they will be achieved is supposed to be quite high<sup>4</sup>. They result from eliminating facilities and related costs, an increase in market power and economies of scale and scope. The potential for these synergies is especially

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<sup>4</sup> Contradictory findings have also been reported by e.g. Harrison, Hitt, Hoskisson & Ireland (1991) and Larsson & Finkelstein (1999)

high in domestic horizontal acquisitions. (Seth et al 2002) The second type of synergies emphasises the possibility for the acquirer and the target to achieve a higher level of sales growth together than either company on its own by combining their resources. These synergies are harder to estimate because they involve external variables such as customer reactions. Such synergies can potentially be realised, e.g. when a superior product of the target is combined with the more extensive distribution channel of the acquirer. (Eccles, Lanes & Wilson 1999, 141-142) This kind of resources transfer is an important source of synergy especially in cross-border M&A (Seth et al 2002).

Assessing these synergies and measuring overall M&A performance is then another matter. Studies adopting a strategic perspective on M&A performance have reported a mixed outcome on the long-term effects of M&A and have failed to find consistent evidence of improved performance in post-merger situations (Kaplan 2000, 3). These studies typically use e.g. accounting-based measures, market share figures, and various self-reported measures to evaluate M&A performance. The variation of findings can partly be explained through the fact that existing academic work has mainly been based on large sample studies, which focus a small number of specific measures. For example, Kaplan (2000) argues that large sample studies cannot possibly capture the richness of different effects in M&A situations. The key to understanding M&A and reaching relevant results would thus be to pursue case studies, where contextual understanding plays an important role and a number of different measurements can be used.

Another reason for the inconclusiveness of research results may be that contemporary studies have used measures, which are no as longer as relevant as they have been for former merger waves. Traditionally M&A research has emphasised market power and scale efficiencies as incentives for horizontal M&A, which are the most relevant explanatory factors in stable industries. However, modern businesses operate in a dynamic environment of frequent technical innovation, regulatory changes and globalisation. Sustaining market power or gained scale efficiencies for long periods in such conditions may be impossible and researchers have argued that companies increasingly use M&A to restructure their businesses as a response to environmental change rather than to reap scale benefits. (Capron, Dussauge & Mitchell. 1998; Seth 1990) This approach builds on the ideas of the resource-based view, and is of special interest to this study. These issues will be discussed further in Chapter 3.

### 3 Resource-based view on M&A

#### 3.1 The resource-based view of the firm

This study focuses on one specific strand of contemporary strategic management literature, which is often referred to as the resource-based, capabilities-based or competence-based view. This view emphasises firm-specific capabilities and assets, and the existence of isolating mechanism as the determinants of firm performance (see e.g. Penrose 1959; Wernerfelt 1984; Prahalad & Hamel 1990; Teece, Pisano & Shuen 1997; Capron 1999; Seth et al 2002). Resource-based theories form a diverse variety of approaches, which can be grouped under this heading. The outlines of this general approach are visible, but there is not yet a consensus over the used terminology and key concepts<sup>5</sup>. This lack of uniform definitions has lead to an ever-increasing amount of new definitions and over-lapping concepts.

In this paper the used key concepts are resources and capabilities, which are defined as follows. A resource is an observable (but not necessarily tangible) asset that can be valued and traded (e.g. a brand, patent or license). A capability is not observable (thus also intangible), cannot be valued per se and can change ownership only as part of its entire unit (e.g. a certain management or logistics system which is embodied in the continuous enactment of people and practices). Furthermore, a capability can be valuable on its own or increase the value of a resource (e.g. the linkage between marketing capabilities and brand value). (Makadok 2001) In other words, resources are company-controlled assets, which are either tangible or intangible. Capabilities refer to the company's ability to perform a set of coordinated activities to achieve a certain result using the available resources.<sup>6</sup> (Helfat & Peteraf 2003, 999)

Both concepts are used to explain the same phenomenon, i.e. competitive heterogeneity. Ultimately, both resources and capabilities are potential sources of competitive advantage and can be seen as having also similar qualities. Thus, scholars have also considered resources and capabilities literature to be as one and the same (e.g. Hoopes, Madsen & Walker 2003). To be a source of sustained competitive advantage, both resources and capabilities must have to same attributes, i.e. they must be valuable, rare, and isolated from imitation or

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<sup>5</sup> This is noted by e.g. Hodgson (1998) who discusses the development of competence-based theories and their relation to contraction theories. See also Foss (1999).

<sup>6</sup> The definition of 'capabilities' given here is similar to the definition of 'processes' used by other authors (e.g. Bower 2001), which is a good example of the lack of joint definitions in this field.

substitution. A valuable resource (or capability) enables a firm to improve its market position relative to its competitors, i.e. is a source of competitive advantage. To sustain this competitive advantage, this resource must be in short supply relative to demand (i.e. rare), and costly to imitate or directly replicate. (Hoopes et al 2003, 890)

Competition and other environmental changes naturally erode the competitive advantage of companies over time. Thus the only real distinctive competence necessary is the ability of an organisation to form new capabilities and to renew them (Hamel & Prahalad 1989). Several concepts have been developed to stress this dynamic viewpoint of resource-based theory and to analyse change in firm capabilities, e.g. dynamic capabilities (e.g. Teece et al 1997) and capability lifecycles (Helfat & Peteraf 2003).

In the context of M&A, the discussion on resources and capabilities can have at least two kinds of implications. First, M&A can be used to respond to changes in the firm's external environment by acquiring valuable resources and transferring capabilities from other firms to sustain or renew the sources of competitive advantage. Second, this strategy may not solely be sufficient to support significant competitive advantage. For example, winners in high-technology industries have demonstrated timely responsiveness and rapid and flexible product innovation coupled with the capability to effectively coordinate and redeploy external resources and capabilities. Others have accumulated a large stock of valuable technology assets and still don't have many useful capabilities. This specific capability of being able to achieve new forms of competitive advantage is referred to as a dynamic capability (Teece et al 1997, 515). Post-merger integration can also be seen as a dynamic capability, which is composed of a set of routines that integrate the resources and capabilities of the merged firms (see e.g. Zollo & Leshchinskii 2000).

### 3.2 Strategic fit of resources and capabilities

Each of the four strategic fits presented in Figure 1 represents a different type of resource and capability combination, and thus also the opportunities for value creation are different in each type. The traditional view emphasises market power and scale efficiencies as incentives for horizontal M&A, in which identical resources play a key role. However, more recently empirical studies have given indications that the integration of complementary and supplementary resources holds greater synergy potential than the integration of identical resources does (e.g. Harrison et al 1991). This finding is explained through the logic that M&A will result in above average returns only when private or uniquely valuable synergistic assets are involved. These kinds of



assets exist when either other potential acquirers do not have adequate information about the combination, or no other combination of firms could produce the same value. (Barney 1988)

From a resource-based viewpoint, M&A that combine complementary resources provide potential to create competitive advantages by combining acquired resources with existing ones to create a unique and difficult-to-imitate resource bundle. This kind of competitive advantage can be sustained for a relatively long period of time, thus leading to higher long-term company performance. Highly similar resources are generally easy for the whole market to detect whereas complementary resources provide synergistic opportunities, which are often not so obvious (Harrison, Hitt, Hoskisson & Ireland 2001). Also, the integration of highly similar resources may only provide short-term benefits and the integration process may result in severe employee resistance (Harrison et al 2001; Larsson & Finkelstein 1999).

### 3.3 Integrating resources and capabilities

A lot of debate on value creation and M&A has focused on whether or not acquisitions lead to value creation from a certain stakeholder perspective on average (e.g. Barney 1988). Less attention has been given to how this value is actually created (Haspeslagh & Jemison 1991). While questions linked to strategic fit may indeed determine the synergy potential of a certain M&A deal, synergy potential requires managerial actions, such as M&A integration planning and implementation, to be realised. Several researchers have underlined the need for active M&A management (e.g. Kitching 1967, Datta 1991). However, results on the “best practices” of integration management and on the linkage of these issues to M&A performance are ambiguous (Nupponen 1995, 17). One logical reason for this is that management actions depend on the underlying objectives behind the M&A. Different levels and types of integration, and thus different post-merger actions, are required depending on the deal in question.

M&A integration refers to the managerial actions taken primarily after the actual M&A transaction has taken place (e.g. Ashkenas & Francis 2000). It can take several different forms and can involve different aspects. The level of integration, in turn, refers to the degree to which processes are linked, aligned or centralised between the two merging organisations. It can generally be described as ranging from minimal, which leaves the acquired company more or less autonomous, through limited integration to complete assimilation or combination of operations. (Zollo 1997)

One classification of integration types which emphasises the value creation aspect of post-merger integration is presented by Haspeslegh & Jemison (1991). They suggest that three different types of integration and related capability transfer exist: 1) operational resource sharing, 2) functional skill transfer, and 3) general management skill transfer. Operational resource sharing involves the combination and possible divestiture of certain operating assets of both companies. Functional skill transfer creates value e.g. through sharing advanced process skills and detailed knowledge of a distribution channel. General management skill transfer aims at improving the range or depth of management skills between the organisations.

Another, slightly overlapping, but central concept linked to M&A integration is resource redeployment. Resource redeployment is defined as the use by a target or acquiring business of the other's resources. This includes both the physical transfer of resources to new locations and the sharing of resources without physical transfer. (Capron et al 1998) In most horizontal M&A, resource redeployment leads to asset divestitures in the receiving firm. From a strategic perspective, M&A provide a way to restructure organisations and their resources, and asset divestiture is a logical consequence of this process. (Capron, Mitchell & Swaminathan 2001) Although resource redeployment in both directions has value-creating potential, research results suggest that the redeployment of the target's resources by the acquirer remains somewhat more problematic and less predictable than redeployment in the opposite direction. (Capron 1999, Capron & Pistre 2002)

Discussion related to resource redeployment and capability transfer has often been limited to the contemplation of the fitness of existing resources and capabilities, and their transference. However, increased interaction between the merging companies may also pose opportunities to create new competences. This aspect will also be taken into account in this paper.

### 3.4 The role of logistics resources and capabilities in M&A situations

This study examines logistics resource redeployment and the sharing of related capabilities between formerly separate companies, which takes place through one of the integration types presented above. Logistics issues in general aren't among the most popular topics of M&A research and much work remains to be done in this field both in terms of conceptual and empirical research. Nevertheless, a number of scholars have touched upon logistics related issues although the primary focus has been elsewhere. Especially case studies on M&A have provided empirical evidence on the role of logistics resources and capabilities in M&A related value creation (Norrman et al 2004; Häkkinen

2003). Here these are defined as the resources and capabilities linked to in-house operations of manufacturing companies in distribution, manufacturing and sourcing (cf. Bowersox, Closs & Helferich 1986).

Case descriptions have given indications of the high expectations of company management concerning especially cost saving type synergies in logistics when closing horizontal M&A deals. Horizontal deals are often motivated by the possibility to benefit from savings due to e.g. increased purchasing power, capacity rationalisation in manufacturing and distribution due to overlapping resources, and improved logistics and warehousing efficiency due to economies of scale and scope (e.g. Harding & Yale 2002). Several studies suggest that especially objectives concerning manufacturing are often linked to seeking economy of scale type synergies from consolidating production facilities (e.g. Light 2001, Nupponen 1995).

However, prior research has reported that these high cost saving expectations are not always so easy to meet. The elimination of overlapping resources may prove to be costly and cause employee resistance. In contrast, the complementarity of some product ranges has, in some cases, more potential for co-operation and value creation (Nupponen 1995, 146-147; cf. Harrison et al 1991). The importance of downstream assets, such as distribution channels and sales forces, can be great particularly in cross-border mergers. (Anand & Delois 2002, Meyer & Estrin 2001) By redeploying these existing resources, the acquiring company can rapidly increase the geographical spread of its products or efficiently reach new customer segments (e.g. Harrison et al 2001, 682). Furthermore, distribution networks are difficult to build from scratch due to the complexity of social organisations and processes, and thus M&A offer a valid option for market entry (Capron & Hullan 1999). These findings highlight the role of revenue-based synergies, complementary logistics resources and capability transfer. However, synergy realisation in this area is also challenging. For example, it is by no means certain that existing customer and supplier relationships will be left intact after the merger has taken place (e.g. Havila & Salmi 2000)

In sourcing, sources of value creation basically reside in cost-based synergies. Consolidation of similar sourcing resources may provide cost savings and reaping benefits from the increase in market power towards suppliers is often mentioned as one M&A objective (e.g. Nupponen 1995). These benefits typically provide easy access to decreased costs with few internal constraints. However, poor M&A management can also induce problems in these areas.

From a logistics point of view, potential sources of value creation exist both in upstream and downstream activities and they can be embedded in either company resources (e.g. distribution assets) or distinctive capabilities (e.g.

R&D capabilities linked to manufacturing, distribution networks and relationships). At best, companies can benefit from better operational efficiency, increased market power and a rapid increase in sales, thus gaining from both cost-based and revenue-based synergies. However, it must be stressed that the pure existence of synergy potential is no guarantee for value creation. As a result of slow and poorly managed integration, even “easy” synergies can be difficult to realise.

## 4 Methodological considerations

The research strategy adopted in this paper is an explorative multiple case study, which aims at describing and understanding the phenomenon under research in the chosen context. Such an approach is considered to be appropriate when little is known about the examined phenomenon and previously adopted perspectives seem inadequate or provide contradictory results (Eisenhardt 1989, 547–548). The present research topic would seem to fulfil these criteria. The research relies profoundly on gathered empirical data as previous empirical evidence on this particular topic is scarce. No strict existing framework is used or tested although the data gathering and analysis have been influenced by the work presented in M&A and logistics literature

As the object of research is a complex system, which is affected by numerous internal (e.g. merger motives, actions of company owners, managers and staff) and external (e.g. policy, reactions of the company’s customers and suppliers) factors, widely prevailing laws may hard to determine and prove to be irrelevant in practice (cf. Stank & Goldby 1998, 378–380). Due to this complexity, the research applies a systems approach, where knowledge depends on the entire examined system, and the explaining parts of the system are interpreted through the characteristics of the whole (e.g. Arbnor & Bjerke 1997). However, as knowledge and understanding grows through the detailed examination of the research object, research could develop towards other methodological approaches.

This paper reports on the results of a multiple case study covering six horizontal M&A deals performed by Finnish companies during 1998-2001. All of the studied cases were cross-border M&A deals, where both counterparts were European-based companies. Also, the scope of the study was restricted to the impact on the companies’ logistics operations within Europe.

The empirical data was gathered through six semi-structured interviews within the selected companies during spring 2003<sup>7</sup>. The informants were top-level managers, whose primary duties were either related to M&A matters or to logistics. This interview data was supported by data retrieved from public domains (e.g. financial statements, press releases).

The case companies were selected based on information from a database on M&A deals conducted by Finnish companies during 1995-2001 and the results from a related survey<sup>8</sup>. Several companies from this group were contacted, which were seen to have a M&A driven growth strategy. Individual case deals were chosen based on the representativeness and importance of the deals for the acquiring company as well as the time when the deal was finalised. Table 1 shows some background facts and figures on the case deals.

Table 1. Background facts and figures on the studied M&A cases

	Size of acquirer	Size of target	Year of acquisition	Stage of integration
A	450 million €	130 million €	1998	Integration not completed
B	1200 million €	2000 million €	1999	Planned level of integration completed
C	600 million €	10 million €	2000	Planned level of integration completed
D	600 million €	10 million €	2000	Planned level of integration completed
E	100 million €	30 million €	2000	Integration not completed
F	250 million €	200 million €	2001	Integration not completed

The studied cases represented five different manufacturing industries and varied to some extent in terms of the size as well as the current integration stage that the companies were going through. One deal can be described as a pure “merger of equals”, whilst in four deals the target was substantially smaller than the acquirer. In one case the target was actually larger than the acquirer. However, both in terms of pre-merger motives and post-merger actions, this deal resembled a “merger of equals”.

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<sup>7</sup> The author would like to thank the students attending the course LOGS1 Advanced Logistics at the Turku School of Economics and Business Administration in spring 2003 for their help in gathering this data.

<sup>8</sup> For a more detailed description see Norrman et al (2004)

## 5 Research results

### 5.1 Strategic fit and motives of case deals

When comparing the strategic fit grid presented in Figure 1 with the studied M&A deals, it can be stated the strategic fit between the merging companies was seldom represented by one single category. In most cases, one single deal covered several fit types due to wide geographical presence and/or product range of the companies. However, most deals represented cases where the fit was primarily either complementary or supplementary, although some identical features were often linked to these deals.

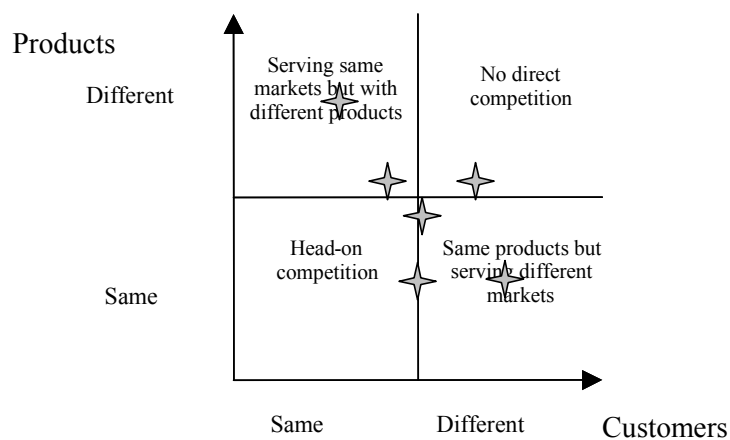


Figure 2. Strategic fits of case deals

This within-case overlap between different strategic fits can also be noted by examining the multiple motives for single acquisitions. Three main motives rose to be dominant in the studied deals. First, companies stressed the importance of M&A in strengthening their current market position. This motive was mentioned by large global companies and regional players alike. In practice, this motive was linked to buying out direct competitors.

The second main M&A motive was to expand into new geographical markets. The current area of growth for the studied Finnish companies seemed to be connected to the EU enlargement process. Presence was increased in future EU member states, especially in the Baltic States and Poland, as well as in Russia. This did not necessarily require that the target was from any of the above-mentioned countries, as long as the target company had resources in these countries. Existing distribution and sales networks seemed to be especially attractive. This motive represents a pure related-supplementary fit.

The third motive was linked to related-complementary. The objective of this motive was to widen the current product range into new related products

and/or to redeploy production know-how and technologies to serve existing customers with more comprehensive solutions. In addition to the internal motives of the acquiring company, external factors also influenced M&A decisions. In industries where the consolidation rate was high, M&A were seen as necessary strategy for company survival and growth. Also, as mentioned earlier, the EU enlargement process clearly influenced M&A decisions.

## 5.2 Integration of logistics resources and capabilities

In the following, the M&A induced changes in the logistics resources and capabilities of the case companies are presented. Table 2 shows the results in brief from case to case in terms of the effects on the resources and capabilities of three logistics activities (i.e. distribution, manufacturing and sourcing).

Table 2. Resource redeployment and capability transfer in the logistics operations of the case companies

	A	B	C	D	E	F
Distribution resources	-	***	**	**	-	-
Distribution capabilities	-	***	*	*	-	-
Manufacturing resources	-	***	*	*	-	-
Manufacturing capabilities	-	***	*	*	***	***
Sourcing resources	-	***	*	*	*	***
Sourcing capabilities	-	***	*	*	*	***
<hr/>						
- resources/capabilities kept separate	** redeployment/transfer from target to acquirer					
* redeployment/transfer from acquirer to target	*** reciprocal redeployment/transfer					

The effects on logistics resources and capabilities varied a great deal from case to case and the integration was carried out in a variety of ways depending on the case in question. It should be noted that a certain integrative action in the resources of a certain activity didn't necessarily mean identical actions in the related capabilities of that activity, though that was often the case.

In Case A, the integration of the logistics resources was minimal. The M&A was primarily motivated by gaining passive market presence as well as economical and financial synergies. These motives seem to be well in line with the adopted integrative actions as realising these benefits doesn't require tight integration of logistics operations. Basically, no alterations to the companies' structures were made and no logistics related skill transfer was carried out. Thus the companies carried on using separate logistics resources and held distinctive logistics capabilities after the acquisition.

In the remaining cases, post-merger actions affected the logistics resources or capabilities at least to some extent. Most commonly this took form in the direct redeployment of the acquirer's resources and capabilities to the target. In Cases C & D, resource redeployment in manufacturing and sourcing lead to divestitures in the target organisation, where the resources overlapped. Also on the logistics capability side, the acquirer's own concepts, working procedures and logistics strategies were implemented to the target organisation. For example, capability transfer related to the acquirer's manufacturing process was seen as particularly successful and worthwhile in both organisations. In Case E, the sourcing practices came largely from the acquiring party and the sourcing facilities of the target were merged into those of the acquirer, which also lead to divestitures in the target company. Resource redeployment also occurred in the opposite direction but not as often. This type of redeployment was typically linked to making use of the target's distribution network and contacts to disperse new geographical markets (see Cases C & D).

Resource redeployment did not always lead to divestitures in the receiving organisation. Some resources could also be left relatively intact if they were more complementary than overlapping. For example in Case B, several factories that manufactured identical products were consolidated, but factories producing complementary products were left running. In Cases B and F, the joint entity actually used reciprocal redeployment, where resources were selectively integrated and restructured. In Case B, this resulted in the introduction of a whole new distribution structure with superior operational efficiency to either of the previous distribution systems. Capability transfer was also in many cases reciprocal. For example, existing capabilities in manufacturing were compared and to some extent combined in Case E. This exchange of knowledge was seen as highly beneficial and had contributed to an increase in sales for certain products. Case F, in turn, had realised cost savings from creating a new joint solution in sourcing, which reflected on the capabilities of the merged company in both sourcing and manufacturing.

## 6 Discussion

In the following, the similarities and differences between the examined case deals are discussed in relation to previous findings in academic research. Table 3 summarises each case and presents the M&A outcomes in terms of company assessment and changes in the selected accounting-based figures.



Table 3 Cross-case comparison of M&amp;A deals

	Case A	Case B	Case C	Case D	Case E *	Case F *
<b>Relative size</b>	Buyer >> Target	Buyer < Target	Buyer >>> Target	Buyer >>> Target	Buyer >> Target	Buyer > Target
<b>Strategic fit</b>	Supplementary	Overlap of different fits	Supplementary (complementary)	Supplementary	Supplementary (identical)	Supplementary (identical)
<b>M&amp;A motives</b>						
Internal	Increasing geographical coverage, economic and financial motives	Increasing current market share, product & geographical coverage	Increasing geographical coverage	Increasing geographical coverage	Increasing geographical coverage, gaining R&D knowledge & technology	Increasing current market share & geographical coverage
External	EU enlargement	Consolidation in industry	Consolidation in industry	EU enlargement	Following customers demands	Consolidation in industry
<b>Level of integration</b>	Minimal	Full integration	Full integration	Full integration	Varied, integration in production and sourcing	Varied, integration in R&D and sourcing
<b>Effects on</b>						
Distribution	Not measured	Increased efficiency and cost savings	Increased efficiency	Increased efficiency	Increase in cost, improved image towards customers	Not measured
Manufacturing	Not measured	Increased efficiency, gains from skill transfer	Gains from skill transfer, increase in cost	Gains from skill transfer, increase in cost	Gains from skill transfer, cost savings	Not measured
Sourcing	Not measured	Cost savings, improved service from suppliers	Cost savings	Cost savings	Cost savings	Cost savings
Sales	Less than combined turnover, subsequent steady increase	Slightly exceeded combined turnover, subsequent decline	Exceeded combined turnover, subsequent fluctuations	Exceeded combined turnover, subsequent fluctuations	Exceeded combined turnover, subsequent steady increase	Reached combined turnover, slight increase
Operating profit	Steady increase	Decline followed by slight improvement	Small fluctuations	Small fluctuations	Increase, subsequent decline	Strong decline followed by slight improvement
ROA (return on assets)	Steady increase	Steady increase	Small fluctuations	Small fluctuations	Increase, subsequent decline	Strong decline followed by slight improvement

\* Accounting-based figures have been calculated from consolidated financial statements (not fully comparable)

The examined deals included capability-seeking M&A involving the transfer of capabilities, deals seeking for a specific resource or a certain combination of resources, as well as more economically and financially oriented M&A. Case A stands out as a deal which was not motivated by any logistics related benefits and had minimal impact on the carrying out of logistics activities in the company. The objective was rather to gain passive market presence (no resource redeployment involved) and financial synergies. Some alterations were made to unify the pricing strategies of the two companies, which company management saw as having a positive impact on profitability. The deal did not involve notable revenue-enhancing synergies, but costs were reduced to some extent (see Table 3). It should be noted that the acquirer was several times larger than the target company, so the true impact may not be directly observable through the accounting-based measures.

All the other examined deals involved at least some kind of integration from a logistics perspective: either pure resource redeployment from one organisation to the other, some type of functional skill transfer, or integration resulting in a new solution which cannot be directly linked to either of the previously separate organisations. General management skill transfer was not mentioned during the interviews. (cf. Haspeslagh & Jemison 1991)

In terms of such post-merger actions, also Case B seems to be quite exceptional. In this case, the acquiring company was more or less half the size of the target company, although both companies were relatively large players in their industry and competed on a global scale. The two companies were merged fully, which in many functions (incl. logistics) meant questioning the previous ways of operating and subsequently involved restructuring and divestitures as well as reciprocal skill transfer. The whole post-merger process consumed several years of time as well as substantially managerial efforts, and as can be seen from Table 3, also financial resources (drop in profitability and ROA). This post-merger period has only recently come to an end and company management now reported to be quite happy with the end results. Especially, the significant changes made in the distribution structure and strategy was finally starting to bear fruit. In the interview related to this case, it was specifically stated that the M&A served as a catalyst for capturing the attention of company management to streamline the logistics resources and the related material flow of the whole company.

In the other four cases, post-merger integration was not seen as such a dichotomy, but actions depended on specific M&A motives. In cases of resource redeployment, highly similar and overlapping resources were divested and only the key resources were left untouched. These key resources were typically related to existing market presence and the distribution networks of the target, or complementary skills in manufacturing. All of these

companies had been able to benefit from increased market power in sourcing in the form of cost savings (cf. Nupponen 1995,80-85).

Cases C & D portrait an identical M&A strategy. The objective of the acquirer was to buy out substantially smaller targets that were then quickly integrated into the acquirer. Overlapping facilities were in both cases divested (from the target's side) and only the key resources of the target company were kept. These key resources were related to existing market presence and the distribution networks of the target (i.e. related-supplementary fit). Capabilities linked to the examined operations were transferred from the acquirer to the target organisation. Benefits were derived from cost savings, but some problems had been encountered in the integration of manufacturing resources, which had in fact increased cost in this area. However, the deals had no significant effect on the result or performance of the acquiring company, as the target companies were substantially smaller in size.

Also Cases E & F have many similar features. Both had varied levels of integration and involved building new capabilities in manufacturing and/or sourcing (see Table 3). In case E, in addition to gaining geographical coverage, the objective was to combine and create new capabilities linked to product manufacturing, which was supported by setting up specific management teams to exchange ideas. In case F, the objectives were similar, but skill transfer was related to sourcing and manufacturing. One main objective was to combine volumes in sourcing, which had indirect effects on R&D and manufacturing (rethinking product composition). Neither case had realised substantial financial benefits to date, but company management was pleased with the outcome in the selected operations. Also further integrative actions were not out of the question.

To summarise, when joining complementary and supplementary resources, the expected synergies had more or less been successfully realised in the case companies, although it might have consumed much more time than originally planned. However, in some deals the divestment of identical resources had not resulted in the expected cost savings, at least not to date. Time and comprehensive planning seemed to be essential for reaping these synergies. These results seem to back the findings of Harrison, Hitt, Hoskisson and Ireland (2001).

When examining the skill transfer aspect, complementarity in R&D and manufacturing technology and knowledge was central. Also functional skill transfer was used in enhancing sourcing capabilities. In cases where the logistics capabilities had been affected by the deal, the acquirer's existing skills and knowledge were commonly transferred to the target organisation, but also new mechanisms (e.g. establishing specific management teams and networks to exchange ideas) to combine and create new capabilities were set

up (cf. Zollo & Leshchinskii 2000) Results in this area were difficult to quantify and perceive by examining solely accounting-based figures. The actions might have lead to improved capabilities in a specific area, but benefits might not have yet been totally capitalised (as opposed to economic and financial benefits in Case A). Therefore, the examination of such capability-based strategic synergies would seem to require different methods and measurements than e.g. cost-based synergies.

## 7 Conclusions

The purpose of this paper has been to take initial steps in filling one of the existing gaps in M&A research. It has aimed at illustrating through exploratory case studies that though many theoretical contributions concerning the relation between logistics and M&A have not yet been made, these issues are frequently encountered and considered in a variety of actual M&A situations.

Empirical findings show that post-merger actions involving the redeployment of logistics resources and transfer of logistics capabilities are often closely linked to realising M&A objectives. The research result indicate that the combining of identical and complementary logistics resources and capabilities can create value through the transference of existing key competences to new contexts, as well as through creating new capabilities. A M&A deal might even give initiative for company management to e.g. redesign existing logistics resources and related material flows anew, which may then produce new sources of competitive advantage.

From a theoretical perspective, the findings support the view of the resource-based strand of strategic management literature and underline the importance of adopting a resource-based evolutionary point of view in M&A analysis (cf. Capron et al 1998). Horizontal M&A cannot be purely viewed as mechanisms for economies of scale and scope and market power as contemporary M&A may well be driven by more long-term objectives linked to the restructuring of company resources or the acquiring of capabilities to strengthen or renew core competences. Also, the aspect of creating new types of resources and capabilities through the M&A process should be discussed more comprehensively in future studies.

From a managerial perspective, the research results point to a number of sources of value creation in logistics related activities. Joining complementary resources in distribution and manufacturing would seem to have significant synergy potential. Also the integration of overlapping facilities can generate cost savings, however this process may turn out to cause friction and require

more managerial attention than expected. The more intense the assimilation of the companies is and the more unique the deal is for both counterparties, the more time and money the integration process will probably consume. Initial plans and budgets may fail, but also the potential long-term operational and strategic benefits may well be worth the wait. Also capitalising on one-sided and especially reciprocal capability transfer may take some time. When dealing with this type of knowledge transfer company management should acknowledge the importance supportive integration mechanisms e.g. creating joint teams or units in the function in question.

The empirical analysis of the integration effects in this paper is however somewhat limited due to the fact that the stage of M&A integration process differed between the examined deals. In some cases, the integration was seen as a matter of the past. In others the integration process was still going on in some areas of business, and even though the actual transaction had taken place 2-3 years ago, company management might still be planning to reap synergies from operations which had been left more or less intact until now. Also M&A related value creation was assessed using primarily subjectively with supporting accounting-based measures. For these reasons, it is rather difficult to report on the total of achieved synergies and make exhaustive case comparisons in terms created value, although some indications were fairly evident. These deficiencies leave room for various further research questions. For example, digging into the relationship between post-merger actions in these functions and the actual quantified short- and long-term benefits of capability-based synergies in more detail would be interesting. Virtually all of the examined cases were frequent acquirers with an active M&A history. Therefore, mapping and analysing the development of company resources and capabilities during a longer period of time and thus encompassing the effects of several M&A deals may provide more relevant results in cases where the effects of individual deals are hard to break down.

Although the empirical data gathered for this study is fairly narrow, the reported results would seem to provide a good basis for continuing research in this area. Hopefully, this paper has underlined the significance of these issues, as well as given initiative to studying post-merger actions and implications through industry and case-level analyses to achieve better understanding of these matters.

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# INTERNAL COMMUNICATION IN AN ACQUISITION. EFFECTS ON WORK SATISFACTION

*Kaisa Aalto*

## 1 Introduction

### 1.1 Background

The number and value of mergers and acquisitions (M&A's) has increased during the last decade. The biggest cases such as Telia's acquisition on Sonera and General Electric's acquisition on Instrumentarium gain much attention in the headlines, but a great number of smaller M&A's is also taking place at the back. As the number and size of M&A's increases they are also becoming more international: the number of cross-border deals has grown three-fold in the past ten years. (Ali-Yrkkö 2002, 1.)

Mergers and acquisitions are popular business strategies for companies in search for financial and operational effectiveness. The primary purpose for companies to engage in mergers and acquisitions is usually to improve overall performance by achieving synergy and competitive advantage (Appelbaum et al 2000a, 649). The expectations for positive outcome of an acquisition are great, but research suggests that up to 50% of mergers and acquisitions in fact end up in failure (Panchal & Cartwright 2001, 424). M&A's are usually well planned in terms of financial and legal aspects, but many researchers believe that a great number of the failures are attributed to poor human resource planning and employee problems. (Butler et al 1991, 208).

Implementation of changes and integration of personnel set enormous challenges for the management in the companies. Maintaining employee moral during the change is essential to acquisition success (Gutknecht & Keys 1993, 26). Communication is agreed to play an important role in managing work satisfaction in times of change. It influences the adoption of a new company culture, change process itself and the level of stress employees experience. In fact, communication is often stated as one of the most important factors to the success of a merger or an acquisition (Appelbaum et al 2000a, 649). It has

even been said that without effective employee communication, change is impossible (Barret 2002, 219).

Previous research mentions many negative side-effects of acquisitions (e.g. Buono & Bowditch 1989; Bourantas & Nicandrou 1997; Risberg 1999). These effects, or consequences, are likely to affect not only the organisation's ability to cope with the implementation of the change process but also its day-to-day functioning. (Hubbard 1991, 32, 91.) It is widely accepted that in order for an acquisition to be successful there must be a wide-spread acceptance of the need of the change at all levels in the hierarchy. (Buono & Bowditch 1989, 14.) Also, it has been suggested that research on acquisitions should move from identifying negative impacts of acquisitions on the acquired employees to factors and processes that promote positive employee reactions and contribute to the success of an acquisition. (Bourantas & Nicandrou 1997, 87.) Previous research indicates that communication has an important role in generating commitment for the change and work satisfaction in acquisitions (Buono & Bowditch 1989, 14). Communication can be viewed as a tool for managing employee's work satisfaction along the change process.

Studying human aspects of mergers and acquisitions is still relevant. Even as the number and experience of mergers and acquisitions has increased in the recent years, they still tend to fail the expectations set for them. Employees are important assets for the company, in many cases a company is acquired because of its intellectual capacity. Addressing employees' work satisfaction throughout the process is an important factor in encouraging them to work for the company goals and participate in generating the anticipated synergy.

## 1.2 Purpose and structure of the article

This article summarises the findings of a study on internal communication in an acquisition made for the author's master's thesis in Turku School of Economics and Business Administration. It presents the communication process of one acquisition through the eyes of the acquisition participants, the acquired company employees. The article aims at defining the critical events in the communication process and presenting their impact on the employees' work satisfaction. The case is discussed in relation to existing theory on communication and work satisfaction in acquisitions.

The empirical study for the thesis that this article is based on was made during summer 2003. The case company was an international company operating in sanitation industry. The company was acquired by its competitor in 2002. The acquisition was special in two perspectives: (1) the acquirer was smaller than the acquired company, (2) the acquirer had no own organisation

in Finland prior to the acquisition. The acquirer had operated in Finland through an agency agreement and had only a modest share of the sanitation markets compared to the acquired company. The empirical data was collected by conducting six personal interviews and a vaster web-based inquiry. The purpose of the study was to *discuss the role of internal communication in an acquisition and assess its effects on employees' work satisfaction*.

This article begins with presenting the concept of acquisition from a process perspective. Then, the concept of internal communication and its role in managing acquisition process will be discussed. After having presented the key concepts for the study communication throughout the acquisition process as well as its effects on work satisfaction will be evaluated. The aim is to compare the reality of the case to the literature and present a conclusion on the role of internal communication in the case acquisition as well as the effects it had on employees' work satisfaction.

## 2 Presenting key concepts

### 2.1 Acquisition

#### 2.1.1 Acquisition process

The terms merger and acquisition are frequently used interchangeably in the literature. Still, they are different activities. Acquisition can be defined as one company taking over controlling interest of another company or simpler as just purchasing another company (Butler et al 1991, 194). Also, in acquisitions one firm tends to be larger and more powerful than the other (Buono & Bowditch 1989, 61). However, there are exceptions like the case company in this study that was larger than its acquirer. Merger then usually refers to two or more organisations of relatively similar size joining forces to form a new entity that is mutually agreed upon by the firms' management and approved by their shareholders (Butler et al 1991, 194). This study concentrates on acquisitions.

Acquisition processes are usually discussed in terms of different phases or stages. However, identifying the beginning and the end of each phase is not easy. The phases do not necessarily correspond with time and events that occur at the same time may well refer to different phases (Erkkilä 2001, 23). Also, different parts of organisations may experience different phases at a different time. Different companies experience the process differently. Environment, timing, atmosphere and organisations of a merger or acquisition vary. Also, hostility or friendliness of an acquisition as well as the size and the

business of the two joining organisations affect the process. (Buono & Bowditch 1989, 57.) Defining where and when the process ends is difficult; many researchers believe that an acquisition is an open-ended, ongoing process that affects the organisation for a longer period and that it can not be defined to start or end at a certain time. (Risberg 1999, 31.)

In this study the acquisition process is divided into three subsequent phases: pre-, during and post-stages. This definition is supported by e.g. Marks and Mirvis who have both together and separately studied acquisitions to a large extent and defined the acquisition process to be formed of pre-combination, combination and post-combination stages (Marks&Mirvis 2001, 81). Another three-stage model for organisational change is that of Kurt Lewin. His three-stage model for organisational change includes phases of unfreezing, changing and refreezing (Marks 1997, 272–273)<sup>1</sup>. Lewin's model both identifies the different stages of the change process and also describes their content. In the first stage the status quo of the organisation is disturbed and change introduced. The second stage includes the actual change, in case of an acquisition e.g. the physical integration of the personnel. The third stage begins when the change is implemented and handles with finding a new status quo for the organisation. (Klein 1996, 36.) These two models for acquisition process are presented in Figure 1.

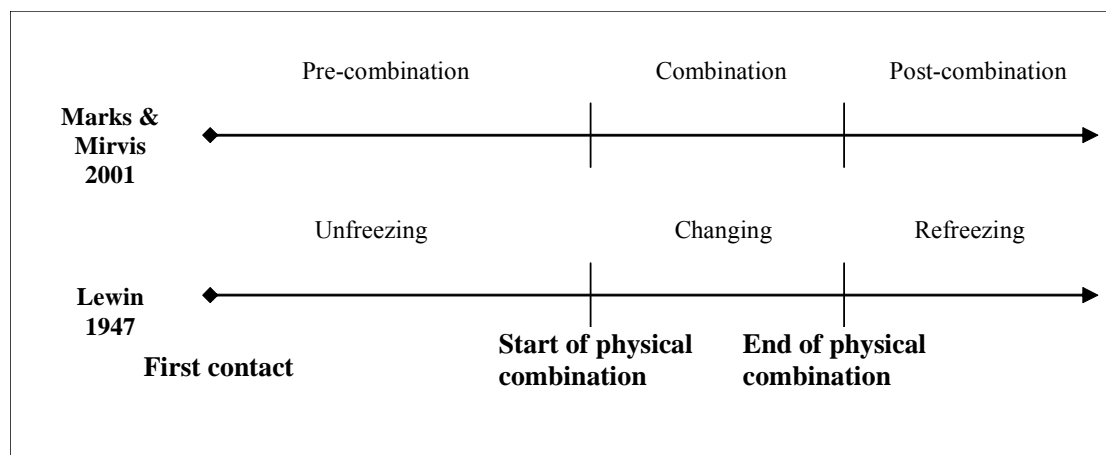


Figure 1. Selected process models of acquisitions

<sup>1</sup> Original source: Lewin, Kurt (1947) Frontiers in group dynamics, *Human Relations*. Vol. 1, No. 1, 5–41.

Marks and Mirvis (2001) state that there is no agreement on when the acquisition process can be seen to begin: when the first contact is made between the two parties, after the announcement or when it receives a legal approval. All these events mentioned do still fall into the pre-combination stage. The stage is characterised by increasing environmental uncertainty, which finally leads to the announcement of a merger or an acquisition. Uncertainty is often a product of the acquisition negotiations conducted in secrecy for both legal and competitive reasons. As pre-combination stage is also the time when organisation must wait for regulatory approvals it may last anywhere from couple of months to several years. (Buono & Bowditch 1989, 89-95; Thach & Nyman 2001, 146; Marks & Mirvis 2001, 81.)

The combination stage is characterised by organisational and cultural instability and ambiguity. This is the time after the announcement of the acquisition that leads to the actual physical combination of the organisations. During this phase the actual change is implemented and employees should be prepared for the new organisation. If the organisation's attention is solely paid to financial and legal aspects and human side is neglected, personal and interpersonal fears, anxieties and conflicts may be easily created as a result at this stage. (Buono & Bowditch 1989, 96–99; Thach & Nyman 2001, 146; Marks & Mirvis 2001, 81.)

Post-combination stage begins with high organisational instability as the organisations are physically and legally brought together. Employees are for the first time faced with people from the other organisation in every-day tasks and are needed to cope with new ways of doing things. In the post-combination stage the attention is on maintaining the performance of the organisation while still continuously improving the working of the new entity. Attitudes during the post-combination phase should move slowly towards stability where the ambiguities are clarified and new organisational structure and culture are adopted. (Buono & Bowditch 1989, 88–102; Thach & Nyman 2001, 147.)

There are different challenges set for different phases in acquisitions. Despite the criticism presented on the process view on acquisitions, it still seems applicable for this study. As acquisitions in general tend to follow a fairly predictable sequence of events, the use of process view helps us to handle it as an entity and to understand its many sides. Also, as the study concentrates on only one case the different timings of acquisition processes are of little significance.

The process view used in this study is composed of phases from pre-, during to post-stages. The company will have different objectives for each phase. These will be discussed in the following chapter.

### 2.1.2 Acquisition objectives along the process

Acquisition objectives work as a basis for planning the level of integration between the two combining companies. The objectives define the changes needed and the ways to implement these (Erkkilä 2001, 87). When defining the objectives for the acquisition the company should consider the situation not only from its own, but also from the acquired company's point-of-view. The objectives should be defined not only in general, but for each stage of the combination process respectively. This early definition of the objectives is important for planning the means to achieve them. Also, clearly defined and stated objectives help the company to argue for the benefits of the deal for the acquired personnel later in the combination process. (ibid., 27.) As communication plays an important role in the implementation of the changes the objectives set for acquisition should also direct communication planning in the different phases.

In order to ensure that communication supports the objectives for each phase it is suggested to form a communication plan. The plan should coincide with the general stages of the planned acquisition process and determine the requirements for communication in the different stages of the process. The objectives set for each phase should also form a consistent entity that summarises the most important objectives that the company has for communication in the acquisition. (Klein 1996, 36.) The purpose of a communication plan is not to make the communication process fixed and inflexible, but to direct the communication according to the company objectives. Each phase has its specific challenges to be targeted, but the challenges also change during the process. Thus, along with the consistency requirements there is also a need for different focuses in communication in different phases in acquisitions. (Risberg 1999, 68; Barret 2002, 227.)

Although acquisition objectives are always specific for the situation and acquisition concerned some general objectives for communication from pre- to post-stages can be defined (Marks 1997, 273). Literature mentions two main objectives concerning communication in pre-combination stage. These are justifying the change for the employees and readying them for the change. (Klein 1996, 37–41; Cartwright & Cooper 1996, 145.) The case company management defined their objectives for the first communication as informing employees on the deal and explaining them how it would affect them personally. Also, their intention was to ensure that employees had the means to conduct their work as normally as possible so that the company operations would not be affected by the deal.

In combination stage efforts to reassure the employees need to be continued and employees informed about the actions taken and the change process.



Organisation should pay attention to delineating and clarifying role of relationships and expectations in combination stage. Over all, the information put forward in combination stage should be more specific than in pre-combination stage. (Klein 1996, 37, 41–42.) In post-combination phase, then, the aim is to celebrate the change and build understanding among employees. The celebration is suggested to be done by spreading the word of success to employees. Building understanding in turn includes providing employees with such communication that enables them to become both aware of and comfortable with the personal implications of the change. (Klein 1996, 37, 42.)

It is often difficult for the acquirers to keep communicating throughout the change process: the day one communication is well planned, but the subsequent phases are paid less or even not attention at all (Hubbard 1991, 121). This was also noticed in the case company. When asked about the communication objectives after the announcement the case company management was unable to answer the question. It seemed that the communication was planned only for the announcement, but the subsequent phases were left with little consideration. Objectives for post-combination stage were not explicitly stated. It seemed that the company had already moved on with the acquisition and no longer felt that there was something acquisition related to be communicated.

Defined objectives and communication plan help the company to direct its communication along the change process. Next, internal communication in its different forms will be discussed.

## 2.2 Internal communication – tool for post–acquisition integration

### 2.2.1 Formal and informal communication

Even in best circumstances managing communication in acquisitions is difficult. People from two different organisations communicate at least from two different organisational and cultural contexts. The relationships within the companies also play their role in how the communication is handled and perceived. It is not rare that the cultures of the old companies remain and live as sub-cultures with the new company. These set challenges for communication in acquisitions and often the way information is given, distributed and handled changes at least for the acquired personnel. (Risberg 1996, 3-4; Tienari 1996, 30.)

A company's internal communication refers to communication that occurs within a network of positions that comprise an organisation (Pace 1983, 30).

In an acquisition, internal communication is used to distribute information and create a positive attitude towards the change among employees. (Erkkilä 2001, 108.) An organisation's internal communication can be either formal or informal. Formal communication includes all the communication that is connected to the organisation's activities and the rest is informal communication. (Wiio 1994, 164.)

Formal communication within the organisation occurs between positions, not people. Those who occupy positions are required to communicate in a certain way consistent with the position. Positions are charged with certain power that is exercised through communication. The existence of power relations and the exercise of power create communication structures and rules inside the organisation. (Pace 1983, 14.)

Informal communication, then, occurs outside the formal communication structures. When employees communicate independent from the position in the organisation, the factors directing the flows of information are personal in nature. Informal communication emerges from interaction between people and often substitutes for formal communication. (O'Hair et al 1995, 53; Pace 1983, 57–58.)

In acquisitions informal communication becomes a powerful source and channel of information to employees. It can either help or hinder the organisation in working towards its goals and objectives. Thus, formal and informal communication structures should not thus be seen only as competitors, but also as to supplement each others. In addition to formal communications transmitted via formal channels, the company can also initiate discussions in the informal communication structures. Both communication structures are important for sharing information within the organisation. (Hubbard 1991, 28.)

## 2.2.2 Communication process

In formal communication the positions within the organisation define the responsibilities for communication. It is usually the management that is responsible for communicating the changes to its subordinates. In the case company the communication responsibility was first on the Finnish management but shifted on to the lower management levels along the process. Every management level that passed communication on to its subordinates had to tailor the message for the situational purposes and assess what information was essential to pass on. Each communicator needed to decide the content of the message, the channel the message is transmitted on and the timing of the communication.

It is important to decide the communication channel that best suits the message and the situation at hand. When making the choice the sender of the message should be aware of the different communication channels available and their impact on the way the message is received and interpreted. Different categorisations for communication channels can be found in literature. The communication channels available to the organisation's internal communication can be divided to three different categories according to their characteristics: face-to-face, electronic and written communications. (Åberg 1997, 102–103.) Also, the channels can be classified by their richness. Whether a channel is low or high in richness depends on four conditions: 1) the capacity for obtaining immediate feedback from the receiver, 2) the ability to use both verbal and non-verbal communications, 3) the possibility to tailor the messages for the specific situation, 4) the ability to use a wide range of word choices. According to this classification, the richest channels are face-to-face meetings and the least rich channels are impersonal written memos and public speaking. (O'Hair et al 1995, 54–55.)

The basic rule for channel choice is that rich channels are most appropriate for complicated messages designed for specific people. For example, in acquisitions such messages as the acquisition announcement are suggested to be transmitted via rich and personal channels. Rich channels allow the receivers to pick up non-verbal cues and give direct feedback. Less rich channels are appropriate for routine communication, that is targeted to a large number of people at the same time and immediate feedback is not necessary. Although personal communication should be the primary communication channel in the early stages of an acquisition, repetition of the message through more than one medium also increases employees' memory of the message and makes communication more effective. (O'Hair et al 1995, 56; Klein 1996, 34–35.)

The timing of the changes and introducing them to employees are likely to affect the way employees react to the acquisition (Bourantas & Nicandrou 1997, 84–85). Delays in communication can result in employees feeling even hostile towards the acquisition, and make any subsequent communication strained and difficult (Appelbaum et al 2000a, 650). It is always better to surprise employees by communicating early than only responding to already come up questions. Employees' need for information usually precedes the official communication. Without early information rumours start spreading and uncertainty increases among employees. It is better to be proactive than reactive with communication. Proactive change communication means preparing for situations and communicating prior to issues taking place. As reactive communication answers to question *what*, proactive communication seeks to explain and answer to question *why*. (Juholin 2001, 199–201.)

The people working for the company are its most critical target group to communicate the change when an acquisition is announced. Communication targeted to other interest groups of the company often handles with financial and legal issues and poorly fulfils employees' need for information. As a result, employees need to be seen as a special group with special communication needs to be fulfilled. (Erkkilä 2001, 119–120.) Thus, instead of starting with the sender and his/her purpose and message, the communication should be started with the receiver and what (s)he needs or wants to know (Kelley 2000, 94).

In acquisitions, internal communication aims at influencing employees and making them to commit to the new organisation and the new company procedures. The acquirer will have specific objectives for each phase and these are directly related to communication. Next, communication throughout the acquisition process will be discussed.

### 3 Internal communication in acquisitions

#### 3.1 Pre-combination communication

The early months of the acquisition have often been stated as the crucial period in the success of an acquisition (Cartwright & Cooper 1996, 117). The pre-combination phase in an acquisition differs from the subsequent phases in that during this stage only negotiators and management of the joining organisations are involved in the actual combination process (Bourantas & Nicandrou 1997, 82). Despite the planning attempted in secrecy, rumours often emerge due to leaks in internal and external information channels. Although the accuracy of these rumours varies from case to case and concerns are mostly general, stressful perceptions of the event are expected. As a result, the first acquisition related ambiguities experienced by the personnel often precede the announcement of the acquisition. (Buono & Bowditch 1989, 91–92.) In the case company, also, the negotiations were not successfully kept in secrecy and the rumours started even one and a half year before the announcement. The first rumours were heard only by the management, but the company employees also started hearing about them half a year before the announcement. The long period of rumours and the postponement of the announcement caused uncertainty, but the effects were less severe than previous research suggests. As the acquisition was finally announced it seemed to calm people down. They were tired to speculating and the confirmation of the deal decreased the uncertainty experienced among them.

Acquisition announcement marks the end of the old organisation to the employees as it is known to them (Cartwright & Cooper 1996, 117). Upon the announcement of an acquisition, tension and distrust are immediately cited as its first consequences in literature (Appelbaum et al 2000b, 676). Employees enter a period of uncertainty, anxiety and stress caused by the lack of control over the acquisition and the perceived uncertainty about the future (Bourantas & Nicandrou 1997, 75; Risberg 1999, 52). Studies mention low employee morale, decrease in satisfaction and commitment, increase in unproductive work, error rates and absenteeism, unproductive behaviour and sabotage as consequences of the acquisition announcement. Although the employee reactions are regarded to a large extent as being negative, positive behaviours are also mentioned in few studies. (Bourantas & Nicandrou 1997, 75.) These positive behaviours and attitudes were noticed in the case company along with the uncertainty. Many of the employees saw the acquisition as an opportunity for the company to improve its business. Also, noteworthy is that only few employees mentioned any uncertainty about future work as a result for the acquisition announcement. This notion contradicts the views literature usually presents, but can be explained by the acquirer's previous position on the local markets.

Due to the employees' emotional reactions to the announcement, the handling of the announcement is the first task in making the acquisition successful. The announcement is the primary source of official information that the acquired personnel will have about their future and about the organisation they will be expected to integrate with and adopt. It is important to not only to guide the way for the change but also to allay fears, dispel rumours and introduce the acquirer to its new employees. (Cartwright & Cooper 1996, 117–118.) Previous research suggests that the announcement is best conducted face-to-face (see e.g. Cartwright & Cooper 1996, 119). This was also supported by the results on the study at the case company. The employees appreciated the company having gathered them up for a meeting where the Finnish management introduced the acquisition and explained its reasons. It was important for them to have personal contact with the management and to have the possibility to discuss the deal and its consequences.

To reduce both rumours and anxiety, communication should start early in the acquisition process and address the anticipated effects of the change (Risberg 1999, 63). It is important that the acquirer maintains high visibility in the acquired organisation, also following the announcement. The attitudes towards the acquiring company are formed in the early phases and the acquirer's presence will maintain the feeling of change among the employees

and make the actions of the acquirer more transparent to them. (Cartwright & Cooper 1996, 127; Risberg 1997, 264–265.)

Literature suggests that both formal and informal communication are increased in pre-combination phase, some researchers state that even to a magnitude of triple what it may have been in the past. (Thach & Nyman 2001, 148.) In pre-combination employees seek information, but paradoxically it is the time when information is restricted. In the planning phase of an acquisition, neither of the joining organisations is allowed to distribute information openly to the other nor the personnel concerned. In many acquisitions the official communication does not even start before the actual combination phase. However, it is almost impossible to keep negotiations as a secret, and the employees should therefore be at least informed that something is going on, this to prevent rumours from flourishing. (Risberg 1999, 63–64.) Providing employees with straight, explicit, honest and concrete information is likely to increase the trust for the company among the personnel even if the issue in question was difficult. The most important qualities of successful communication in an early, and also in the later phases of the acquisition process are honesty, trustworthiness, reliability and consistency. The more open the communication is the more it supports the integration between the merging companies. (Erkkilä 2001, 111-121.) These qualities of communication were also listed by the interviewed employees in the study. It seemed that especially the honesty and openness of communication served as describing the company's concern and appreciation to its employees.

### 3.2 Combination stage communication

In the combination phase of an acquisition a lot of decisions are made concerning the future operations of the company. These decisions are often specific and made by a small group of managers. The majority of the people in the workplace is unaware of these. In order to keep them motivated to work and committed to the company constant communication also about the small decisions and how the change proceeds is needed. (Risberg 1996, 9–10.) In general, the communication in combination stage should be more specific than in pre-combination stage. As more information on the implications of change becomes known, it should be transmitted to employees concerned to decrease the uncertainty they feel. Especially, an extra attention should be paid to informing about work and role related details as they become known. (Klein 1996, 37–42.)

The key point is to provide employees with concrete information concerning change outcomes and to ensure that they have a clear sense of

where to go and what to do (Bijlsma-Frankema 2001, 202; Klein 1996, 38). The combination stage communication thus aims to make sense to people's work by informing and supporting them in times of change. Once the acquisition is announced and on its way the primary function of communication is to supplement initial information. More importantly the communication should give direction to employees for the values and beliefs to be translated into clear behavioural practices. (Cartwright & Cooper 1996, 145.) The information put forth should never elaborate or speculate upon hypothesised scenarios of the future. Employees should not be expected to see more advantages or opportunities than realistic, nor should they expect that there will be no setbacks. (Appelbaum et al 2000b, 676.)

In the case company the combination stage communication was not previously planned and it was more reactive in nature than the communication in pre-combination stage. At the combination stage the communication mostly handled with concrete acquisition effects and emerged problems. Employees turned to grapevine in search for answers to human resources questions and the official communication was less continuous and consistent than in the previous phase. It seemed that the literature suggested efforts to reassure the employees should have been continued also in the combination stage.

A major problem for acquirers is the ability to keep communicating throughout the change process. It often happens that the day one communication is well planned, but as the implementation begins and other issues gain importance the management stops paying attention to communication. This was noted also in the case company studied. The early phases of the acquisition were carefully planned in terms of communications, but as soon as the deal was closed communication was no longer planned and given as much attention as earlier. Another factor impeding effective communication in combination stage is just waiting for information to be communicated. However, employees still expect communication do not know it and may start believing that decisions are being made without their knowledge. The answer is to communicate when employees expect communication, whether there is or not something concrete to inform about. (Hubbard 1991, 121–122.)

### 3.3 Post-combination communication

Even in the best circumstances, an acquisition can change the organisations in such extent that five to seven years are typically needed for employees to adopt and feel assimilated in the acquisition entity. (Appelbaum et al 20001, 653.) Post-combination phase is the phase when the goals set for the

acquisition are expected to be reached in form of synergy and increased efficiency. However, although questions about organisational structure and related issues begin to fade during this period, a number of cultural and role-related ambiguities still tend to remain. (Buono & Bowditch 1989, 99.)

In post-combination stage, the company has usually started revitalising from the previous' stages disturbances. The revitalising process is, however, slow and it can take easily a period of one to two years to fully recover. (Pritchett 1985, 101.) The recovering is the beginning for adaptation and it has been suggested that it often takes as much from 5 to 7 years the personnel to adopt the new corporate culture and be fully integrated into the new organisation (Covin et al 1997, 22). One of the management's most important tasks in post-combination phase is thus to find out what remains of each organisation, which employees remain and how they fit into the new organisation (Appelbaum et al 2000b, 681).

In post-combination phase it is important to create feeling of togetherness among the employees. Communication should celebrate the change and build understanding by spreading the word of success to the employees. Understanding in turn includes providing employees with such communication that enables them to become both aware of and comfortable with the personal implications of the change. Closest supervisors play key roles in this stage as the attention is in finding employees new and comfortable positions and work descriptions in the joint organisation. Communication has an important role also in supporting organisation's values and meeting objectives set for the acquisition. (Klein 1996, 37, 42.)

Acquired employees often experience high emotions whether or not there are to be any massive changes in the organisation. They often believe that acquirer's actions include "hidden agendas" and expect the "worst-case scenario". It has been noted that as a result to these negative expectation employees tend to reminisce about the past and the "good old days" in the old organisation. Employees often tend to forget much of the negative aspects and remember the past rosier than it actually was. Comments such as "they bought us because we are better than they are" are common. (Hubbard 1991, 33–34.) The new co-workers and their culture are seen as enemies threatening the old system (Risberg 1999, 57). This was also seen at the case company. Although employees were told how much the new owner appreciates them and how good an employer it is, it seemed that employees rather trusted themselves and their own perceptions. They wanted to see it for themselves how justified the company's procedures are before they accepted the contents of the pre-information.

In post-combination stage, frequent communication is needed in helping employees to adjust to changes made. They no longer expect as useful



information as in earlier stages, but support from the management. Thus, the communication should target the employees' need to organise their work and roles in the new organisation (Nikandrou et al 2000, 349; Risberg 1999, 64). Also, communication should be dictated by the motive behind the acquisition (Whalen 2002, 6). This means trying to persuade employees on the benefits of the deal rather than just telling them (Marks 1997, 275). It must be realised that for an organisational transformation to be successful, there must be an acceptance of the need for change at all levels of the hierarchy. The employees must be encouraged to let go off the past and the old habits, so that a widespread commitment to the change inside the organisation can be achieved. (Buono & Bowditch 1989, 14.) Employees of the acquired company need to be introduced to the history, values and norms of the acquirer. Introduction is best handled in a honest and humble way from preventing it to be regarded as brainwash. (Pritchett 1985, 117.)

Similarly to the views on acquisition process, communication also needs to be considered as a never-ending process in acquisitions. As the need for acquisition related communication within the organisation decreases the requirements for day-to-day communication maintain. This was the case also in the case company where the communication in post-combination phase was characterised by normal business operations and thus many of the interviewed employees felt that the acquisition related communication ended to the previous phases. They reported that the situation has already started to calm down and they no longer concentrated on the acquisition. This is in line with the previous studies indicating that the acquisition related communication slowly turns to everyday operational communication. Communication's most important task in an organisation is to support its business functions by informing and motivating employees to perform well in their work. (Åberg 1997, 110.) As it is, the need for communication in an organisation never ends, although the acquisition related restructurings will at some point.

## 4 Communication and work satisfaction in acquisitions

### 4.1 Challenges for work satisfaction in acquisitions

Employees in the acquired firm can find themselves in the difficult position of being members of an organisation in to which they never agreed to enter. As a result they may be reluctant to support the change and adopt the new organisation's procedures. (Hubbard 1991, 28–29.) Employees are concerned with how they will integrate to the new system and where they will be in the hierarchy (Appelbaum et al 2000b, 678). New relationships develop among

employees of combining firms, which will set a tone for the post acquisition climate. When the relationships between the employees of both joining organisations are good, employees do not feel threatened. In case of dissatisfaction, there is a high chance of "us versus them" feelings. (Nikandrou et al 2000, 336.) These kinds of attitudes emerge often early and continue throughout the process. Employees often keep speaking of "we" and "they" even after having worked together for years. (Panchal & Cartwright 2001, 425.)

The existence of two companies prior to integration phase in an acquisition may easily confuse employees. The role of an employee and his/her job description often changes in an acquisition. Traditional work rules about the "right way to do things" often fade away and employees need to find new, creative ways of performing their work (Thach & Nyman 2001, 149). In post-acquisition setting it is not unusual for the employees in the acquired company get the idea that the acquirer views them as less capable to meet new work standards. As a result, people in the acquired company may become less motivated and suffer a loss of confidence. (Pritchett 1985, 113–114) If employees feel that the acquiring company has no goals for them and they are uncertain about whether they will keep their jobs, it is unrealistic to assume that the activity in the acquired company will be constructive and future-oriented. (Risberg 1997, 263.)

In all, the new company procedures, environment and colleagues set challenges for adapting to the new company and letting go of the past. The employees' working environment is in change which is likely to affect also the way they perceive their work. Next, work satisfaction in relation to communication in an acquisition setting will be discussed.

## 4.2 Defining work satisfaction

Work satisfaction can be defined as the degree to which employees like their work and its different aspects (Spector 1997, 2) or as one's sense of satisfaction not only with the work but with the larger organisational context within which work exists (Büssing et al 1999, 1000).

One of the most classical theories of work satisfaction and motivation is that of Herzberg's. In his *motivation-hygiene theory* Herzberg (1996) has divided the factors affecting work satisfaction into two different sets of factors, dissatisfiers and satisfiers. The first set of factors, the dissatisfiers comprise of factors that essentially describe the environment in which the work occurs. These factors serve primarily to prevent work dissatisfaction and have only little effect on positive work attitudes. The other set of factors,

satisfiers, then include factors that describe an employee's relationship to his work and is thus intrinsic to her. Satisfiers or *motivators* positively affect an employee's satisfaction in his work. Thus, the factors involved in producing work satisfaction are separate and distinct from the factors that lead to work dissatisfaction. Furthermore, since separate factors are considered for work satisfaction and dissatisfaction, these are not obverse of each other. Thus, the opposite of work satisfaction is not dissatisfaction but no work satisfaction. (Herzberg 1966, 72–76.)

Another view on work satisfaction is on Crow and Hartman (1995) who suggest that instead of trying to improve employee satisfaction, a company should more concentrate on reducing employee dissatisfaction. They believe that work satisfaction has gained too much importance on organisational effectiveness and that employees even expect work satisfaction from their employers as an entitlement. As a result, they believe that employers should concentrate on eliminating sources of dissatisfaction such as abusive supervision, favouritism, poor working conditions and poor communications and that what most people view as a satisfaction, is in fact nothing more than absence of dissatisfaction. (Crow & Hartman 1995, 34, 37.)

It is still suggested in the literature that work satisfaction positively influences work performance. However, Crow and Hartman (1995) argue that it is more work dissatisfaction that affects performance, but in a negative way. What they mean is that when employees are dissatisfied they become preoccupied with their sources of dissatisfaction and can no longer perform as usually. When employee attention is absorbed in a frustrating, difficult or uncertain situation, they are not as effective as they in normal conditions could be. (Crow & Hartman 1995, 35–36.)

According to Herzberg (1966, 78) work satisfaction can be enhanced only by satisfiers, hygiene factors fail to provide positive satisfaction as they do not possess the characteristics for giving an individual a sense of growth and satisfying his/her sense of self-actualisation (Maslow 1954, 30). As it follows, managerial efforts to enhance an employee's work satisfaction could be targeted to changing his work and its content as the efforts to decrease employee's work dissatisfaction should target the work environment and working conditions. (Herzberg 1966, 78.)

In acquisitions, the management's primary concern is to implement and manage the change as smoothly and effectively as possible. This means that it concentrates on the change of the organisation and the work descriptions of the employees in times of change come second. From this perspective, the management's efforts during the acquisition should be targeted in decreasing the dissatisfaction created by the change among employees. Also, as already stated, an acquisition creates uncertainty and ambiguity to employees'

working conditions. According to Herzberg's theory this perceived uncertainty leads to work dissatisfaction that may also negatively affect the employees' work performance. Although other views on work satisfaction have been presented and argued in relation to the Herzberg's theory, it seems applicable for the study of acquisition effects on employees' work satisfaction (or dissatisfaction), being mostly extrinsic.

Previous research on work satisfaction suggests that communication practices within the company influence the level of satisfaction the employee experiences in his/her work. In the following chapter the relationship of communication and work satisfaction will be more closely discussed.

### 4.3 Communication's role in creation of work satisfaction

Communication is an important element in managing employee satisfaction in acquisitions. Studies have found that in the months following the acquisition announcement adequate communication correlates highly with employees' work satisfaction. (Hubbard 1991, 91.) The concept of work satisfaction is closely linked to another concept of satisfaction, the concept of communication satisfaction. Communication satisfaction refers to how well the available information fulfils employees' requirements for information or how satisfied they are with the information (Pace 1983, 129). Communication satisfaction is in other words an evaluation based on employees' subjective observations (Tukiainen 2001, 48).

Previous research on communication in mergers and acquisitions indicate that employees should be provided with honest and open, but also realistic view to the process (Schweiger & Denisi 1991, 113). Noteworthy is that the quality of communication is never distinct from the content of the communication. Rather, both serve as factors influencing the level of communication satisfaction an employee experiences. In fact, in the case company open and honest communication were reported to have caused both satisfaction and dissatisfaction among the employees. Communicating honestly and openly about the problems did not raise moral, rather it made the situation look even worse. It seems that although openness is suggested and communication should be real time, the messages should be translated to as positive as possible with the message being fact. It was mentioned in the interviews that the receive of constant negative communication made some employees even tired for communication. Thus, it seems that although it was good to be frank, it would not have been always necessary to introduce employees only with the cruellest reality. Rather, when the communication topics are negative, it might be of idea to regularly pass on some good news

also. There is always something to share with employees, something that is positive and might help employees to create a more positive attitude towards the changes.

The quality of communication is not the only factor affecting communication satisfaction, information adequacy also plays its role in the picture. Information adequacy means the actual amount of information and employee perception about whether they were adequately informed. From the management point of view the concept of information adequacy includes the question of 'what employees should know'. Decisions concerning what information should be transmitted to the lower levels of organisation are usually made in top management and are likely to contradict with the employee perceptions of what they should know. (Pace 1983, 130–132.) In the case company each management level passed on little less and modified communication than they self received. This enabled the messages to be tailored for the target group's needs, but reduced the feeling of communication openness at some points. Also, it was noted that different employees perceived information adequacy differently. Others found information adequate and even excessive where as others found it clearly inadequate.

When people are not happy with their work, they are said to experience work dissatisfaction. Two important causes of dissatisfaction are communication related. First, an employee may feel that (s)he has inadequate information to do her job. Second, (s)he may feel that the working environment and the relationships at the workplace, either with colleagues or superiors, are poor. (Hunt 1980, 42.) In acquisitions these both scenarios are likely. In most cases, the tasks of employees will change. Some more than others, but the changes will still cause dissatisfaction if the employee does not receive adequate information and support from the management to overcome the stressful situation. As change always brings along uncertainty, the working environment is stressful and ambiguous in acquisitions. Many researchers state that the ambiguity employees experience in acquisitions is the outcome of lacking communication. Ambiguity is often associated with decreased work satisfaction and commitment. However, it is not just failing communication that creates ambiguity but the change itself. (Buono & Bowditch 1989, 102.) It seems that the acquisition in most cases decreases work satisfaction even if communication is successful. Thus, the impact that communication has on work satisfaction can be seen as alleviating to the stressful impact of the acquisition.

Research indicates that communication satisfaction precedes and signals for work satisfaction. (Juholin 2001, 113.) Employees satisfied with communication are also more satisfied with their work. Communication satisfaction and work satisfaction also indicate work motivation. (Åberg 1997,

106.) The quality of communication is important for the creation of both communication and work satisfaction. It is important to find a balance between informational and emotional aspects of communication in order for the employees to be satisfied with the company's communication. On one hand communication should be informative and give employees means to cope with the ambiguities experienced and on the other hand it should indicate the company's care and concern for the employees. The more open, honest and connected to employees the communication is the better it is experienced and the more satisfied the employees are with their job, their supervisor and the whole company. (Juholin 2001, 111–112.)

Communication satisfaction and work satisfaction seem closely linked to each other. Although it is not always clear which one is the cause and which one the effect, it is suggested that a company concerns with its internal communication. Open and honest communication is more likely to affect employees positively than not communicating at all. Even if communication fails to create work satisfaction, it in most cases has the possibility to alleviate the effects of acquisition by letting employees know their position and where the company is going.

## 5 Summary and Conclusions

The purpose of the study was to discuss the role of internal communication in an acquisition and assess its effects on employees' work satisfaction.

In acquisition the employee needs and company goals for communication change along the process. Employees have different needs for communication in different phases of an acquisition. Also, the company has different challenges for communication in different phases of an acquisition. Thus, the success of the communication efforts much depends on how these two are combined. Successful communication not only meets the employee needs, but at the same time it also encourages them to adapt to the new company procedures and support the change.

The way the acquisition is handled from day-one affects not only the pre-stage but also the subsequent phases in the acquisition. Rumours preceding the official acquisition announcement usually create ambiguity and uncertainty among employees. Communication's role in the pre-stage is to alleviate these effects and give employees some direction for the future. The pre-stage thus handles most with reassuring acquisition involved employees. These were well noticed in the case acquisition. Although the rumours lasted long, the announcement and first months of the combination were carefully planned in terms of communication. Employees received the announcement as a relief

and as communication was constant, they reported only few concerns about the future.

In combination stage the actual changes start taking place and employees need more concrete information concerning their own position and role in the company. They still need to be reassured about the future, but the emphasis should be more on making them to accept the changes and the new direction of the company. In the case company combination stage communication was characterised with acquisition related restructurings as well as every-day issues. No special attention was paid to acquisition progress. In fact, communication at this stage was no longer planned and it only reactively answered the questions came up within the organisation.

In post-combination stage the challenge is to make employees to commit to the new organisation and their new own place in it. The communication should turn slowly to handling every day issues and be more concrete in nature than in the previous stages. The need for acquisition related communication within the organisation eventually decreases, but the requirements for day-to-day communication maintain. In the case company the acquisition related communication had mostly ended already in combination stage. Post-combination stage was more characterised with giving order to the company's business and continuing it under the new company name and culture.

It seems that open and real time communication were most appreciated qualities of communication among the acquired employees. Knowing what happened gave employees certainty about their own positions as well as about the company's direction. However, it must be noted that real time communication did not seem to be the only key to success. Although suggested that communication should always be as open and frank as possible, it should still aim at meeting the employee expectations. Communicating frankly about problems does not always lead to satisfaction. Rather, employees anticipate good news. Successful communication meets or surpasses the expectations both in timeliness and openness as in quality. Communication should be open and real time, but the messages should be translated to as positive as possible with the message being fact. It is not always necessary to introduce employees only with the cruellest reality. Rather, when the communication's topics are negative, it might be of idea to regularly pass on some good news also. There is always something to share with employees, something that is positive and might help employees to create a more positive attitude towards the changes.

The relationship between communication and work satisfaction seems to exists, but to be never solely direct. Previous studies on the subject have much concentrated on presenting the negative effects poor communication may have

on employees in acquisition. The positive effects have gained less attention. In fact, communication as a management tool in change situation is still a good and relevant topic for further studies. Assessing communication from the positive view-point would give companies an insight on how to benefit from carefully planned communication in managing change and employees' work satisfaction in acquisitions.

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# CULTURAL INTEGRATION IN A CROSS-BORDER ACQUISITION. A CASE STUDY

*Niina Nummela*

## 1 Introduction

Globalisation and the constantly changing business environment have forced enterprises to become more dynamic and adaptive to change. Increasing deregulation and disappearing boundaries on all levels have made competition the dominant element in every field. Additionally, worldwide industry consolidation and privatisation can be mentioned as global trends which have changed the global business environment permanently. As a result, growth-oriented companies have encountered the fact that organic growth on international markets – as traditionally understood – has become less lucrative option or sometimes even impossible. At the same time, acquisitions have often provided opportunities for gaining new knowledge and thus offering competitive advantage (Hitt & Pisano 2004). Consequently, growth with mergers and acquisitions has become a viable strategy for numerous internationally expanding companies.

In the literature the terms merger and acquisition are often used interchangeably. However, there is a clear difference between the two concepts, and this study focuses on the latter, particularly in the case when the parties in question represent different nationalities.<sup>1</sup> Acquisition is here defined as "the act of buying more than 50 per cent of a vendor's equity after which the vendor's assets are incorporated into those of the acquiring company. The vendor as a legal entity disappears" (Lees 2003, 273).<sup>2</sup>

The number of cross-border acquisitions has increased both in the Finnish economy (Ali-Yrkkö et al 1997) but also on a global scale (New patterns ...

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<sup>1</sup> In line with Shimizu et al (2004), a cross-border acquisition is understood here as an acquisition in which the headquarters of the acquirer and the target are located in different countries.

<sup>2</sup> Nevertheless, for an outsider the change may not be very noticeable, as the units may continue to operate under their earlier names.

2001). In Finland the share of foreign-owned enterprises has grown steadily and, in 2002 their turnover was 17.5 per cent of the turnover of Finnish enterprises (Foreign-owned enterprises in Finland 2004). On the other hand, globally the value of international M&As has exceeded USD 1 trillion and the number of particularly large-scale deals is increasing (New patterns ...2001).

Therefore, it is not surprising that also the research on the field of mergers and acquisitions is living a period of renaissance. Whereas the focus in earlier research was on hard facts related to value creation and capital markets, the emphasis seems to have shifted towards softer values and human behaviour.<sup>3</sup> Additionally, a temporal change in the research focus has occurred: instead of antecedents, the process and outcomes of acquisitions have become increasingly interesting (Shimizu et al 2004). In other words, the interest of academic research has been transferred to the end of the acquisition process arguing even that 'all value takes place after the acquisition' (Haspeslagh & Jemison 1991). It seems that particularly from the viewpoint of cross-border acquisitions, more research would be required in order to increase our understanding on the effects of culture and institutional differences on post-acquisition integration (Hitt & Pisano 2004).

A successful acquisition is reflected both in the performance of the company and in the wellbeing of the employees (cf. Birkinshaw 1999). Lees (2003) even argues that in order to succeed in an acquisition, instead of financial or market knowledge, the parties need deep understanding of human and organisational and cultural processes. It can be argued that acquisition is a critical event from the perspective of employees. Organisational change and the often resulting cultural shock may be a turning point from which the development of employees' commitment to the organisation may turn either to positive or negative direction, only very seldom it remains unchanged (cf. Cartwright & Cooper 1995). From managerial perspective, one of the most challenging tasks is to keep the employees motivated and committed (Shrivastava 1986).

Earlier research on mergers and acquisition includes discussion on human resources and culture, but they have not been often studied in the context of cross-border acquisitions (e.g., Lees 2003, Very & Schweiger 2001, Krug & Nigh 1998, Olie 1994 could be mentioned as exceptions of the rule). This is rather surprising as the international aspect adds a new and quite challenging

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<sup>3</sup> Haspeslagh and Jemison (1991) have identified four schools of thought in studies of mergers and acquisitions: (1) capital markets school, (2) strategic management school, (3) organisational behaviour school and (4) process perspective.

dimension in the integration process. This study intends at least partly to fulfil this gap. *The purpose of this study is twofold: first, to describe the integration phase of cross-border acquisitions from cultural perspective and, second, to demonstrate the versatility of the phenomenon with the help of a case.* The perspective taken is the one of a Finnish company acquired by a Swedish one. The case selection is discussed in detail in section 4.1.

To sum up, although domestic and cross-border deals share significant similarities, it can be argued that also differences exist. Operating in a novel business environment is challenging and involves problems that are rooted in national, business and/or organisational culture, which also may have an impact on the implementation of acquisition (cf. Olie 1994). However, it should be noted that problems in cross-border acquisitions are not only due to cultural differences but also other types of challenges exist due to the geographic and institutional distance, market structures and differing strategic orientation of executives (Hitt & Pisano 2004, Risberg 2001). Hence, it seems that cross-border acquisitions offer a fruitful and interesting context which to study.

## 2 Integration of two units into one

From managerial perspective the primary target after acquisition is to integrate the companies into well-functioning – but not necessarily single – unit sharing similar organisational culture. It can even be argued that the success of an acquisition depends how well the managers manage the difficult integration process at the newly purchased company (Legare 1998). However, the need for integration varies considerably. From the viewpoint of integration, the extreme cases include those in which the target remains wholly independent of the acquirer after the deal and the ones in which it is fully merged to the acquirer. Between these two opposite examples, numerous alternative degrees of integration exist, ranging from changes in top management and strategy to more comprehensive or selective merging of some functions. (Lees 2003)

This integration occurs at several levels and it can be classified, for example, into procedural, physical and managerial integration (Shrivastava 1986). Another type of classification is the division between task integration and human integration (Birkinshaw 1999). The difference between the two classifications is that the first focuses on the object of integration (procedures, systems, product lines, units, technologies, personnel), whereas the latter emphasises the outcomes of integration (task integration referring to the successful combination of activities, human integration referring to the creation of satisfaction among employees). Both dimensions of the integration

process – task and human – are significant for the outcomes of the acquisition (Birkinshaw et al 2000, Birkinshaw 1999). One of the major managerial challenges in the integration process is how to prioritise the dimensions. There is always a trade-off: when focus on rationalisation of activities easily results in improved performance but demotivated personnel, emphasis on organisational acculturation ends up with happy employees but less measurable cost savings (Birkinshaw 1999).

It has been argued that the different types of integration vary in implementation. Although all types of integration include their own, sometimes very specific problems, it has been suggested that the most straightforward type of integration would be procedural; a bit more complicated the physical integration (such as combination of product lines and technologies) and finally, the most complex being managerial complication (Shrivastava 1986). In addition to the complexity, the timescale of managerial integration differs from the others; for example, cultural change is a long and difficult process (cf. Cartwright & Cooper 1995). In line with many other researchers, here it is assumed that the *managerial dimension is critical in the success of post-acquisition integration and therefore this viewpoint is applied in this study* (see Figure 1).

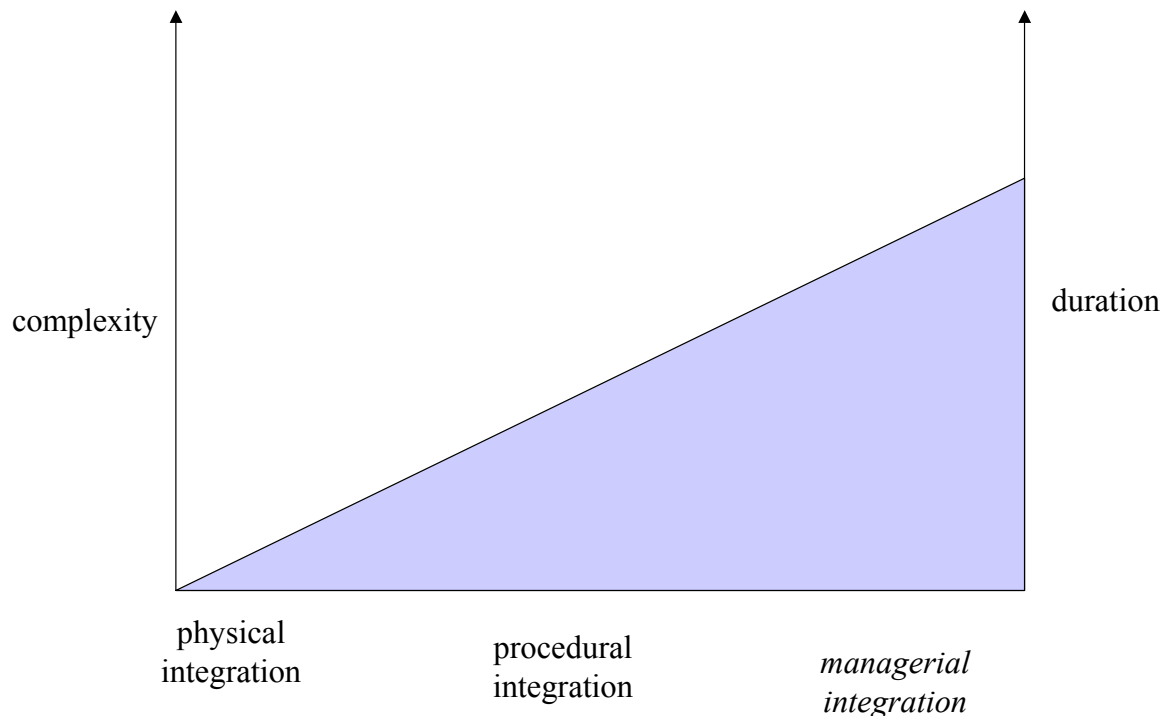


Figure 1. Post-acquisition integration and the focus of this study (Nummela 2004, 101)

The context of cross-border acquisition brings additional challenges to the post-acquisition integration, as the parties represent different nationalities and, thus lack a common cultural frame of reference. Additionally, the institutional contexts may differ between the countries and both types of obstacles may increase the perceived cultural differences between parties. (Olie 1994) Earlier research has also shown that the preferences for certain types of integration processes depend on the nationalities of the parties (Shimizu et al 2004). These impediments are further complicated by personal dissimilarities and, it can be concluded that there is no uniform way to guide the managerial integration and the organisational and cultural changes that result from a cross-border acquisition (Legare 1998).

### 3 Cultural perspective to post-acquisition integration

In earlier research particularly the significance of culture in managerial integration has been highlighted (Shrivastava 1986). Buono et al (1985) stated already almost two decades ago that combining two different organisational cultures is one of the major difficulties in acquisition, and the topic has remained a salient factor affecting the acquisition process as well as its outcomes (e.g., Hitt & Pisano 2004, Krug & Nigh 1998, Cartwright & Cooper 1995). The challenge for managerial integration is probably even bigger when the parties represent different national cultures (Lees 2003, Weber et al 1996, Olie 1994).

Lack of cultural fit between the partners – i.e., the degree of compatibility between cultures – has often been named as an important antecedent of failure (Weber et al 1996, Olie 1994). In other words, the motives for acquisition and strategic fit between partners determine the need for integration but from the viewpoint of the implementation of integration, cultural fit is crucial. However, the concept of cultural fit has so far been poorly defined (Cartwright & Cooper 1993), and particularly the various levels of culture have been ignored (Weber et al 1996). The next section discusses the various interpretations of culture in the context of acquisitions.

#### 3.1 Cultural elements of the integration

From organisational viewpoint acquisitions are dramatic events that trigger various kinds of changes in the organisational culture (Vaara et al 2003). Cross-border acquisitions are particularly interesting research objects, because they bring together firms with different organisational cultures as well as

different national cultures (Larsson & Lubatkin 2001, Weber et al 1996), thus increasing the probability and degree of adaptation required. Consequently, in the context of international acquisitions cultural differences should be interpreted broadly.

Although generally culture has been defined in numerous ways, in the context of cross-border acquisitions most authors seem to focus on one level of culture, i.e. national or corporate culture (Weber et al 1996). However, a few studies exist in which the different layers of culture have been distinguished. For example, Teerikangas and Laamanen (2002) divide the cultural dimension in acquisition into functional culture (unit culture, professional culture), corporate culture (power, network, task and person culture) and national culture (power distance, uncertainty avoidance and context of communication). On the other hand, Buono et al (1985) separate subjective and objective organisational culture as well as organisational climate. However, as the cultural integration focuses first and foremost on adaptation of individuals, in this study the layers of culture are drawn from Lees' (2003) domains of human factor in acquisition (Figure 2). It is assumed here that cultural integration takes place on all the levels.

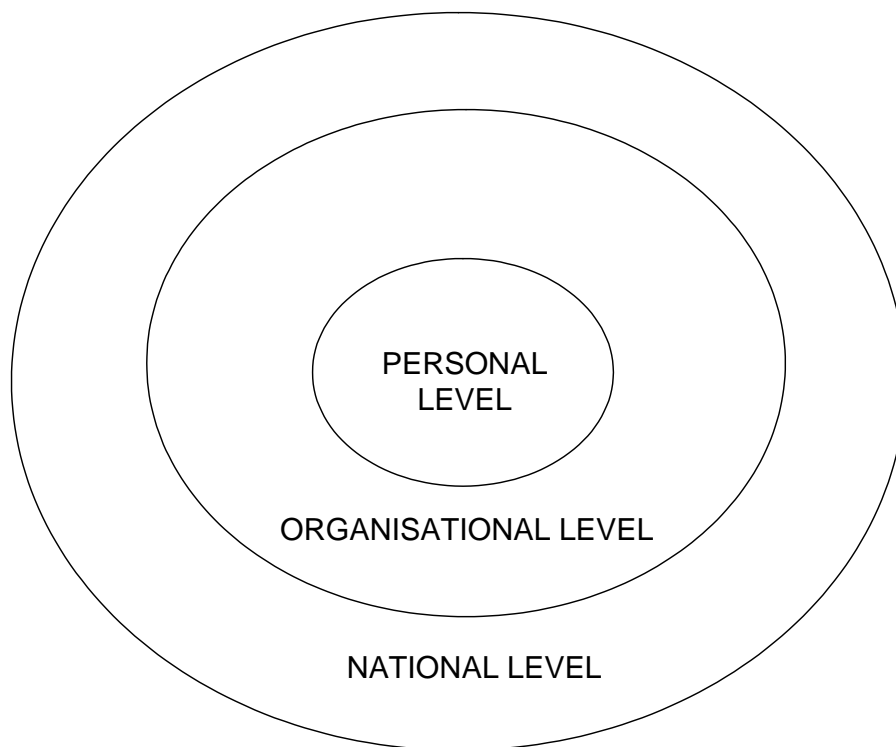


Figure 2. Layers of culture in cross-border acquisition

*Personal level* refers here to the reactions of individuals in the target company. Organisational change – such as an acquisition – has immediate



impact on employees' understanding of the organisation and their membership and role within that organisation (Vaara et al 2003). The experiences that employees relate with acquisitions vary considerably, depending on how they are cognitively appraised and interpreted. An individual's appraisal is determined primarily by uncertainty, duration of uncertainty and imminence. (Ivancevich et al 1987) Often the outcomes of acquisitions are viewed as negative, such as job relocations and loss, causing fear, uncertainty and stress (Lees 2003). Lacking information makes the employees turn to speculations and rumours and the longer the uncertainty take or the more imminent the events are, the more stress the person experiences (Ivancevich et al 1987).

However, the impact of acquisition differs depending on the individual's position in the company. Usually it can be assumed that the effect is stronger on managers than other employees. Managers may lose some of their earlier authority as they are required to ask for approval from their new superiors (Haspeslagh & Jemison 1991). Because of this autonomy retrieval and new power structure the managers in the acquired company may feel dissatisfied and be unwilling to adjust to the new organisational culture (Larsson & Lubatkin 2001). Managers from different national cultures also understand nature of management, authority, structure, and organisational relationships in a different way (Laurent 1989). On the other hand, managers' personal characteristics – such as their global mindset – may help them to adjust to new cultural settings because it allows them to recognise the value of diverse cultural perspectives (Shimizu et al 2004).

If the immediate outcomes of acquisition are mostly seen on the individual level, the success of integration is usually evaluated on the level of the acquired organisation. The *organisational level* here relates with acquisition-related changes in the corporate/organisational culture of the target company. These changes may manifest themselves, for example, in the values, self-image, work-related norms, organisational practices (management and control, treatment of employees, artefacts) and power structure in the firm (cf. Lees 2003, Cartwright & Cooper 1992). The acquirer may try to manage the cultural change on organisational level, but it has to be kept in mind that change processes in organisational culture are complex, slow and bound to encounter resistance (Schein 1989).

In addition to cultural clashes on organisational level, in literature on cross-border M&As, the differences in national cultures are highlighted. Cultural integration should be also evaluated on *national level* because organisations are embedded into national cultures which reflect shared historical experience and institutions. As members of one nation are expected to share a common set of values which shape their preferences for many issues (cf. Hofstede (1980), it can be assumed that in cross-border acquisitions the interface

extends beyond one's own culture and the parties are bound to encounter something different (Lees 2003). Additionally, organisations with distinct national cultures are likely to favour diverse means in order to implement the desired changes (Laurent 1989).

The degree of difference between national cultures maybe measured with the concept of cultural distance. It has been defined as "the sum of factors creating, on the one hand, a need for knowledge, and on the other hand, barriers to the knowledge flow and hence also for other flows between the home and the target countries" (Luostarinen 1979, 131-132). In the context of cross-border acquisition it also reflects the acquirer's ability to apply its strategic advantages to a different location (Shimizu et al 2004). It could be assumed that a lower cultural distance would also mean easier integration of the companies. However, earlier research findings are slightly contradictory and actually instead of distance, both parties' familiarity with the business environment or socialisation may be more decisive (Larsson & Lubatkin 2001, Weber et al 1996). Additionally, the request for cultural fit is strongly intertwined with the integration process and, the need for integration in particular. It is natural to assume that cultural clash is more probable in acquisitions where need for integration is more significant (Weber et al 1996, Nahavandi & Malekzadeh 1988). Furthermore, differences in national cultures do not only pose challenges but also present important opportunities for market entry, learning and acquisition of knowledge (Hitt & Pisano 2004).

This study includes a description of a cross-border acquisition in which a Swedish company acquired a Finnish one and, therefore the next section discusses the cultural distance between Finland and Sweden.

### 3.2 Finnish vs. Swedish culture

At first glance it might be argued that the distance between the two neighbouring countries is quite low. However, a closer look reveals that despite the short physical distance some differences between the national cultures can be identified. For example, the well-known classification of Geert Hofstede points out some diversity between the Finnish and Swedish culture (Table 1).

Table 1. Classification of Finnish and Swedish cultures (based on Hofstede 1980)<sup>4</sup>

	<i><b>Individualism</b></i>	<i><b>Power distance</b></i>	<i><b>Uncertainty avoidance</b></i>	<i><b>Masculinity</b></i>
Finland	63	33	59	26
Sweden	71	31	29	5

The comparison reveals that particularly when measured with power distance, the two cultures resemble each other. In other words, in both countries organisational hierarchies are low. However, all other dimensions in the classification indicate a clearer distinction between the cultures. The most noticeable difference seems to be in uncertainty avoidance: Finns tend to use diverse norms and rules more than Swedes in order to avoid the uncertainty related to decision-making, for example.<sup>5</sup>

Hofstede (1980) also attempted to integrate the four dimensions and based on that to cluster countries. Measured with uncertainty avoidance and masculinity, Sweden and Finland belong to the same cluster of countries, but they are quite far away from each other. On the other hand, when described with power distance and uncertainty avoidance, Sweden and Finland are in different clusters. According to these dimensions, Sweden belongs to a cluster with other Northern European countries (Denmark, UK, Ireland), whereas Finland is in same cluster with mainly German-speaking Central European countries (Switzerland, Austria, Germany, Israel). To conclude, it seems that Finnish and Swedish cultures share certain similarities but also considerable differences exist. However, it has to be kept in mind that Hofstede's research dates back to the 1970s and since that time the world has changed considerably. A growing number of researchers have argued for homogenisation of markets and amalgamation of cultures.

On the other hand, empirical research on cross-border M&As has also highlighted the role and significance of national differences. For example, in a recent study on a Swedish-Norwegian merger one of the reasons for failure was lack of preparation on both sides because of the perceived similarities between the two countries (Fang et al 2004, cf. also Weber et al 1996). Moreover, also other studies indicate that Finns and Swedes seem to perceive

<sup>4</sup> This classification originates from a well-known international research project in which Hofstede studied culture and work-related values with data from 117.000 individuals from 66 countries (Hofstede 1980).

<sup>5</sup> Hofstede (1980) mentions memos, reports, planning and controlling systems as well as expert opinions as means to control the uncertainty.

themselves as different (e.g., Laine-Sveiby 1987). This perceived difference may partly due to sentiments related to history<sup>6</sup>, as Finland used to be a duchy of Sweden for 600 years, until early 19<sup>th</sup> century. This has sometimes lead to a ‘big brother – little brother’ attitude, which was demonstrated in a recent merger of Merita and Nordbanken (Vaara et al 2003).

In spite of the common history, the two countries also differ clearly from political point of view. Although both countries can be described as Western democracies, the political life in Sweden has been dominated by one party – the Social Democrats – for decades. Under their rule, the state has been dominated by consensus decision-making and welfare state and it has created a culture resulting in a situation where the transactions in the Swedish economy are based on jointly negotiated agreements, long-term considerations of resource dependence and voluntary compliance (Larsson & Lubatkin 2001). In spite of the strong and long presidency of Urho Kekkonen, the number and power of political parties has been more versatile in Finland and, also the distribution of power has been more equal between parties. For example, in Finland the three main parties have taken turns as the leading political party.

The society and organisations reflect shared values of both national cultures. Swedish organisational culture has been described as participative, planning-oriented and conflict avoiding, whereas Finnish organisational culture emphasises individual responsibility and decision making, spontaneous and action- and fact-oriented (Laine-Sveiby 1987). These characteristics and their empirical expressions (such as indefinite discussions of Swedes) were clearly visible in the mentioned Merita-Nordbanken merger as well (Vaara et al 2003).

However, all is relative. First, cultural compatibility does not always imply cultural similarity but complementarity (Hitt & Pisano 2004, Cartwright & Cooper 1993, 1992). In other words, there may be cases where the cultural clash between Finns and Swedes has been noticeable whereas in other cases the parties have felt that the cultural fit has been excellent. Additionally, from the viewpoint of a third party, the situation may look totally different. For example, according to a recent study on Swedish-Norwegian merger, co-operation between Finns and Swedes seem to function better than Norwegians and Swedes, because of common interest in technology and production (Fang et al 2004).

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<sup>6</sup> For example, Fang et al (2004) have strongly emphasised the role of historical sentiments and emotions as explaining factors in the success of international mergers.

### 3.3 Acculturation – the underlying process in cultural integration

Acquisition is not an end but a start for a complex social identity-building process both on organisational and individual level (Vaara et al 2003). In this lengthy process a new social identity is created, based on joint experiences, beliefs, values and assumptions (Larsson & Lubatkin 2001, Olie 1994). The aim is a jointly shared, constructive culture (Larsson et al 2004).

In acquisitions two simultaneous processes takes place: reconstructing one's own identity in relation to the other party (images of Us and Them) and a common identity in the new organisation (images of Common Future) (Vaara et al 2003). Additionally, in a cross-border acquisition one needs to keep in mind that acculturation is double-layered, i.e., adjustment both to a foreign national and foreign corporate culture is required (Barkema et al 1996). The co-existence of two layers of culture which the companies must contend creates potential for additional conflict (Hitt & Pisano 2004).

Earlier research has shown that there is no universal way for acculturation but instead, numerous paths lead to the same end result and also the degree of acculturation may vary. For example, Sales and Mirvis (1984) distinguished three levels of acculturation after an acquisition: cultural pluralism (partners cultures are allowed to coexist), cultural integration (at least partial integration of cultures) and cultural assimilation (the culture of one party is absorbed by the other). Another well-cited classification has been presented by Cartwright and Cooper (1992) who state that acculturation may take the form of assimilation, separation, deculturation or integration, depending on the parties' satisfaction with the existing culture and the attractiveness of the other culture

In addition to satisfaction with own culture and the attractiveness of the other, also other factor have been found significant in determining acculturation. These include, for example, autonomy retrieval, merger relatedness, relative size of parties, social control and national culture (Larsson & Lubatkin 2001). Barkema et al (1996) also found that in ventures which required double-layered acculturation, the parties attempted to increase their cultural fit through learning.

The progress of acculturation can be followed through employee resistance, which is employees' reaction to the acculturation process (Hartog 2004). The sources of employee resistance may be individual or collective and they may originate from different cultures but additionally from communication problems and negative effects of acquisition on personal level (Larsson et al 2004). The resistance is highest in situations which involves both high level of organisational and personal uncertainty (Hartog 2004).

Acculturation takes time, and therefore it is probable that we can not draw any definite conclusions on acculturation in our case. However, the case

description in the following section takes into account the different factors that may have an impact on the acculturation in this particular case. Additionally, we have to keep in mind, that organisational culture is a dynamic phenomenon and thus under constantly ongoing change (Schein 1989). Therefore, acquisition is not an end of one culture but it could be described as a critical turning point in the development path of one corporate culture.

## 4 Case Carrus Turku

### 4.1 Case selection and data collection

In order to demonstrate the complexity of the phenomenon in question, the post-acquisition integration of one cross-border acquisition is described. Case study approach seemed appropriate, as this ideographic research design allows us to investigate the cultural issues and ‘softer’ processes of integration in their real context (cf. Larsson & Lubatkin 2001). The case selected is the acquisition of Carrus by Volvo Bus Corporation in 1998. The case seemed suitable for several reasons. First, as a Finnish-Swedish acquisition it seemed to represent a rather typical case of cross-border acquisition.<sup>7</sup> Second, the timing for data collection (in 2001) was appropriate: three years after the acquisition the integration phase should be finalised and the impact of the acquisition visible. Third, the case was interesting from the perspective of industry. The company sold was a major player on the Nordic market and the price paid for it was approximately 27 MEUR (Suomalainen bussikorien valmistaja... 1997). Fourth, as the interest in this study lies in cultural integration, it was interesting to study a case in which the cultures of two very different companies were integrated. Basic information of both companies is given in Table 2 below.

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<sup>7</sup> The majority of foreign-owned companies in Finland are owned by Swedish companies (Foreign-owned enterprises in Finland 2004).

Table 2. Basic information of the parties in the case acquisition<sup>8</sup>

	<i><b>Role in acquisition</b></i>	<i><b>Turnover 1997</b></i>	<i><b>Personnel 1997</b></i>	<i><b>Ownership</b></i>
Volvo Bus Corporation	Acquirer	10582 MSEK (~96176 MEUR)	4220	A division of multinational Volvo Group which is a listed company <sup>9</sup>
Carrus	Target	697 MFIM (~116 MEUR)	662	Family-owned private company

Although Carrus Oy had been a significant actor on the Scandinavian market for years, the difference to Volvo Bus Corporation was considerable. At the time of the acquisition the market share of Volvo Bus Corporation was 14 per cent on the world market and 21 per cent in Europe (Suomalainen bussikorien valmistaja... 1997). It was the leading manufacturer of buses and bus chassis weighing more than 12 tons in Europe, and globally the second after Mercedes (Suomalainen linja-autokorien valmistaja... 1997). Today, its manufacturing is located in Europe, North America, South America and Asia. The product range is also considerable: the products include various types of buses and transport systems for urban and tourist traffic. (Volvo Group 2004)

From financial perspective the acquisition seems to be a rather successful one. After the acquisition, the performance of Carrus Oy has developed positively until 2001 (Figure 3). The decrease in turnover in 2001 was mainly due to the closing of one manufacturing unit but as the number of personnel decreased accordingly, the operating margin and business profit remained stable. The impact of the acquisition on the performance of Volvo Group is very difficult to evaluate as the development of the value of Volvo's shares (see The Volvo share 2004) reflects numerous other issues as well.

<sup>8</sup> This information is collected from the Voitto (2004) database and the annual report of Volvo Group (Volvo Group 1997).

<sup>9</sup> The shares are mainly traded at the Stockholm Stock Exchange, London and on NASDAQ. Volvo Group had 225 000 shareholders at the end of year 1997; the largest being Swedish institutional investors, such as banks and insurance companies (Volvo Group 1997).

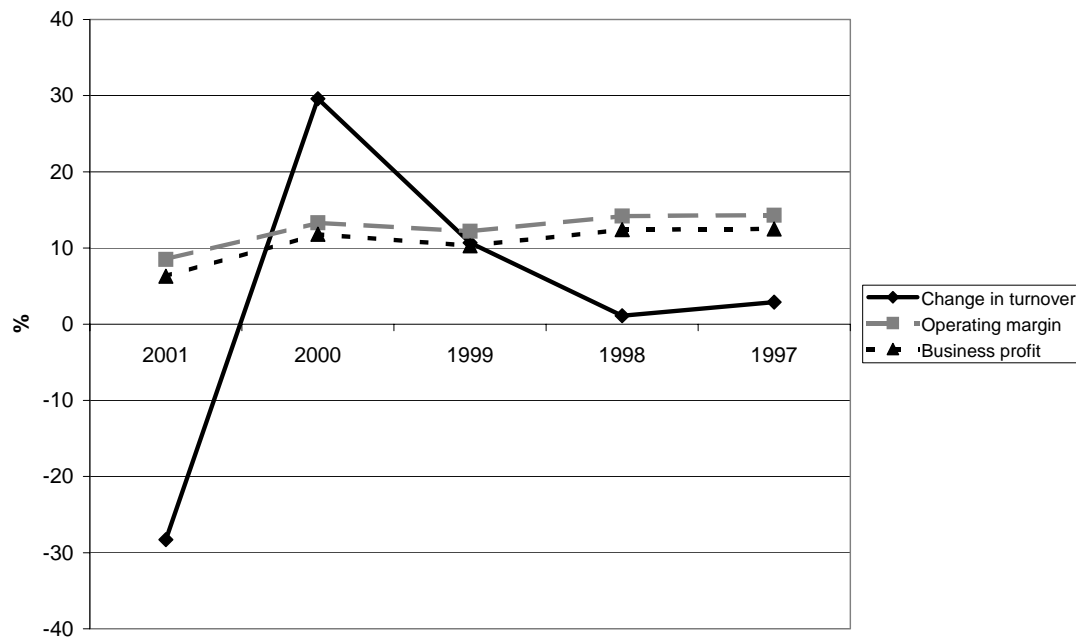


Figure 3. Development of selected financial indicators of Carrus in 1997-2001<sup>10</sup>

The viewpoint taken in this study is the one of the acquired company, to be precise the perspective of one of its units. In 1998, at the time of acquisition Carrus had three manufacturing units located in Vantaa, Tampere and Lieto. The unit in Vantaa has been later closed down. After the acquisition the company has established a service and engineering centre in Helsinki in 2002 and a subsidiary – Carrus Scandinavian Ltd – in Sweden in 2001. The subsidiary is responsible for spare part deliveries to foreign customers. (Carrus 2004) Carrus Turku (located in Lieto) was selected as the focus of this study because of its longest history (see Figure 4) and its closest proximity.

For this study the main source of data information was face-to-face interviews with the personnel of the Carrus Turku unit. The interviews were conducted by students of the Turku School of Economics and Business Administration.<sup>11</sup> Altogether six persons were interviewed for the study. The main selection criterion for interviewees was that the person had had to be employed at the company already before the acquisition. The interviewees included senior managers and one shop steward. All face-to-face interviews

<sup>10</sup> Information based on the Voitto database (Voitto 2004)

<sup>11</sup> The students worked in groups of three and each group did one interview. This interview was part of their assignment for a course on qualitative research methods. The students gave their permission to use the interview material in further studies.



were conducted in autumn 2001 at the premises of Carrus Turku. Each of these interviews was tape-recorded and transcribed.

In addition to the interviews, secondary data of the companies and acquisition was also collected and used in the analysis. The sources for complementary data included various public databases for financial information as well as published material, such as newspaper articles and company websites.

## 4.2 Description of Carrus Turku

Carrus Oy as a legal entity was created in 1989 as a result of a merger of two bus body manufacturers (Carrus 2004).<sup>12</sup> However, Carrus Turku – the unit studied for this study – has a long history before that (see Figure 4); it goes back to the 1930s.<sup>13</sup>

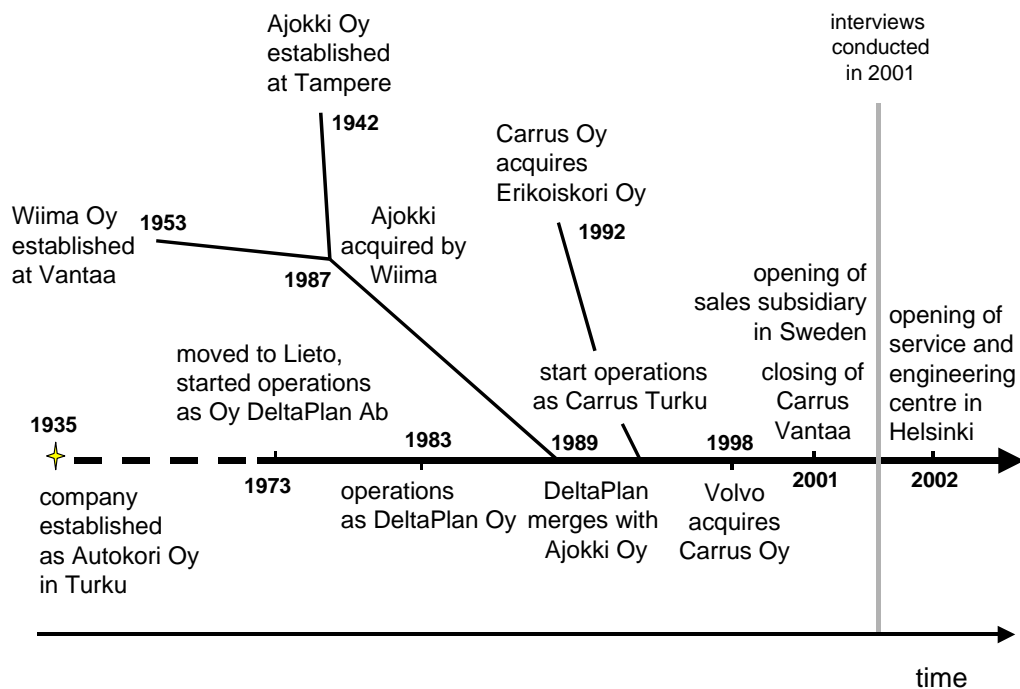


Figure 4. Critical events in the history of Carrus Turku

<sup>12</sup> In June 2004, Carrus was renamed as Volvo Bus Finland.

<sup>13</sup> All company details were checked from an official database of the National Board of Patents and Registration of Finland (YTJ 2004).

The company which now operates under name Carrus Turku has its roots in the 1930s when a company called Autokori Oy was established in Turku. As its operations grew it started looking for new premises and gradually moved its manufacturing unit to Lieto.

A major change occurred in 1989, when the company was acquired by Ilmari Mustonen, the owner of Ajokki Oy. He was a well-known person in the business; he had owned Wiima Oy since 1979, and later in 1987 he had acquired Ajokki Oy in 1987 and merged these two companies together. All three companies were merged into one company, which started its operations under name Carrus Oy. After the merger all three companies continued their operations but under different name: the three manufacturing units were renamed as Carrus Helsinki (operating in Vantaa), Carrus Tampere, and Carrus Turku (operating in Lieto).

The next turning point was in 1998 when Volvo Bus Corporation acquired Carrus Oy. Carrus Turku became one business unit of its subsidiaries and part of a large multinational company. As a consequence of the acquisition, a notable change was made in Carrus Oy: the Helsinki factory was closed in 2001 and its production was transferred to Poland.<sup>14</sup> Although the need for structural changes was announced already a few months after the acquisition in 1998, the shutdown of a traditional manufacturing unit caused a lot of turbulence in the company. The decision got a lot of interest in the media as well, not least because the year 2000 was financially quite good for Carrus (see Figure 3). The shutdown of Carrus Vantaa was a part of larger rationalisation of production in Volvo Bus Corporation<sup>15</sup>, e.g., also a considerable number of workforce was cut on a successful production unit in Mexico in September 2001 (Volvo Bus de Mexico reduces ... 2001).

Today Carrus Finland is a subsidiary of Volvo Bus Corporation. It has its own executive group, in which the head of Carrus Turku, is a member. Additionally, Carrus Turku has its own internal management team, which consists of senior managers. At the time of the interviews, in 2001, Carrus Turku accounted for approximately one third of the personnel and turnover of Carrus Oy. However, since the acquisition because of the restructuring in the

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<sup>14</sup> Volvo Bus Poland Company Ltd. was formed in June 1995 as a joint venture of Carrus Oy and Volvo Bus Corporation. Since 1998 Volvo Bus Poland has been a wholly-owned subsidiary of Volvo Bus Corporation (Volvo Group 1997).

<sup>15</sup> In the annual report of Volvo Group (Volvo Group 1997), two of main objectives for the operations of Volvo Buses for 1998-2000 were continued expansion and rationalisation of production. The acquisition of Carrus Oy and the later shutdown of Carrus Vantaa can be seen as progenies of this strategy. Moving the production to Poland is also in line with the strategic decisions of the company, as Poland had been selected as the base for Volvo's expansion eastward (Volvo Group 1997).

company, the responsibilities of the Carrus Turku unit have increased. Nowadays both the support of the Stainless Steel-concept and the service and engineering centre in Helsinki are run from Turku. (Carrus 2004) In 2003, the turnover of Carrus Turku was approximately 35 MEUR and the number of personnel 300.

#### 4.3 The acquisition process

For Volvo, Carrus was a tempting target for several reasons. First, it was a leading bodybuilding company in the Nordic region. Second, the company had a long experience in producing bus bodies. Third, Volvo was interested in the technology which had been developed by Carrus. Carrus had introduced an interesting concept – Carrus Stainless Steel – which is today globally marketed under name Volvo Carrus Stainless Steel-concept. (Carrus 2004, Suomalainen bussikorien valmistaja... 1997)

Although the acquisition was realised in the beginning of 1998, the process started already in 1997. Press release of the forthcoming acquisition was given in October 31, 1997 and a press conference was held at the same day. At the press conference of the acquisition, Ilmari Mustonen, the previous owner of Carrus, declared that his main motive for selling the company was the fact that he considered it as the only possible way to maintain the manufacturing of bus bodies in Finland. According to him, the development of the business required international expertise and resources, which he did not possess. (Suomalainen bussikorien valmistaja... 1997).

Acquisition usually creates uncertainty among employees of the acquired company, particularly based on fear for downsizing. When the acquisition was announced both the buyer and the seller argued that the acquisition will strengthen the position of personnel, although now new recruits were promised (Suomalainen bussikorien valmistaja... 1997, Suomalainen linja-autokorien valmistaja ... 1997). However, only a few months passed and the situation changed. A large restructuring process in the production of Volvo Buses was initiated. As a result, in June 1998 it was announced that their European production will be centralised in Poland, and some manufacturing units in Austria, Germany, Scotland and Finland will be closed.

From the viewpoint of Carrus the most significant outcome of this process was the decision to close the manufacturing unit in Vantaa (Carrus Helsinki) by the end of 2001 and to move the production to another Volvo unit in Poland. This information was communicated to the employees and the media simultaneously, with the same press release. This sudden change of plans was interpreted rather negatively among the people in Carrus, the new acquirer

towards whom they originally had positive feelings had suddenly turned them down. This has left also some tension between the acquirer and acquired and particularly it put all communication under suspicion.

## 5 Integration and Change in Carrus

### 5.1 Post-acquisition integration at Carrus Turku

On the strategic level, Carrus has had to adapt to the strategy of Volvo. In manufacturing, Volvo's long term strategy is to centralise the manufacturing of buses globally in three manufacturing hubs: one in Europe (Poland), one in North America (Mexico) and one in Asia (Shanghai). To be in line with that strategy, Carrus Turku cannot continue as a solely manufacturing unit but it has to be able to offer some further value added both for the mother company and its customers. Consequently, the focus of their operations has been gradually shifting from manufacturing to engineering and technology transfer, mainly based on the Stainless Steel Body Concept.<sup>16</sup> This change has aroused a feeling of uncertainty, particularly among the employees whose work is related with production.

Additionally, the acquisition was followed by several significant organisational and operational changes. First, the organisation of Carrus Turku had to be in line with the organisation of Volvo Buses. As a result, the organisation chart of Carrus was split into two independent parts: the manufacturing organisation and the commercial organisation. Carrus Turku as a unit is a part of the manufacturing organisation of Volvo Buses, whereas the commercial organisation of Volvo Buses is spread worldwide. The employees of Carrus Turku may belong to either organisation or to both. The latter case refers mainly to the sales personnel: administratively they are employed by Carrus Turku but they report to the commercial organisation. For example, the marketing director is a part of a global team and his superiors are located in Oslo and Copenhagen. This reorganisation creates naturally challenges for coordinating and controlling different tasks, and it also sets new requirements for the competencies of personnel.

Externally the most noticeable outcome of the integration is probably related to the product range of Carrus Turku. At the time of the acquisition the

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<sup>16</sup> Stainless Steel Body concept is based on a corrosion resistant framework which reduces the maintenance costs of a bus body but also extends its usability (Carrus 2004).

product range was rather versatile, and the company was also able to offer tailor-made solutions to their customers. After the acquisition, the division of labour between the three Carrus units was clarified and as a result of that the number of products of Carrus Turku decreased. In 2001, at the time of the interviews Carrus Turku manufactured three versions of bus bodies, Carrus 302, 502 and 602. All three were mainly targeted for tourist buses. In 2004, the product range of Carrus Turku includes different versions of Volvo 9700 coaches. Additionally, the support of the Stainless Steel concept and the service and engineering centre in Helsinki are run from Turku. Today Carrus bodies are sold worldwide through Volvo's marketing organisations (Carrus 2004). This development is in line with earlier mentioned strategic decisions made on the company level.

The current product offering reflects also another strategic decision made at corporate level. At the time of the acquisition approximately 40 per cent of the bus bodies of Carrus were made on the platforms of other manufacturers than Volvo. At the press conference of the acquisition, representatives of Volvo stated that Carrus will continue to make bus bodies on the platforms of other manufacturers as well (Suomalainen bussikorien valmistaja... 1997, Suomalainen linja-autokorien valmistaja... 1997). However, since 2002 Carrus has been only building bus bodies on the platforms of Volvo. This change has caused some dissatisfaction, as some customers who have required the bodies to be built on the platforms of competitors (Scania, Mercedes) have been lost. It could be argued that as a result of the acquisition the company has lost some of its flexibility and ability to respond to customers' needs.

On the other hand, the losses have been compensated by new business. First, the large network of Volvo has offered Carrus the opportunity to transfer their knowledge and know-how to other Volvo units. For example, co-operation with the Volvo plant in Mexico has been extensive. Second, the sales to some European countries have increased, in other words, the acquisition has facilitated the company's entry to several international markets. Nevertheless, it can be questioned whether it would have been better to remain a major player on a marginal market (Scandinavia) than to become a marginal player on a major market. From the viewpoint of Carrus Turku this may be a very strategic question as it has been growing out from its natural business area.

Internally, the level of integration varies slightly across different functions, although some impact of acquisition can be seen most of the activities. As an example, the outcomes of acquisition can be seen in the procurement decisions. Co-operation with the Volvo organisation has brought some scale advantages and lowered the price level of raw material and components. Also the purchasing processes have been simplified and the number of suppliers has

decreased. In most operations Carrus has adopted the norms and practices used in Volvo. These standards and instructions are quite detailed and they are used in all Volvo units worldwide.

Additionally, the flow of technical information between Volvo and Carrus has improved as it now has become internal communication instead of communication between customer and supplier. Generally, collection of information has become more systematic and after the acquisition Carrus Turku has also adapted some of systems used in Volvo Buses. This procedural integration is reflected particularly in internal reporting but also in market intelligence and quality control, for example. Systematic documentation and regular reporting have been introduced in all activities, and this represents quite a big change compared with the earlier situation.

Also the fact that Volvo is a listed company has brought some changes, particularly related to communication. The acquisition has naturally increased the communication between Carrus Turku and the main organisation of Volvo. Particularly after the acquisition, the mother company was very active in distributing Volvo-related information, in order to help the employees to identify with their new employer. The company language is English and the majority of information given – including the personnel magazine and information on the Intranet – is in that language. The acquisition has also changed the forms of communication, and particularly the use of information technology has increased considerably. This is sometimes also considered also a negative feature, as instead of sending e-mails sometimes it would be worthwhile to walk at somebody's office and talk the issue through, particularly when you are not so fluent in writing English.

However, the communication has mainly been directed to the mother company, not to other stakeholders. Increase in communication is mainly due to the new position as a subsidiary which has required more reporting. Internal communication inside Carrus Turku is rather limited, and it is quite reactive based on aroused need or obligation by the law. It is also hierarchy-based, the information is expected to flow from top to bottom. The number of meetings has been low; usually one production meeting per week, a monthly management meeting (all managers present).

Volvo's communication strategy is very general, everybody is given the same piece of information. However, according to the head of the unit sometimes 'an interpreter' would be needed in between. In Finland people have been used to that managers interpret the strategy for the employees, whereas Volvo anticipates that everybody in the shop or individual salesman understands the strategy. That culture requires a lot from personnel.

## 5.2 Cultural integration

When evaluating the cultural integration in Carrus, the original setting of the acquisition has to be kept in mind. It was expected that Volvo as the acquirer and stronger party in the acquisition would be the one to bring the cultural elements to which Carrus needs to adapt to. In other words, some changes at Carrus could be expected. The major changes are described in the following sections

### 5.2.1 Major change due to acquisition

Employees' first reaction to the news that Volvo buys Carrus was positive because everyone understood that a change was needed. The previous owner was already 74 and his children were not interested in continuing in the business. Volvo was considered as a strong, well-known and Scandinavian player – a good alternative. However, in course of time the first impression seems to have changed. In order to understand what has happened, each of the interviewees was asked about the major change due to acquisition. It seems that the major change is related to the change of turning from family firm to a subsidiary of a multinational giant. In other words, the major changes seemed to be related to the power structure and organisational culture.

The majority of the interviewees described the major change to be the shift in decision-making and locus of control. When asked about the change, the interviewees used interesting metaphors when describing the relationship between Volvo and Carrus. The following citations highlight quite well the major reflections of the acquisition on the organisation:

*"We are tied to the apron strings of the global Volvo organisation."*

*"Every issue needs to be circulated through all possible ivory towers."*

*"We used to be the Family Inc. Father, mother and three sons."<sup>17</sup>*

Particularly the managers felt that they had lost control of decision-making as all the major decisions had to be approved by Volvo. Also compared with the time before acquisition, the decision-making processes now last longer, particularly because Volvo follows the typical Swedish tradition of seeking for

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<sup>17</sup> This comment refers to the history of Carrus, and the fact that it was established as a combination of three smaller firms.

consensus, i.e., approval from all levels. Additionally, the interviewees highlighted the fact that ownership of the company had become faceless. As a result, the interviewees felt that the company was more controlled by the distant market forces, that is, by international financiers. Instead of Ilmari, the former owner, whom they knew personally, now the owners were members of the board. In other words, as the company is a full subsidiary of Volvo, they are representatives of Volvo Corp. And from their viewpoint, the true organ in control – the board of Volvo Buses or Volvo Group – is quite far away.

From the viewpoint of communication it is important to keep in mind that the true opinions of decision-makers are filtered through different levels in the organisation, and the interviewees were not able to contact them directly, which was possible earlier under family ownership. Actually, the only channel for influencing the superiors is through reporting. Consequently, interaction with the key decision-makers has clearly decreased and their power to affect the decision-making has been considerably reduced.

### 5.2.2 Organisational culture of Carrus after the acquisition

Employees of Carrus Turku are very committed to the organisation; the most visible sign of that are the long careers which most of them have had within the company. According to the interviewees, the major factors which have strengthened their commitment have been good, family like atmosphere and the lack of strong organisational hierarchy. Additionally, the shared pride of their special expertise in the field has been an important motivator. Before the acquisition, the major creator and maintainer of positive working climate at Carrus Finland was Ilmari Mustonen. He was considered as a very co-operative person and partly also as the “rescuer” of the industry, as he merged the less profitable, competing units together and made them to collaborate. As a person he was also highly respected, not least because of his history as a ‘self-made man’ who had reached his position with his own effort.

Although the work atmosphere has not changed remarkably, there is some indication that the work atmosphere was better before the acquisition. The acquisition as such brought uncertainty and particularly the incident with the Vantaa unit created negative attitude. Employees have also sometimes been frustrated with the slow and complicated decision process, which is impairment compared with time before the acquisition. Also the increased bureaucracy (rules, norms, standards) are considered as drawbacks of the acquisition.

Evaluation of the current organisational culture in Carrus requires understanding of the cultural integration which has happened since the



acquisition. In the earlier sections the importance of cultural fit between parties was introduced. In this case it has to be admitted that the cultural distance between the organisational cultures was quite high, as the differences between organisational cultures were many (see Table 3). Thus, it seems that the cultural fit in the case acquisition has not been optimal.

Table 3. Some cultural differences between the parties in the case acquisition

<i>Volvo</i>	<i>Carrus Turku</i>
Formal interaction (meetings)	Informal interaction (grapevine)
Shared decision-making (slow)	Centralised decision-making (fast)
Information distributed through formal channels (intranet)	Information distributed through informal channels

The lack of cultural fit has been highlighted because of the fact that Carrus Turku still has a strong cultural identity of its own. However, the cultural identity at Carrus Finland was not very uniform itself, because of the company history (see Figure 4). The differences among corporate cultures are still noticeable, and the separate identities of the units have remained strong because of the internal competition between them.

Because of their long careers inside the same company, some of the employees of Carrus Turku still carry the identity of the previous company, Delta-Plan. Delta-Plan was a state-owned company, and the hierarchical organisational culture of Delta-Plan was in the beginning also transferred to Carrus Turku. However, gradually the hierarchies started to lower and an identity for Carrus Turku was created. It could be argued that at the time of the acquisition the employees of Carrus Turku had just been able to reconstruct their own identity and the acquisition aroused the need for reconstruction again.

As stated earlier, the case acquisition was a deal between two partners with considerable differences, particularly when it comes to power. Therefore nobody really expected that the culture of Carrus would have been able to coexist independently on the side of the Volvo culture. However, it still seems to have been a surprise that actually a complete cultural assimilation was expected from Carrus employees. This together with some negative experiences (particularly the closing of the Vantaa factory) decreased the employees interest to become a part of Them, i.e., and it has slowed down the process of cultural integration. The history of Carrus Turku is full of mergers and acquisitions but all of them have left less traces on the corporate culture,

as the following comment of one interviewee illustrates their feelings quite well:

*“[I guess] we have to be moulded [into the same culture] as others. We have always found new managers a bit strange and they have also slightly wondered the culture here, it is quite distinct. When one thinks that we have manufactured buses for 65 years, the history and the personnel have created their own culture and atmosphere and it is difficult to take in a global way of thinking.”*

### 5.2.3 National reflections in the change

One of the positive surprises related to the acquisition has been the increased interaction with foreigners. Particularly extensive co-operation with Volvo units in Mexico and India has made it possible even for blue-collar workers to visit the other units personally. Naturally, the increased internationalisation has also brought new requirements, such as the importance of language skills – both Swedish and English, which is the corporate language. Those employee who have the skills, communicate in a normal manner with other Volvo units, and for them this change has been a motivator to improve and practice their language skills. The need for these skills is particularly highlighted with some managers, for whom the co-operation has become a part of daily or at least weekly routine. However, some of the employees without the language skills sometimes feel that they have ended up on a side-track, when they cannot participate in the decision-making as much as earlier.

This frequent interaction has also highlighted the differences between Finnish and Swedish cultures. Particularly the amount of lengthy meetings and the desire to agree on every issue has surprised many of the managers. The interviewees had also noticed that their Swedish counterparts needed a lot of plans and calculations in order to be able to make decisions, whereas the Finns would have preferred faster actions. Swedes are also very polite in the meetings, where as the lack of pace in the negotiations makes the Finns sometimes slightly aggressive.

*“Swedish corporate culture means that we are discussion partners, they do nothing but discuss. Responsibilities are divided to full, so that actually nobody is responsible of anything. It is extremely show, because it requires managing a hell of an orchestra and negotiations which seldom lead anywhere. In Finland in a similar factory there is one patron and it's his factory and he says that this is how we are doing it. The decision is there and made.”*

The case acquisition seems to reflect quite well the typical characteristics of Finnish and Swedish organisational cultures and thus it is in line with earlier research findings (see also discussion in section 3.2).

#### 5.2.4 On personal level

The job descriptions of some of the personnel has changed (partly due to organisational changes, partly not). For many of the managers the biggest change is the autonomy retrieval: since the acquisition and organisational changes they do not have any budget on which to account for neither do they have any subordinates to supervise. Of course, this may be interpreted positively, as loss of stress but some of the managers seem to interpret it negatively as well.

The change in job descriptions is particularly noticeable in the sales organisation: earlier the product to be sold was bus bodies, now they are selling whole buses, as they are a part of Volvo's commercial organisation. In other words, the need for technical competence has increased considerably. Additionally, some of the sales arguments – elementary tools in their work – have also changed. The major sales arguments of Carrus were quality and flexibility and quality is still an issue, but the message from Volvo is that one should aim at more standardised products, i.e., the flexibility towards customers is decreased. Because of the concentration on Volvo platforms, the production of Carrus has also become quite dependent on the production of Volvo; even small delays and problems in production there are instantly reflected also here. The organisation of Volvo has not experience of planning bus bodies, so there is not much assistance available. All these matters have changed the content of the people at the sales organisation.

It could be argued that also the way of working has changed since the acquisition as nowadays an elementary part of managers' work is interaction with the people in other units of Volvo. This is sometimes a bit complicated because of the vast and changing organisation. Additionally, the number of people involved in each decision and process makes it sometimes very difficult to keep track who is actually the person responsible. The description given by one of the interviewees illustrates the situation:

*“There is always a roomful of guys, totally new faces in each meeting. It is actually surprising where all they come from. ... They are so isolated, it is so different the whole organisation. The person there who is responsible for [the same task], he does not have anything to do with the problems I am encountering here, unfortunately. ... Here I am holding the leads, I know what is happening. But sometimes I get a call from Sweden, and then we discuss, and then a bit later another guy from the other side of the room calls*

*me and asks the same thing. It is so widespread [organization] that people do not know what the others do."*

It seems that Volvo as an organisation is very active in providing information but sometimes it is not so easy to find out the person responsible for each issue. Some of these problems are due to limited information on the organisation; a few of the interviewees even claimed that they did not know the organisation chart of Volvo. This means that interaction is very much based on earlier experience and social networks; the employees of Carrus Turku contact the people with whom they have been communicating before.

The issue which has probably had an impact on each employees work is the increase in reporting. Carrus Turku has adopted the majority systems of Volvo, which have originally been developed for manufacturing of personal cars, i.e., standard products. However, the systems are sometimes very heavy to use at Carrus, which often manufacture tailor-made solutions for individual customers. This makes the requirements for documentation quite extensive. Sometimes the rules and norms of Volvo are also considered to be very inflexible, in contrast to earlier times when the company was family-owned and had the organisational flexibility of a small firm.

## 6 Conclusions

It has been argued that acquisitions are complicated because they are exceptional and happen infrequently (Lees 2003). In other words, because of limited experience companies would not have any guidelines or existing routines which to follow. However, nowadays the argument does not hold true. There are several companies which have chosen acquisition as their primary growth strategy and they have collected considerable experience in takeover and integration process. The case acquisition has provided another description, mainly in line with earlier findings.

Also in this case national and organisational cultures seem to collide, although double-layered acculturation is difficult to identify as national characteristics are embedded in organisational norms and practices. For example, in the interviews it was clear that sometimes the employees described some characteristics of Volvo as general Swedish features and vice versa. On the other hand, it has to be kept in mind that the case also clearly demonstrated that the primary element in cultural integration is on organisational level. That is, in this case the difference between small and large was more significant than Finnish-Swedish cultural distance. Therefore one might question, whether some of the outcomes or changes might be similar if the acquirer would have been a large Finnish company.

However, the most common national stereotypes were brought up in this study as in many others earlier: Finns typically interpret Swedes as very interactive people who want to hear the opinion of each employee, and this makes the decision-making often quite slow and less efficient. Nevertheless, in this case the fact the change was from a small family-owned company to a large multinational was of more importance. The interviewees experienced a move towards a power culture (cf. Cartwright & Cooper 1993), they felt that their possibility to participate and effect had decreased. This is contradictory to what one might expect of moving into Swedish business environment.

Acculturation as an identity reconstruction process has encountered strong resistance in the target company. It seems that the employees had expected structural changes due to the integration but the desire for extensive cultural integration was more of a surprise. At the time of the data collection the two organisations seemed to be rather separate and there was still a strong feeling of Us and Them in Carrus Turku. The vision of Common Future is yet obscure and the true outcomes of cultural integration remain to be seen.

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Productivity manager, 6.11.2001; interviewers Pia Jämsä and Suvi Kurppa



# **ROLE OF RESEARCH AND DEVELOPMENT IN FOREIGN ACQUISITIONS - FINNISH R&D INTENSIVE COMPANIES AS ACQUISITION TARGETS**

*Sanna Kaarina Pennanen*

## **1 Introduction**

During the recent decades mergers and acquisitions (M&A) have become a central theme in international business. M&A are also everyday phenomena for many companies and their impact is reflected in many daily operations. Companies merge with, acquire or become acquired by other companies. During the recent decades M&A intensity in Europe has increased and European companies have been acquiring more than American companies (Ali-Yrkkö 2002, 15; Buckley & Ghauri 2002, 423; Gonzalez & Vasconcellos & Kish 2002, 288; Hopkins 2002, 88). Also Finnish companies have become active both as acquirers and acquisition targets since the beginning of 1990s – during that time Finnish companies have been acquiring or have become acquired more than before during the past 15 years. (Pajarinen & Ylä-Anttila 2001, 12; Ali-Yrkkö 2002, 26)

Need for growth or expansion has been seen as the major motive for international mergers and acquisitions (Penrose 1959, 156, 187; Hopkins 2002, 90-92). Acquisition is often an alternative for foreign direct investment, joint venture or licensing when a company is seeking international expansion or growth (Trautwein 1990, 291; Pajarinen & Ylä-Anttila 1998, 16; Hopkins 2002, 93; Lehto & Lehtoranta 2002, 12). Foreign acquisitions might thus also be a part of company's internationalisation process and strategy (Andersson & Johanson & Vahlne 1997, 68) More generally, M&A take place because companies believe them to be potential synergy sources. By acquiring another company the acquirer can obtain synergy effects which result as the companies and their resources are combined. (Pablo 1994, 807; Lehto & Lehtoranta 200, 13) This synergy may be based on the relatedness or unrelatedness of the two companies (see Harrison, Hitt, Hoskisson & Ireland 1991, 175-178). Unrelatedness means that the two companies have different

resources and as they are combined, a superior bundle of resources is developed. The other option is based on synergy effects, which are created through complementary resources, and the resulting combination offers potential and competitive advantage. (Capron & Mitchell 2001, 185-186)

One reason for an acquisition can be an intention to acquire technology (Lehto & Lehtoranta 2002, 12). Haspeslagh and Jemison (1991, 27-36) emphasise capabilities as synergy sources in strategic acquisitions. According to their view, the value creation in strategic acquisitions can be based on capability transfer, corporate renewal through acquisition or on a specific business strategy. Also Bresman, Birkinshaw and Nobel (1999, 440) have emphasised the access to knowledge as a motive behind an acquisition although the transfer of this knowledge to other parts of the organisation might turn out to be difficult. The success in these attempts is widely seen to be related to the integration of the acquired unit (Larsson & Finkelstein 1999; Inkpen & Sundaram & Rockwood 2002, 244).

It is also important to notice that the optimal integration after acquisition does not automatically mean as perfect or tight integration as possible. An earlier study on R&D intensive acquisitions indicated that R&D units of acquired firms have remained pretty autonomous for the first post-acquisition years (Birkinshaw, Bresman & Håkanson 2000, 407). Depending on the acquisition objectives various integration approaches can come into question. Both Cartwright and Cooper (1990; 1993a; 1993b) and Haspeslagh and Jemison (1991, 145-149) have presented three different options for post-acquisition integration. These models present optional acquisition integration types, which vary from the level of needed strategic interdependence and in the level of organisational autonomy.

In this paper international acquisitions will be studied from Finnish point of view. Foreign acquisitions of Finnish companies increased significantly in the 1990's. It should also be kept in mind that many of the acquired Finnish companies have been from industries which have relatively high technology and R&D intensity. (Ylä-Anttila & Pajarinen 1999, 7) Therefore, the aim of this paper is to discuss the role of the R&D in foreign acquisitions of Finnish companies. Key questions here are *what kind of role the research and development play in foreign acquisitions* and *how these international acquisitions may affect the Finnish R&D intensive companies*. In cases when Finnish R&D intensive companies have been acquired by international players, the role of the R&D, related technologies and knowledge can be considered to be high. R&D related resources as acquisition drivers as well as the role of post-acquisition integration development will be approached by using resource-based-view and post-acquisition integration theories as

theoretical frames. The next section focuses on Finnish companies as acquisition targets.

## 2 Finnish companies as acquisition targets

Foreign direct investments into Finland increased in the 1990s. Reasons for the growing interest of foreign companies and investors towards Finland were many. One of them was the liberalisation of ownership, which took place in 1993. Also the devaluation of the Finnish markka and economic depression in the beginning of 1990s made Finnish companies lucrative investment targets. Additionally, a couple of years later, in 1995, Finland became a member of the European Union. Another factor in favour has certainly been the good knowledge and technology base of the Finnish companies. For example, according to one Finnish study 70% of the executives of foreign affiliates considered that the Finnish technology and knowledge had had influence on investment decisions. (Pajarinen & Ylä-Anttila 2001, 39) On the other hand, the concentration on core competencies and streamlining of businesses undertaken in Finnish multidivisional companies made the Finnish companies as lucrative acquisition targets. However, very few potential acquirers for these companies existed on the Finnish market. As a result, many of the business units of the diversified companies, which have been for sale after strategic stream-linings, have continued operations under command of a foreign owner. (Pajarinen 1997, 25, 31; Ylä-Anttila & Pajarinen 1999, 5 Pajarinen & Ylä-Anttila 2001, 19-20) The most active acquirers of Finnish companies by country in 1990s were Sweden, The USA, Switzerland, Germany and the other Scandinavian countries (Pajarinen 1999a, 9-10; Pajarinen & Ylä-Anttila 2001, 14-15).

Acquisitions as a form of the foreign investments started to increase significantly in the 1990s. The Finnish target companies have been generally bigger than average concerning the amount of employed personnel. The acquired companies have also been so called high-technology companies which have roused the interest of foreign acquirers. Especially specialised science-based companies, such as producers of information technology solutions and optical devices as well as pharmaceutical companies, have been lucrative targets. (Ylä-Anttila & Pajarinen 1999, 7; Pajarinen & Ylä-Anttila 2001, 15-16)

At the same time as foreign companies have acquired technical knowledge and innovations in Finland they have also kept on investing into their Finnish subsidiaries. The foreign acquisitions had not lead to significant transfer of technologies, personnel reductions or plant closures in Finland at least until

the beginning of this century. Due to the international acquisitions the Finnish target companies have actually gained from the global market presence and distribution channels of the new parent companies. (Pajarinen & Ylä-Anttila 1998, 92-93; Pajarinen & Ylä-Anttila 2001, 16)

In innovating and high-technology industries heavy R&D investments have been seen to impact the potential of companies to become acquisition targets (Lehto & Lehtoranta 2002, 33-34; 37-38). This can be seen in the cases of Finnish companies. The pre-acquisition level of investments on R&D or at least the knowledge and technology base of Finnish companies have been attractive for foreign investors. The post-acquisition development has also been positive: after the acquisitions most of the foreign owners have continued or increased the investments on R&D. (Pajarinen 1999a, 28-29) For example, in 1999 the R&D expenditure of foreign companies was significant in chemical and pharmaceutical industries as well as in the construction sector. This is mainly due to the take-overs of those companies, which already had had remarkable R&D functions in Finland. (Pajarinen 1999a, 29)

A recent study indicates that international acquisitions of Finnish companies can be even patent-driven. Patents indicate that the company has made innovations, and that it has knowledge or technology resources to be able to create something new. It can be even argued that patents thus increase the risks of Finnish companies to become acquired by foreign players. (Ali-Yrkkö, Hyytinen & Pajarinen 2004, 17) The above mentioned study also revealed that the interest towards knowledge and technology resources of Finnish companies explain at least in some extent the foreign acquisitions. Resource-based-view as a theoretical frame provides with a good starting point to explain the resource utilisation in companies. Additionally, it is worth remembering that post-acquisition integration plays an important role concerning the acquisition outcome and synergy realisation. In the following these two theoretical frames in relation to acquisitions are discussed more in detail.

### 3 Resource-based-view and post-acquisition integration development theories

#### 3.1 Resource-based-view on acquisitions

*Resource-based-view* or theory (RBV) on companies dates back to Penrose (1957, 24-25) who defined companies as collections of productive resources and classified the firm resources to physical and human resources. The RBV emphasises the role of company-owned and firm-specific tangible and

intangible resources as sources for competitive advantage. Resources are considered valuable if they have contribution on efficiency and effectiveness. The technology resources are considered to be of remarkable value, because they involve a lot of tacit knowledge. This characteristic makes them difficult to imitate and therefore good basis for sustained competitive advantage. Technologies, which score high in uniqueness and value, can be called as key technologies. (Medcof 2000, 60-61, 67-68)

In corporations, resources are managed, obtained, generated and controlled collectively. The role of the corporation is therefore to take care of the resource allocation and provide its business units with these inputs. Corporate inputs might be powerful assets if they are wisely selected and carefully administered. For the corporation there are two ways to enhance the effectiveness of the operational units: providing of resources on attractive terms or central management of synergies among business units. Yavitz and Newman (1982, 15) have stated that the achieving of synergies requires usually strong guidance and involves interaction between business units.

A resource-based-view on acquisitions sees the companies as a collection of resources where an acquisition creates opportunities to employ the resources in a more efficient way. The benefit potential in M&A is seen to be reached by combining the resources of two companies. The origin is in Penrose's idea that the acquiring company in an acquisition not only inherits the potential for growth but leaves pools of unused resources which can be better utilised by the merged company than by two separate companies (Penrose 1959, 195). According to the same logic, Shelton (1988, 279) has presented that acquisitions mean asset combination and that the value creation in acquisitions is related to the fact that the combined resources can be used more effectively by the new company than by the two companies on their own. Company resources' heterogeneity and immobility are the sources for firm-specific competitive advantage. Because these kind of critical resources are hard to acquire otherwise, they drive the acquiring companies to buy entire businesses (Capron & Hulland 1999, 42-43). By acquiring another company the acquirer company realises synergy effects that are realisable through combination of the firms and their resources (Pablo 1994, 807).

Based on the ideas of the resource-based-view it is easy to understand why that theory has been widely used to explain the acquisition motives. Especially in relation to R&D related acquisitions it seems to work well. The R&D related resources, which may include technologies and knowledge resources as well as patents and other more tangible but rare resources, are hard or impossible to copy or get access to otherwise than by acquiring a company, which owns these needed resources. The following question is then related to the acquirer's capabilities to utilise these acquired resources; can the acquirer

company reach the expected gains by acquiring the company with tied bundle of rare resources, and how it will do it? The common truth is that most of the acquisitions do not reach the targets and can be in that sense regarded as unsuccessful (Kitching 1967). The key to the acquisition success seems to be in the integration of two units (Larsson & Finkelstein 1999). Thus, some theories concerning the post-acquisition integration have been presented to explain how the integration takes place and how the acquirers try to ensure the expected gains and acquisition success. In the following couple of these theories will be presented.

### 3.2 Post-acquisition integration and it's relevance for acquisition success

The post-acquisition integration process has been found crucial in relation to acquisition success and the value creation potential (Larsson & Finkelstein 1999; Birkinshaw, Bresman & Håkanson 2000, 419-421) When two companies are put together, the integration is a complex challenge, because both organisations have had its own systems, procedures and cultures. To be able to integrate two companies into one asks actions on different areas. Shrivastava (1986, 68) has divided these integration types as procedural and functional, physical and managerial and socio-cultural integration types. These integration types take place, at least partly, simultaneously. *Procedural integration* of two companies into one legal and on the system level functioning unity is not that complicated and time consuming as physical reallocation of resources and creation of new management and organisation culture.

The integration of acquisition or merger parties' resources and assets is called *physical integration*. According to Shrivastava (1986, 69) this includes consolidation of product lines, production technologies, R&D projects, production units and equipment and real estate assets. Compared to the first integration actions the physical integration of two companies into one takes time and is not an easy task. The problems are mostly related to the companies' resources. The resources can be seen as common and mutually exclusive. The latter are the basis for potential synergy effects, but the common assets are the problematic ones: Because merging partners usually possess some common assets, they are all not needed after the merger or acquisition. These common assets are either physical (product lines, production systems, R&D facilities, raw material reserves) or non-material (tax credits, cash flows and reserves, personnel) assets. Divestiture of some resources is therefore ineluctable. During the physical integration phase all



assets and properties are evaluated. Redeployment of assets possibly means reduction of duplicated functions and relocation of production and equipment and other resources. The restructuring follows the company strategies, which means that some functions can be divested. Through these kinds of actions the frames are made for the newly formed company's strategy implementation. (Shrivastava 1986, 69)

The third type of Shrivastava's (1986) post-merger integration is the *socio-cultural integration*. This part of integration includes so called "soft issues" like changes in organisational structure, development of new corporate and decision making cultures, motivation and commitment of personnel and implementation of new leadership.

Also Birkinshaw et al (2000) have studied companies' post-acquisition integration, but particularly from the viewpoint of R&D intensive industries. They used terms *task integration* and *human integration* of two conceptually distinct but closely intertwined processes, which occur during post-acquisition integration. Task integration includes value creation in forms of transfer of capabilities and resource sharing, which involve identification and realisation of operational synergies. Human integration concerns primary generation of satisfaction and shared identity among employees. (Birkinshaw et al 2000, 398, 400) Compared to Shrivastava's (1986) typology the human integration can be defined to be related mainly to socio-cultural integration and the task integration to the physical integration. In Shrivastava's classification the procedural and functional integration contains aspects of both integration types presented by Birkinshaw et al (2000).

Even though task and human integration as processes are conceptualised as distinctive, they are interrelated and support each other. As an example, Birkinshaw et al (2000, 3999) argue that the enhanced employee satisfaction improves the likelihood of capability transfer. It also makes the resource sharing between units easier. Following the same logic successful task integration improves employees' satisfaction and shared identity. The problem is that these two dimensions of integration do not automatically take place in the same extent. High level of completion in human integration can improve the employee satisfaction, but the operational synergies do not need to be reached. On the other hand, if synergies on operational level are achieved, it can have happened by the cost of employees' motivation or satisfaction.

In Birkinshaw's et al (2000) empirical research was found that the integration process altogether was very slow in the studied case companies. It took from five to seven years to proceed in the whole integration process. It was also found that well developed human integration promoted the task integration. Years after the acquisition the task integration leapt to a new level due the achievements on human integration side. This result supports the view

that integration is long, time consuming and two-fold process, where each development phase provides with the prerequisites for the next one. Years after the acquisition the process can still be developing and proceeding further on towards achievement of the strategic goals.

The task and human integration processes in post-acquisition integration are based on the selected integration strategy. In the research findings Birkinshaw et al (2000, 407) have reported several actions, which were taken in the case companies in order to manage the task integration process. These were for example *new R&D plan and integration mechanisms between other functions and R&D, regular technical manager meetings, rotation of personnel between the acquired and acquirer companies, standardised documentation, international technical seminars, training classes and project teams*. As a result, they noted also that level of achieved task integration was not the expected one in most of the case companies. Despite the integration attempts the acquired units had received significant grade of autonomy and decision making freedom over time. They also noted that the task orientation with more result oriented R&D integration strategy was installed first three to five years after the initial acquisition. Based on this finding they stated that the dissatisfaction with limited level of task integration will in the medium to long term lead to renewed efforts of achieving full task integration. This evolution towards greater task integration was noted to be related to in the meanwhile complete human integration process. Task and human integration processes can develop in different speed, but concerning the achieved integration success they both play an important role.

One important finding in the research of Birkinshaw et al (2000, 396, 419) was that the second phase of task integration started again after significant improvements on the human integration side had taken place. From the synergy realisation perspective none of these two integration processes can be considered as less critical. The human integration process seems to facilitate the effectiveness of the task integration process. If the task integration process alone has started, likelihood of acquisition problems increases because individuals do not know and understand the acquirer's management. On the other hand, if the task integration process has restarted when the human integration process aligns the closure, much greater interdependencies between acquirer and acquired companies can be reached. (Birkinshaw et al 2000, 398, 419)

As presented above, the post-merger integration process has been seen as an essential factor affecting merger or acquisition success (Shrivastava 1986; Haspeslagh & Jemison 1991, 12; Lees 2003). The integration grade and operations towards the acquired unit depend although on the merger or acquisition objectives (Datta 2002, 371; Lees 114-115, 137.) It is obvious that

the aim of the integration process is not always a fully merged unity. If the acquisition or merger has for example conglomerate features, potentially no integration will be needed and the acquired unit keeps operating very independently after the merger. Also the industry sector affects the need and extent of integration (Shrivastava 1986, 66-67, 73; Buckley & Ghauri 2002, 424). Some industry specific features may affect that the integration has to proceed very slowly and the acquirer company has to be very careful with all integration related intentions. For example, in the pharmaceutical industry the role of R&D is considered to be so important that the acquirer company has to deliberate carefully how to implement the integration in the R&D function. For example, an earlier study in a Finnish pharmaceutical company revealed that in order to avoid destroying value, which was related to the key technology and competencies in the acquired pharmaceutical company, the acquirer company had to implement the integration in that particular R&D unit in a different way than it did in some other parts of the R&D function. The solution was to provide the unit with key competencies with significant grade of freedom and a special status among the company wide R&D function. (Pennanen 2004, 81-85)

### 3.3 Post-acquisition integration outcomes

Previously presented post-acquisition integration theories belong to the process theories, because they have concentrated more to explain the post-acquisition process itself. In a similar way some other researchers have tried to explain the outcomes of the integration process. As follows two of these views will be presented in this paper.

Lees (2003, 114-117) has classified integration structures into four types. They vary from wholly independent portfolio model to fully merged Blitzkrieg model (see Figure 1). In the middle of the integration deepness are organisations, which after an acquisition stay substantially autonomous or become substantially merged. Substantially merged companies can be unified technologically (Greenfield model), which includes merging of selective functions like R&D to imply knowledge sharing, or they can become mutually merged companies (Best-of-worlds model), in which the new organisation incorporates the best practices of both companies. (Lees 2003, 116) In R&D intensive companies the integration type and grade can also vary inside the organisation. In the previously mentioned single case study of a Finnish pharmaceutical company was noticed that the outcome of the integration development varied depending on the strategic relevance of certain R&D areas. Even though the aim had been to merge the functions globally to fit to

the acquirer company's patterns, some strategically important R&D functions were allowed to remain more independent. The aim with these selective arrangements was certainly to protect the knowledge and technology resources. (Pennanen 2004) The substantially merged or technology merged integration models presented by Lees (2003, 199) are thus very potential integration options in R&D related acquisitions.

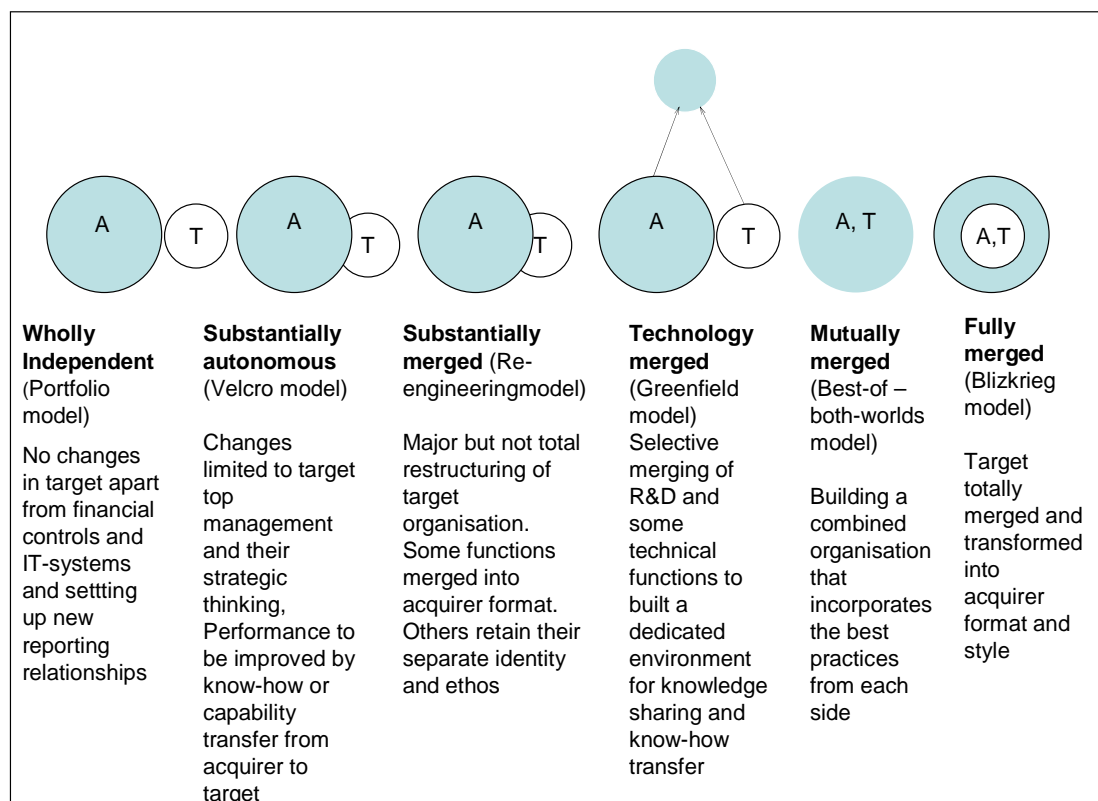


Figure 1. Integration grade options and categories of structural relationship between acquirer (A) and target (T) companies. (Modified from Lees 2003, 119)

Concerning to the integration outcomes Haspeslagh and Jemison (1991, 139) have seen two central dimensions, which affect the post-acquisition integration processes. These are the need for strategic interdependence and the need for organisational autonomy. The matrix of these dimensions shows (see Figure 2) what kind of relationship the acquirer and the acquired company have, and how the acquisition related value is expected to be reached. Strategic interdependence is needed if the two companies together are planned to create more value than the separate companies alone. The assumption is that some kind of resource sharing drives towards acquisitions. In organisational autonomy the question is about the integration grade, which helps the

organisation prevent those capabilities which could be destroyed by too tight integration. Maintaining the cultural differences between acquired and acquiring companies can in this sense serve a useful purpose (Haspeslagh & Jemison 1991, 143-144), which also links this view to the RBV and ideas of companies as bundles of rare resource combinations (Penrose 1959).

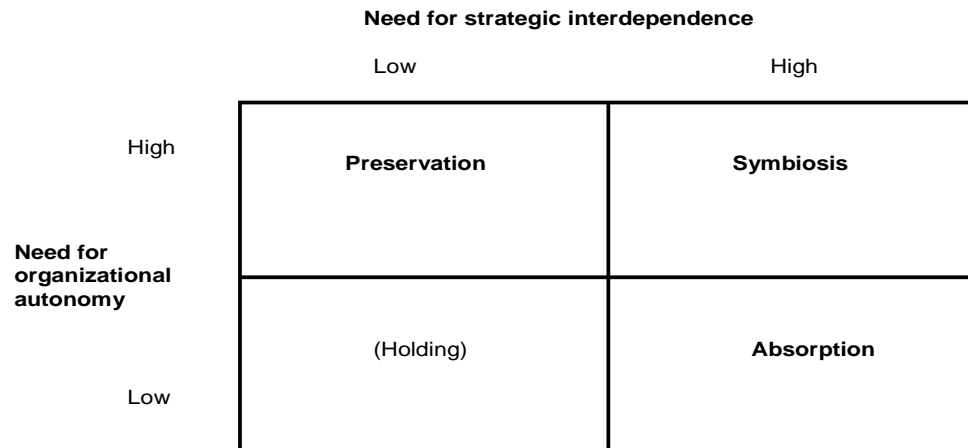


Figure 2. Integration options, called as intergration approaches by Haspeslagh and Jemison. (Modified from Haspeslagh & Jemison 1991, 145)

In the above presented acquisition integration approach matrix (Figure 2) are presented the three main alternatives for post-acquisition integration by Haspeslagh and Jemison (1991, 145-149). Absorption represents the traditional tight integration, which involves high need for strategic interdependence and low need for organisational autonomy. The aim is to dissolve the boundary between the previously two separate organisations and to create a one unity. Preservation acquisition involves high degree of autonomy and less need for interdependence. This combination might not be easy to provide after the acquisition and the situation can be described as “managing at arm’s length”. By Haspeslagh and Jemison (ibid) the acquisition in this kind of approach can be explained with risk or financial sharing motives.

Acquisitions are the third type of the acquisition integration. They involve high needs for strategic interdependence but also high needs for organisational

autonomy. Post-acquisition integration processes in R&D intensive industries have been noticed to have this kind of symbiotic characteristics (Birkinshaw et al 2000; Haspeslagh & Jemison 1991, 140-144.) The symbiotic integration approach was noticed to be relevant in R&D intensive companies' post-acquisition integration studied by Birkinshaw et al (2000). The acquired organisations were provided with high level of operational autonomy while strategic interdependence was seen important in aiming towards synergy realisations. After successful human integration had taken place, relationships and knowledge sharing across company borders were noticed. Interactions between people were not forced but they developed actually as a following of normal interaction process. Human integration further on affected the second phase of the task integration. In the R&D related acquisitions it has been seen to be obvious that autonomy in the beginning of the post-acquisition period provides good opportunities for interdependencies in later stages of the post-acquisition integration. At least some value destruction development can be prevented by this way.

Cartwright and Cooper (1993a; 1993b; 1995) have compared the post-acquisition acculturation or integration processes with different marriage types<sup>1</sup>. There are three alternative options for this post-acquisition development: open, traditional or modern marriages. In the case of open marriage the organisations accept each others as they are and both sides maintain their independence. In a traditional marriage one of the marrying partners, in acquisition case the acquirer, obtains dominance over the other. As soon as the acquisition takes place, the dominant partner starts to redesign the acquired organisation and displace its existing culture to make the other to be more like itself. This type of organisational marriage is the most typical one. The modern or collaborative marriage emphasises the differences in organisational personality and culture as potential sources for added value. The intention is to create "best of two worlds" culture. This marriage type is still pretty rare even among mergers. Collaborative marriages occur if the acquisition success is clearly dependent upon the integration of operations or exchange of technology or expertise.

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<sup>1</sup> The original idea that mergers and acquisitions fall into three main types was presented in Napier, N.K. (1989) Mergers and Acquisitions: Human resource issues and outcomes. A review and suggested typology. *Journal of Management Studies*, 26, 271-287. These three types of mergers (or acquisitions) were extension, collaborative and redesign mergers. Cartwright and Cooper have developed this view towards their three alternative acquisition approaches by naming them as different organisational marriage types.

The organisational marriage types as acquisition approaches presented by Cartwright and Cooper (1993a; 1993b; 1995) remind the acquisition approaches introduced by Haspeslagh and Jemison (1991, 145-149). When comparing the categories of Haspeslagh and Jemison (1991) and Cartwright and Cooper (1993b) they find them counterparts. In the latter categorisation the open marriage reminds the preservation approach presented by Haspeslagh and Jemison (1991, 148). Traditional marriages are similar with Haspeslagh's and Jemison's (ibid. 147-149) absorption acquisitions and the modern, collaborative marriage has similarities with symbiosis approach.

The post-acquisition theories presented in this chapter have concentrated on the final outcomes of the integration process. Contrary to the process perspective views (see Shrivastava 1986; Birkinshaw et al 2000) these theories concentrate on describing the integration outcome or final tightness of the achieved integration. Nevertheless, both these theoretical approaches are important. While the integration outcome represents the reached integration the management of the integration development and the process as such has been noted to be important factors affecting the post-acquisition integration.

## 4 Discussion

Some of the key drivers why Finnish companies, particularly those from relatively high technology sectors and those with high R&D intensity and potential, have been acquired by foreign players during the recent years and decade have been presented earlier in this paper. Resource-based-view and post-acquisition integration theories have been presented in relation to foreign acquisitions to work as a frame when observing the drivers and impact of foreign acquisitions. In the following discussion some thoughts concerning to the consequences and the role of R&D in relation to foreign acquisitions are presented. The potential impact on the target companies' R&D functions are also discussed shortly.

The role of R&D in international acquisitions is related to the nature of key technology resources (see Birkinshaw et al 2000, 401). Some foreign acquisitions can be seen to be research and development driven, when the motive for acquisition is to get access to technologies or ownership of R&D innovations or patents. In this sense the research and development functions of companies can be seen to consist of valuable and rare resources. Usually a lot of tacit knowledge and other human related know-how aspects form the backbone of R&D innovations. Technologies which have been developed in-house or other mostly intangible resources are difficult or impossible to copy

or imitate by competitors. Generally this is why companies with high R&D resources are attractive targets for acquisitions.

It is clear that the motive in many foreign acquisitions of Finnish high technology companies has been to acquire needed complementary R&D resources. Research and development can therefore be interpreted to have had a central role in many acquisitions. But the access to the needed R&D resources does not solve the problems of the acquiring company. In reality the acquisition creates new problems to be solved, namely those related to the post-acquisition integration. An essential question is how the acquirer company makes the acquisition a successful one in sense of usage of the acquired resources. If the idea has been to gain from the acquisition by having access to the R&D resources and capacities, they have to become harnessed to the usage of the new owner company. The challenge lies in this relation, because the transfer of knowledge or technology is usually considered as a very complicated process. Because of the need to prevent loss of valuable R&D know-how all actions concerning transfer of knowledge or technology have to be done deliberately. The questions are obviously not only about prevention of more tangible resources, but also of retaining human tied knowledge resources. Therefore, R&D related acquisitions set special needs for the post-acquisition integration management. Additionally, for example, R&D personnel's retention has to be taken care of to be able to handle the potential brain drain. If the key personnel will be lost as a following of an acquisition, there is a possibility that some of the key resources will be lost at the same time. This kind of resource related acquisition impact is therefore important to be identified in order to handle it in an appropriate way.

From theoretical point of view the knowledge transfer during post-acquisition integration period can be seen as a bridge building issue between RBV and process perspective theories on acquisitions (Bresman et al 1999, 443-444). The critical features in the integration of R&D functions can be in connection to the tacit nature of knowledge, because knowledge and capabilities involve not only the previously mentioned human ties, but also in terms of information or capability transfer or sharing voluntary interaction between individuals. (Birkinshaw et al 2000, 401) Therefore, approaching the role of R&D in acquisitions brings us back to the features of R&D related resources, and also to the post-acquisitions integration development issues. *The acquisition success depends on the successful reallocation of R&D resources and management of the integration development.*

Combining two companies and their resources after an acquisition affects not only the acquired, but also the acquirer company's units. What comes to the reorganising of R&D functions, the international companies have been noted to have three different alternatives to organise their international R&D



function (Räsänen 1999, 51): *R&D centers, development units and support units*. In fact the internationalisation of research and development as a phenomenon is quite recent. Traditionally, even in multinational companies, most of the R&D was performed in the company's home country. The headquarter closeness was an indicator of perceived strategic relevance of R&D. For example, internationalisation of sales or production has been more common than abroad located R&D facilities in many global companies. (Pajarinen 1999a, 18) Whereas the internationalisation development of R&D has taken place first during the recent decades, the international R&D related acquisitions have certainly affected the increase of internationally spread R&D units. The acquirer companies have had to find ways to gain from the acquired R&D without destroying value. As a result, the R&D units located outside home country may have many functions and their importance can vary significantly. The taxonomy of international R&D units presented by Räsänen (1999, 51) characterises but also differentiates the roles and functions of different R&D units. *The R&D centres* are the most important technology units of the company, which generally conduct some basic research and product development and maintain active roles in international technology scanning and networking to remain current on relevant scientific developments. *The development units* differ from R&D centres in the scale because they participate in all areas of R&D. The R&D in these units is not so wide scaled and their work is strictly application oriented. *The support units* participate only with limited role to the R&D and are usually very small from headcount. The type of the R&D unit is important in sense of the strategic relevance. Acquired R&D units with R&D centre status are likely to be handled with kid gloves during the integration process, just because their strategic importance. If the acquired R&D is not considered to be of high strategic relevance, the implementation of integration will probably be not so sensitive. Therefore, the role of R&D in foreign acquisition is very important also in sense of post-acquisition development.

As presented already earlier, a foreign acquisition means internationalisation for the acquired company and its R&D functions. More generally, one motive for international companies to internationalise their R&D has been a desire to gain from acquired companies' local knowledge and technology spillovers. (Pajarinen 1999a, 18) Against the common believe that foreign acquisitions mean lost or negative effects for acquired units, the new role as a part of an international R&D function can be very good for acquired Finnish companies and their R&D functions. As Pajarinen (1999b, 130-131) has noted, investments on R&D have seldom decreased after an international acquisition. On the contrary, further investments have taken place and have been targeted to the Finnish R&D function. The key R&D activities have

continued in Finland, although some industry specific differences have also been noted (Pajarinen 1999b, 110-127) As an explanation for this phenomenon, Pajarinen (1997, 30; 1999b, 30) has been referred to the nationality of R&D. This term brings us again back to the features of R&D related resources: Despite the shift in the ownership and the nationality of the new owner company the technological innovations remain Finnish from their nationality. Thanks to the fact that the personnel behind the break through technologies in Finnish companies have mainly been Finns and that the knowledge and technologies are considered to be hard to transfer, the R&D related acquisitions have not been expected or seen to lead to closings in the acquired R&D units. Therefore, the nationality of R&D is an additional feature, which at its part makes the R&D resources difficult to transfer inside a global organisation and thereby protects at least the key R&D units from major reorganising.

The role and impact of foreign acquisitions on Finnish target companies and their special functions is certainly an interesting theme to study. Further research on this area, especially in relation to the R&D functions, is needed. These further research needs could contain case studies from various or more concentrated from couple of named industry sectors. That way both some industry specific but also more general patterns relating to the acquisition impacts could be found.

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# IDENTIFICATION OF KEY EMPLOYEES IN CROSS-BORDER ACQUISITIONS

*Melanie Raukko*

## 1 Introduction

### 1.1 The purpose of the research

A great amount has been written concerning acquisitions, but acquisitions are still a very interesting subject for studies. This is mainly because truly successful acquisitions are few in numbers. Less than half of the acquisitions fail to fulfil the expectations. (Cartwright & Cooper 1995, 39; Hubbard 1999, 11.) Furthermore, employees have been often ignored as being soft issues and they have been labelled the ‘forgotten or hidden factor’ in the success of acquisitions (Cartwright & Cooper 1992, 1). In the 1990’s the human side of the acquisitions got more attention, and the literature concerning post-acquisition management concentrates on the issues of integrating the acquired firm into the acquiring organization (e.g. Buono & Bowditch 1989; Datta 1991, 2; Haspeslagh and Jemison, 1991; Birkinshaw, Bresman and Håkanson 2000).

Much of the previous studies concerning knowledge and acquisitions have concentrated in purely knowledge management issues such as knowledge transfer (e.g. Bresman, Birkinshaw & Nobel 1999; Birkinshaw 2001). There has been studies concerning turnover and retention as well (e.g. Ranft & Lord 2000; Somers 1995; Russ & McNeilly 1995). Nevertheless, little research seems to be done on who are the knowledge holders in acquisitions. The existing literature offers limited understanding of the reasons for key persons to leave and consequences of retaining them throughout an acquired firm (Ranft & Lord 2000, 297). Furthermore, much of the predominant focus is on the ‘upper echelons’ of the organization and empirical research to date has primarily focused on turnover in the top management team of the acquired company (see Walsh 1988; Cannella & Hambrick 1993; Very, Lubatkin, Calori & Veiga 1997; Krug & Nigh 1998; Bergh 2001; Davis & Nair 2003). However, employees represent the intellectual capital and the knowledge, which are difficult to measure in money and in some fields they represent the

core competence of the company. Therefore, this study focused on the key persons in the acquired company who have valuable know-how or knowledge. The primary objectives were *to define who the key persons are in the acquired organization from the point of view of the acquirer, and how to retain and commit them in order to maintain the business successful*. The main research problem *'How to prevent brain drain in cross-border acquisitions'* was examined through the following sub problems;

1. *How the risk of brain drain relates to other risks in cross-border acquisitions?*
2. *How the acquirers define key person: who the key persons are in cross-border acquisitions?*
3. *How to identify key person in the acquired organization?*
4. *How to retain and commit key person in cross-border acquisitions?*

The research questions were examined through several theories, such as human resource management, knowledge management, motivation theories, organizational commitment theories, and literature and theories related to acquisitions. This was a qualitative research which was conducted using the collective case study approach. The empirical research concentrated on Finnish cross-border acquisitions.

In Finland the number of cross-border acquisitions has increased five-fold during the time period of 1990-1999 (New patterns of industrial globalisation 2001, 131). Many reasons may explain the high Finnish cross-border acquisition activity. First, a large amount of the Finnish target companies have been small companies with less than fifty employees. Second, during the 1990's the structure of Finnish national economy has drastically changed as former conglomerates have carried out restructuring through divesting. Third, the industry shock explanations such as deep bank crisis, the deregulation of financial market explain the slow activity in the early 1990's and the increase in the mid 1990's. Fourth, Finland is a small country with a small domestic market. Thus, Finnish companies have sought for growth by expanding their international operations. Finally, the unification and integration of EU has enhanced the possibilities and incentives to undertake cross-border M&As. Furthermore, the liberalisation of restrictions of foreign ownership has made it possible to conduct acquisitions abroad. (Ali-Yrkkö 2002, 26.) However, Figures from 2002 and the beginning of 2003 indicate an important decline in cross-border M&A in the OECD area (International investments perspectives 2003, 14–15). As it appears that M&A occur in waves, a sixth wave can be anticipated in the future. These current trends in cross-border acquisitions and the challenges related to the human resource side of acquisitions inspired this research to concentrate on Finnish cross-border acquisitions.



## 1.2 The definition of key concepts

*Cross-border acquisitions.* This research focused on Finnish cross-border acquisitions. Cross-border mergers and acquisitions (M&As) are those undertaken between companies of different national origins (New patterns of industrial globalisation 2001). The terms of merger and acquisition are often used interchangeably in literature. However, considering this research the distinction is essential; this research focused only on acquisitions, because the focus was on deals where *the acquirer obtains total control over another company due to majority ownership* (Cartwright & Cooper 1999, 33–35). The phenomenon of key persons may be very different in mergers, where two companies form one entity and the power has to be divided (e.g. Hall 1986, 27; Hubbard 1999, 6).

*Key person and brain drain.* The definition of the concept key person may vary a great amount. Generally, a key person could be defined as a person who strongly support and use their know-how in order to enhance the realization of the strategic goals of the company. (Erkkilä 2001, 168–169.) Key persons to retain are those who possess individual expertise about a particular technology, or those individuals who are part of a group that plays a critical part in generating the company's value-creating capabilities (Ranft & Lord 2000, 299). *In this research the concept of key person refers to individuals who have critical knowledge regarding the acquisition.* The concept of brain drain has been used to describe the departure of key persons (e.g. Bukowitz & Williams 1999; Buono & Bowditch 1989). Brain drain takes two basic forms as it can mean that experienced people leave under their own steam or that experienced people are cut loose as part of an across-the-board downsizing initiative (Bukowitz & Williams 1999, 5–6). *Here, brain drain refers to the risk of one or more key persons leaving the acquired company either directly after the acquisition or after a certain time period after the acquisition.*

*Committed employees.* Committed employees are usually highly motivated to work to achieve their own goals and, hopefully, those of the organization. (Wickens 1998, 4–5.) Furthermore, committed employees are typically those who stay with the organization through thick and thin, attend work regularly, protects company assets, and shares company goals (Meyer & Allen 1997, 3). Commitment may take many forms (e.g. Mowday, Porter & Steers 1982; Reichers 1985; Allen & Meyer 1990) and there are multiple commitments e.g. towards work, career or the organization (Nummela 2003, 7). This research concentrated on organizational commitment, and how the key persons can become committed to the acquirer and its goals. The figure below illustrates the relation of the concepts presented above.

## 2 Theoretical background

### 2.1 The human resource side of cross-border acquisitions

Acquisitions have become a common reality of the organizational life as part of a strategy designed to achieve growth, economies of scale, vertical integration and diversification (Buono & Bowditch 1989, 3). The intensification of international competition due to globalisation and the economic unification of Europe drive companies to become international or pan-European (Clarke and Brennan 1997, 38). However, the acquisition represents a complex and high risk area of business activity. The “soft” issues as cultural compatibility and the integration of the people are often subordinated to the “hard” issues of strategic fit and financial competence. (Cartwright & Cooper 1995, 40.) However, the human resource side of acquisitions requires the same amount of attention accorded to financial, legal and strategic issues (Buono & Bowditch 1989, 248).

The existing literature concerning acquisitions emphasises that acquisitions are major organizational changes, and they represent for the employee a significant and potentially emotional and stressful life event, which may affect both his/hers professional and private life (Buono & Bowditch 1989; Cartwright & Cooper 1992; Nobel, Gustafson & Hergert 1997). The acquisition creates an organizational trauma and, therefore, the post-acquisition integration and the acculturation process may affect how successful the acquisition will be (Nobel, Gustafson & Hergert 1997, 52–55). In the integration phase, the essential human resources issues to deal with are; selecting the integration manager, creating new strategies, designing or implementing teams, managing the change process, retaining key persons, motivating the employees, communicating with and involving stakeholders and deciding on the human resources policies and practices (Schuler & Jackson 2001, 245).

The importance of the human resource issues varies depending on the nature of the acquisition. For example, an acquisition leading to full integration requires more attention to human resource issues than acquisitions leading to only partial or little integration allowing for separation of the acquired company. (Schuler & Jackson 2001, 243.) Moreover, the synergies only lead to a superior performance if they are accompanied by an effective integration plan. The integration, the motivation and the retention of key personnel from both acquired and acquiring company are essential regarding the performance since a lack of a clear strategy concerning these soft organizational issues is one of the main reasons for poor post-acquisition performance. (McKiernan & Merali 1997, 60.)

In the recent years, much of the writings on post-acquisition integration have argued for rapid integration and speed. Successful acquirers usually base the actual level of integration on the type of company acquired. Consequently, *the greater the innovation the less there is integration*. (Chaudhuri & Tabrizi 1999, 130.) Thus, when the assets are the knowledge workers who have the option of leaving the acquiring company, the integration should proceed slowly by integrating first human resources and once this is completed to integrate resources and operations (Birkinshaw 1999, 39). Furthermore, *the way in which the acquisition is conducted is critical*. Employees who feel they have been sold may not be willing to make their expertise available to the acquirer and they may even use it for sabotage or disinformation. (Probst, Raub & Romhardt 2000, 116–117.)

Acquisitions represent challenges and risky business activities to management teams. The geographical distance is often perceived as a risk (Erkkilä 2001, 38), thus cross-border acquisitions are widely perceived as more risky than domestic acquisitions (Angwin & Savill 1997, 427, 434). However, recent research implies that the differences are expected and acquirers tend to have high cultural awareness in international acquisitions. (Risberg 2001, 59). The risks related to cross-border acquisitions can be subdivided into two categories: fit and process issues. The fit issues comprises the size, diversification, previous acquisition experience, strategic and cultural fit, and other demographic issues, e.g., the healthy condition of the seller. The process issues comprise the risks involved in the transaction and the implementation process, e.g., problems related to negotiations, inadequate pre-acquisition planning, the price paid, and human resource problems. (Hubbard 1999, 15–16.)

The scale of the ‘human problems’ in acquisitions and the time scale within which the culture change could be achieved are often seriously underestimated. One of the problems concerning human problems is that the acquiring company usually automatically expects the acquired employees to adopt its culture. (Cartwright & Cooper 1992, 40.) Literature concerning cross-border acquisitions has focused to a great extent on cultural differences. Recent research suggests that managers of the acquiring company making acquisitions in culturally distant countries should not underestimate the value of specific firm routines embedded in the target company’s national culture, which can have a beneficial impact on the performance of the combined firm (Morosini, Shane & Singh 1998, 153–154).

However, employees react to acquisitions differently. Although acquisitions are stressful events, some employees may perceive acquisitions as opportunities and not necessarily as threats. (Ivancevich, Schweiger & Power 1997, 20–22.) *Employees are often well aware of that there will be*

*management and organizational changes following the acquisition; employees usually expect change after acquisition* (Hubbard 1999, 3). Usually employees are worried about the extension and the timing of these changes. Implementing changes too fast leads to resentment, dissatisfaction and to the loss of key persons. (Buono & Bowditch 1989, 14–15.) They will not tolerate being kept in the dark, being treated badly or being misled. *Therefore, the key to acquisition is managing employees' expectations:* doing adequate planning, telling employees about the future and implementing the changes as communicated. (Hubbard 1999, 3.) Managing change resistance is one of the biggest challenges in the human resource side of the post-acquisition integration (Schuler & Jackson 2001, 247). This research focused on risks related to human resource; losing key personnel has been widely acknowledged as a typical acquisition risk (e.g. Cartwright & Cooper 1995; Erkkilä 2001; Risberg 2001). The focus was on the retention of key persons, which have valuable knowledge.

## 2.2 Brain drain in cross-border acquisitions

Brain drain in this research refers to the voluntary leaving of key persons with valuable knowledge. Various reasons may lead to brain drain during acquisitions. Employees may decide to leave the company voluntarily due to uncertainties. Furthermore, the loss of talented employees may lead to further losses as some employees may resign because they feel an attachment to others who had also resigned. (Schweiger et al 1987, 129.) This form of voluntary resignations has been referred to as 'the post-acquisition drift factor' or 'the haemorrhage effect' (Cartwright & Cooper 1999, 45). Key persons may also leave the firm taking with them one or more loyal subordinates leaving the acquiring company run the business by itself (Lindgren 1982, 137). In the worst scenario, these employees may leave only to start up a rival company (Probst et al 2000, 116).

Acquisitions may represent very stressful events for employees. Different acquisition stages affect the stress levels differently. The key stressors during the pre-acquisition phase are uncertainty of the future, the possibility of job loss and organizational changes. During the acquisition the period of waiting and uncertainties continues, and the acquisition stress may prevail even during the post-acquisition phase as there might be unforeseen changes not considered before. (Ivancevich et al 1987, 20–25.) Many issues lead to acquisition stress, such as uncertainty about the future, the change in the psychological contract, changes in the culture, and the employee-supervision relationship (e.g. Ivancevich et al 1987; Cartwright & Cooper 1992; Hubbard

1999). According to Herzberg's motivation-hygiene theory these stressors are classified as dissatisfiers, which have the potential to increase job dissatisfaction and may increase the turnover intentions (Herzberg, Mausner & Snyderman 1959; Herzberg 1966). However, employees react differently on stress depending on their personality type, their previous experience of acquisitions and the organizational context (Ivancevich et al 1987, 20–22; Lees 2003, 144.)

There has been little research on the causal order of stress, job satisfaction, commitment and turnover. Researchers agree that organizational commitment reduces turnover rates and absenteeism, but it does not have definitive positive impacts on work effort and job satisfaction (May, Korczynski & Frenkel 2002, 776). However, according to a recent research stress affects job satisfaction, which in turn affects commitment. Commitment would be the only antecedent of turnover intention and this relation is reciprocal, suggesting that low organizational commitment leads to higher propensity to leave the organization but also that higher propensity to leave further lowers the organizational commitment. (Elangovan 2001, 163–164.)

However, this model applies to companies in their everyday business life. Acquisitions are major events, which affect these links differently. As mentioned earlier, employees do not experience acquisition stress similarly (Ivancevich et al 1987, 20–22). Nevertheless, regarding those employees who experience acquisition stress, the increased level of acquisition stress and uncertainty can lead to reduced job satisfaction and less organizational commitment (Fairfield-Sonn et al 2002, 4; Hubbard 1999, 32). As acquisitions entail changes in the ownership, the commitment needs to be developed towards the new owner. Consequently, acquisitions and the stress related to them may affect both satisfaction and commitment directly. As it has been mentioned earlier previous research has also found a link between job satisfaction and turnover (e.g. Herzberg 1966; Steers & Porter 1975). Thus, in the figure below, there are links from the acquisition stress to both satisfaction and commitment, which both lead to turnover intentions. The link between satisfaction and commitment, and the reciprocal link between turnover intentions and commitment have remained according to the original model proposed by Elangovan (2001).

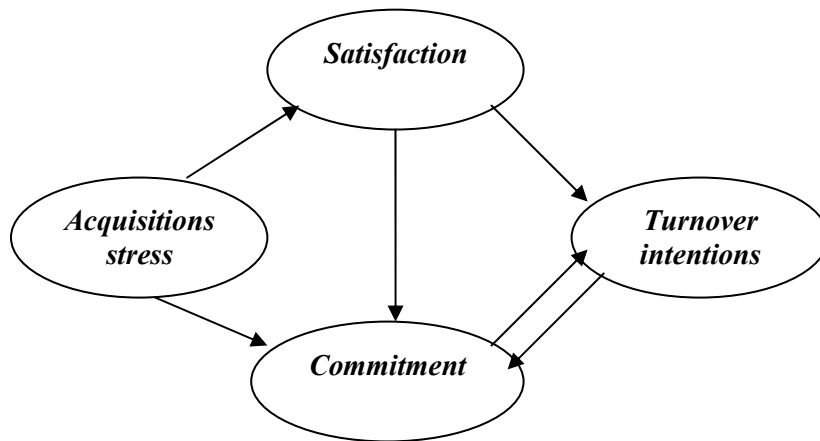


Figure 3. The model of Elangovan (2001) in the context of acquisitions

Concluding, acquisitions represent a complex context for analysing the relation between job satisfaction, commitment and turnover. There is not much research done in this context. Nevertheless, this research did not attempt to study these relations or their causal order but rather this causal model may help to understand how to commit in cross-border acquisition. In order to commit employees from the acquired company to the new owner, factors affecting commitment have to be properly understood. Consequently, *in cross-border acquisition commitment cannot prevent turnover as the commitment needs to be first rebuild through increasing job satisfaction and decreasing the level of acquisition stress*. The next section will introduce various means to commit key persons toward the new organization.

### 2.3 Identifying and retaining key persons

Literature regarding turnover in acquisitions has been to a great extent about executive turnover in the context of acquisitions (e.g. Walsh 1988; Cannella & Hambrick 1993; Krug & Nigh 1998; Bergh 2001; Davis & Nair 2003). However unplanned personnel losses occur at all levels, not only among top executives (Cartwright & Cooper 1999, 47). Furthermore, key persons prior to the acquisition may not be critical anymore, as there might be more competent personnel in the acquirer's organization. In addition, key person during the acquisition process are not necessarily needed once the implementation process has been completed. (Erkkilä 2001, 169). Consequently, there are various knowledge holders and their importance varies regarding the acquisition process and the knowledge needed.

There are several ways to identify key persons during acquisitions. The acquirer may gain information from senior people and fellow employees in the

target assuming the acquirer values their opinion (Erkkilä 2001, 169). Furthermore, industry knowledge, meetings with the acquired company's managers and employees, one-on-one interviews, and existing performance reviews are useful methods to identify key persons (Hubbard 1999, 150–167). Existing knowledge maps can also be useful (Probst, Raub & Romhardt 2000; Vail 1999). Ideally the acquirer should use as many sources of information as possible to assess, which persons are important to the new organization and which are good to involve in the implementation process (Hubbard 1999, 150).

The retention of key persons should start already at the pre-acquisition phase (Erkkilä 2001, 166). In order to retain key persons managers should attempt to manage acquisition stress and to reduce job dissatisfaction, and if possible, they should attempt to increase job satisfaction. In order to reduce the level of uncertainty during the acquisition the acquiring company should communicate as much as possible, and preferably give accurate and reasonable information (Gutknecht & Keys 1993, 31; Schuler & Jackson 2001, 247; Risberg 2001, 78). Other means to retain key persons found in literature are: transition and turnover teams, renegotiating employee contracts, rebuilding the psychological contract, maintaining the status and prestige in the new organization, effective leadership, and incentives (Ivancevich et al 1987; Buono & Bowditch 1989; Cannella & Hambrick 1993; Hubbard 1999; Erkkilä 2001). According to Herzberg's motivation-hygiene theory financial incentives are classified as dissatisfiers and therefore, they do not have the potential to increase job satisfaction (Herzberg 1966, 72–77). The ability to retain key persons depends largely on non-monetary factors (Hiltrop 1999, 424). However, turnover or retention is strongly linked with commitment theories (e.g. Allen & Meyer 1990; Elangovan 2001) and therefore, retention can never be truly effective in the long run unless key persons are committed to the acquirer.

## 2.4 Committing key personnel in cross-border acquisitions

Maintaining the organization commitment of employees in the face of downsizings, mergers and acquisitions, and other turbulent changes is a challenging dilemma of all managers today (Dessler 1999, 58). Much of the literature concerning the human factor in acquisitions deals with employees' attitudes during and after acquisitions (e.g. Buono & Bowditch 1989; Cartwright & Cooper 1995; Hubbard 1999; Marks & Mirvis 2001). Although, recent research has been more and more interested in the organizational

commitment of the acquired employees, research in this field is still very scarce (e.g. Schraeder 2001; Fairfield-Sonn et al 2002).

The level of commitment among the employees of the acquired company may be very weak (Erkkilä 2001, 171). Decreases in job satisfaction, organizational commitment, job involvement, morale, performance, perceived organizational and management trustworthiness, and motivation, can result in emotional distress, increases in absenteeism, intentions to leave and turnover. Consequently, the organization's day-to-day functioning and its ability to cope with the implementation process can be seriously hindered. (Hubbard 1999, 32.) Research implies that even if an individual would experience low commitment and low need to remain, he/she might remain because of desire or obligation (Meyer & Allen 1991, 73–74). Consequently, even though a key person would like to leave the company, he/she might be obliged to stay due to e.g. poor employment situation.

When commitment is analysed in the context of cross-border acquisitions, the different types of commitment, that is commitment to work and career, and organizational commitment have to be distinguished (Nummela 2003, 10). Acquisitions are powerful events which have the potential to change the relationship between work and careers; acquisitions may initiate several changes such as loss of job, changes in job, transfer to a new job, changes in the career path etc. (Ivancevich et al 1987, 21–22). Furthermore, the loss of commitment during acquisitions is resulting from a lack of direction, as the company goals are unclear at the beginning, and from the sense that the acquirer is concerned only about financial outcomes (Pritchett 1985, 51–52). Research implies that committed persons are more likely to remain in the organization and to work in order to achieve organizational goals (Shrivastava 1985, 72; Mowday et al 1982, 19). Thus, committing the acquired employees to the new owners will enhance the achievement of the operational and strategic objectives of the acquisition (Hunt & Downing 1990, 196). Consequently, *this research focused on how to enhance organizational commitment toward the acquirer in order to ensure the success of the acquisition.*

### 3 Methodology

This is a qualitative research using the collective case study approach (Stake 1995, 2–3). This research used the collective case study approach based on the instrumental approach, i.e. the cases were chosen in order to accomplish something other than understanding a particular case (see Stake 1995, 2–3). The purpose of this research was to investigate the contemporary phenomenon



of key persons within its real-life context, which in this case were cross-border acquisitions (see Yin 2003, 13). Therefore, the case companies remained anonymous when analysing the results. There are two reasons for choosing this approach. First, if the research would concentrate on a specific acquisition it would have been probably more difficult to obtain proper answers, since these issues tend to be delicate. Second, the focus was not on how a certain company deals with these issues but rather on the acquisition process itself.

In this research purposive sampling was used to select the appropriate interviewees. There were several issues that guided the purposive sampling of the companies in this research. First, the research problem focused on foreign or cross-border acquisitions. Therefore, the companies were primarily selected based on whether or not they had conducted cross-border acquisitions. Second, the cross-border acquisitions had to be relatively recent. Consequently, the research focused on cross-border acquisitions having occurred during the time period 2000–2002. Third, this study concentrated on companies which have a great deal of experience in cross-border acquisitions. These companies are more likely to have well established practices to identify and commit key person in cross-border acquisitions.

The cases were selected based on their cross-border acquisition activity. Acquisitions of domestic firms listed in the weekly issues of the review *Talouselämä* formed the database required for the initial set. In order to obtain a sufficient coverage of cross-border acquisitions done by Finnish companies, all the acquisitions done during the time period of 1998–2002 were listed and grouped by companies in an Excel sheet.<sup>1</sup> Using the computer it was easy to pick up the firms, which had made the most acquisitions abroad. Top ten lists were gathered from the years 1998–2002, 2000–2002 and 2001–2002. The purpose of these lists was to identify which companies had made the most acquisitions during the past five years and also to identify the most recent cross-border acquisitions. However, the ranking itself was not important, but it served as a tool in order to find the firms to contact for the interviews. In fact the three top ten lists together resulted in the total of 14 companies, which gave a really good start for contacting the companies in order to obtain interviews.

Altogether 13 companies were contacted. Five companies agreed to be interviewed and these were UPM-Kymmene Oyj, Hackman Metos Oy, Karl

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<sup>1</sup> Due to missing issues in the library, data from issues 43/1998, 11/2002 and 34/2002 was not available. These issues were not available in the Internet either. However, considering the amount of information available this was not regarded as having an effect on the results received.

Fazer Oy, TietoEnator Oyj and Wärtsilä Oyj. They all have a very different background and represent very different industries. The companies were able to choose who would be the best person to be interviewed based on the interview request. This resulted in a variety and diversity in the background of the interviewees. There was one CEO, one Vice President, one Executive Vice President, one General Counsel and one Vice President of Human Resources. However, each interviewee had experience and had been part of acquisition processes and therefore, they were without doubt qualified to be interviewed for this research. The interviewees were regarded as experts considering cross-border acquisitions.

The data was gathered through semi-structured interviews, meaning interviewees could answer freely on pre-designed interview questions, which were the same in each interview (Eskola & Suoranta 1998, 87). Consequently, it was easier to compare the answers and discover similarities and differences. However, as it was important to obtain information about the phenomenon of key persons, the questions were not too specific in order to leave room for unexpected information to emerge. Once the interviews were conducted, the data was analysed through transcription and coding (Eskola & Suoranta 1998, 151). The interviews were then grouped together, meaning that all the answers were grouped under the relevant question. The data was then coded and arranged under themes. The key variables were analysed and compared by bringing them in an Excel sheet, e.g. the answers related to how to retain key persons were all brought in an Excel sheet, in order to better identify similarities and differences. However, as the Excel tables give thinner information than the original database, the tables were analysed together with the original database. (Miles & Huberman 1994, 10–11.)

## 4 Results

### 4.1 The risk of brain drain in cross-border acquisitions

Cross-border acquisitions involve many risks and losing key personnel count among the typical acquisition risks (e.g. Cartwright & Cooper 1995; Erkkilä 2001; Risberg 2001). Brain drain was analysed in relation to other risks related to cross-border acquisitions in order to obtain a broader view on the phenomenon of key persons in cross-border acquisitions. The main idea was to define whether brain drain is seen or not as an important risk. However, the results of this research show that brain drain is not perceived among the important risks in cross-border acquisitions. However, this does not mean this phenomenon can be ignored.

Several other risks appeared to be more important than brain drain. Although the interviewees came from very different fields of industry, the risks appeared to be very similar. Research results imply that regardless of the business activity, the takeover and the integration phase were perceived either as a risk or a success factor. Other risks mentioned were those related to poor assessment during the pre-acquisition phase. Furthermore, one of the most obvious risks in cross-border acquisitions appeared to be the risk concerning culture. Cultural risks referred both to risks related to national and organizational culture. Although brain drain was not perceived as a risk, the results imply that it is rather regarded as a consequence of other problems related to the acquisition and the integration phase.

Most of the interviewees did not experience the loss of key persons or they acknowledged only one such case. There might be several reasons for this result. In most cases technology was not perceived as a key asset in the acquired company. Although a few interviewees admitted that employees had left during acquisitions, none of them had really been such a key person or a key knowledge holder whom they would have wanted to retain. According to most interviewees there had not been any key person to retain as their company had the core knowledge. At least three interviewees said that usually they have brought their knowledge and know-how to the acquired company. This implies the acquisitions of the companies in question have been more about e.g. expanding the market area, entering new markets or achieving growth, than about acquiring critical technologies or capabilities. Moreover, as all the interviewees were chosen based on their wide experience regarding cross-border acquisitions, brain drain might not be an issue for them due to well established procedures and routines. The results might have been different if the interviewees would have experienced only few cross-border acquisitions, or if the focus of the research would have been on companies acquiring specific technological knowledge.

Although the interviewees had barely experienced the loss of key persons, they did acknowledge the problems related to brain drain. According to the results the loss of knowledge is perceived as the main problem related to brain drain. This is consistent with literature which implies that losing key persons is a damaging problem (Schweiger et al 1987, 129), and a form of organizational forgetting leading to the loss of valuable knowledge (Probst et al 2000, 238–240). Furthermore, the eventual interruption of the business was seen as a critical problem; e.g. the loss of key salesmen may affect the sales as they can take key customers with them. Apart from losing valuable knowledge, there also is the risk that more employees leave leading to a decrease in customers' trust towards the company and potentially to the emergence of a new competitor. Moreover, a few interviewees pointed out that

the harms caused by brain drain are especially great during the integration phase and the take over, as usually in one or two years the acquirer has had time to obtain the critical knowledge. However, the interviewees who made larger acquisitions emphasized that retaining key persons is important in every acquisition in order to avoid more employees to leave.

## 4.2 Various key person in cross-border acquisitions

Although much of the existing literature written about turnover in acquisitions has been about top executive turnover (e.g. Walsh 1988; Cannella & Hambrick 1993; Krug & Nigh 1998, Bergh 2001), it has also been implied that unplanned personnel losses can occur at all levels (e.g. Cartwright & Cooper 1999, 47). As the interviewees came all from very different companies, there was some variation regarding who the key persons are in the acquired company. Five interviews resulted in almost five different definitions. The variety of backgrounds of the interviewees provided a better and more comprehensive understanding regarding the concept of key persons in acquired companies.

All the interviewees had first some difficulties to define key persons. However, the difficulties related to the definition of key persons in general are somewhat understandable. As many of the interviewees stated, everyone can be defined as a key person, as it can be assumed that everyone brings its own contribution to the company. It appeared to be easier to define key persons in the acquired company. The responses concerning who the key persons are in the acquired organization *during the acquisition* could be divided into five categories; *top management team including the CEO, the Controller and the Chairman of the Board or the owner of a small family owned company, the process and production experts, key personnel in sales and marketing, lawyers, M&A experts and communication managers*. The answers regarding lawyers, M&A experts and communication managers were confusing as these seemed to refer to employees in the acquiring firm. The key persons *after the acquisitions* are: *top management including potentially new CEO, controller or in small firms the owner, production and technology managers, HR-managers, which can also be new, key salesmen, chief shop steward, and communication managers*.

According to the results key persons can be found in all the layers in the organization. There are some similarities and some differences in who is defined as a key person depending on the stage of the acquisition. Usually, key persons during the acquisition are those who have a useful skill base regarding the implementation process (Hubbard 1999, 150). Furthermore, during the

acquisition the knowledge immediately usable is very valuable and critical in order to make the implementation successfully (Probst et al 2000, 108–109). After the acquisition key persons are those with core knowledge, for example technology experts and key salesmen. Communication managers were perceived as key personnel both during and after the acquisition. This implies that the importance of communication often emphasized in literature (e.g. Ivancevich et al 1987; Schweiger & Weger 1989; Schuler & Jackson 2001; Risberg 2001; Erkkilä 2001), has been acknowledged in companies.

The results imply that there are several factors affecting who the key persons are in the acquired company from the point of view of the acquirer. There are at least six factors which affect who the key persons are in the acquired company: *the size of the acquired organization, the business activity of the acquirer and the acquired company, the knowledge intensity of the industry, the knowledge available in the acquiring firm, the acquisitions stage, and the motives of the acquisition and the acquisition type*. The results concerning the definition of key persons showed that there is not necessarily one single right answer, but rather it depends on the business activity and the size of the acquired company and the knowledge intensity of both the acquirer and the acquired company. Although it is dangerous to draw conclusions and to compare the answers of the interviewees as they were selected only on the basis on how many cross-border acquisitions they had conducted, the results show that in smaller acquired companies the key person is the owner and the top management. Furthermore, the definition of key persons varies according to the acquisition type and the acquisition stage. During the acquisitions key persons are usually at the management level, those involved in the negotiation process, and persons involved in the implementation of the acquisition. After the acquisition the original management team becomes less important. Employees involved in the production processes, the core business activities and sales are crucial during the whole process in order to ensure the smooth continuity of business.

### 4.3 Identifying and retaining key persons in cross-border acquisitions

Although losing key persons was not seen as an important risk during acquisitions, the results revealed that all the interviewees used several ways to identify key persons. Both key persons, whether they are key persons regarding the acquisition process or key persons with critical knowledge necessary even after the acquisition, are important to identify and retain in order to ensure the smooth continuity of the business. The interviewees used all very similar techniques to identify key persons and knowledge relevant to

the business, which implies that the field of industry does not affect how the company identifies key persons. Altogether, five different methods were identified: *personnel and management assessments, one-on-one discussions and interviews, meetings and discussions with top management or the owner, the organizational position, and the existing databases.*

However, the results indicated that the size of the company is a key determinant regarding which methods are the most effective or whether any techniques are even needed. Usually, in relatively small family owned companies the key persons are relatively easy to identify and it can be very self evident who the key persons are. However, in large acquisitions, where the organization may consist of thousands of employees, various techniques, such as mapping, management assessment and one-on-one interviews, are needed to identify the key persons. In addition the organizational position and the existing HR databases may give some indication of the key persons to retain. Consequently, the results indicated a clear and rather obvious division between small and large acquisition. However, even though results imply that it is relatively difficult to assess the acquired employees before the announcement of the acquisition, all the interviewees emphasised that the identification of key persons should start already before the closing of the deal.

There are various ways to ensure that key persons remain in the company. According to literature, preventing acquisition stress and increasing job satisfaction are efficient ways of avoiding turnover (see e.g. Herzberg 1966; Ivancevich et al 1987; Hiltrop 1999). The five interviews resulted in an impressive amount of retention modes. At least the following methods were used: *identifying key persons at an early stage, communication, incentives and contracts, involving the acquired employees, respecting the culture of the acquired company, and demonstrating the potential of the company.* According to the findings, in order to avoid brain drain it is important to identify key persons as soon as possible, to discuss a great deal with them from the very beginning, to keep them informed and to involve them as much as possible. Communication and one-on-one discussions were very important at least in larger acquisitions. According to the results, although many of the interviewees mentioned that they used different types of incentives in order to retain key persons in the acquired company, these incentives and bonuses did not appear to be the primary mean of retention. At least two of the interviewees did not mention incentives. Furthermore, key persons also are retained by making them feel as an important part of the new entity, by inviting them to meetings and involving them in the integration process. Hence, the key persons obtain truly the feeling that they have a future in the

company. Moreover, one way to retain key persons is to show the potential of the new entity through expected synergies.

There were few issues that did not come up during the five interviews that were mentioned in literature: dealing with rumours, turnover and transition team, maintaining status and prestige, redefinition of the psychological contract and effective leadership. Nevertheless, some of these were embedded within the answers even though the interviewee did not use the specific terms. Moreover, dealing with rumours already at the pre-acquisition phase may not be even possible for the acquirer, as many interviewees mentioned that effective communication can usually begin only once the deal has been closed. Effective leadership may appear self-evident, and thus it has not been mentioned separately as a mode of retention. Nevertheless strong leadership was mentioned in the context of success factors related to cross-border acquisitions as a mean to decrease uncertainties. Acquisition teams were used in large acquisitions. As none of the interviewees had experienced critical turnover, the acquisition team mapping and assessing the acquired personnel was not perceived as a turnover team. The acquisition teams would be closer to transition teams planning the transition stage, although the specific words transition or integration were not used during the interviews.

#### 4.4 Committing key person in cross-border acquisitions

According to literature job satisfaction would be an important antecedent of organizational commitment (e.g. Elangovan 2001). Consequently, in order to clarify the concept of commitment and various methods of committing key persons, the interviewees were asked to define both how they motivate and how they commit key persons after the acquisition. The main purpose was to identify various means of committing key persons in cross-border acquisitions. Nevertheless, it appeared to be difficult to answer the questions related to commitment, and the results indicated that the interviewees use similar ways of motivating key persons than to commit them to the acquirer's organization. According to all the interviewees, committing employees in cross-border acquisition is important.

The five interviews resulted in various ways to commit key persons such as *personal conversations, communication, promotion and giving more responsibility, competitive wage together with bonuses and incentives, involving in the new organization, emphasising the positive outcome of the acquisitions, and making the key persons feel important*. Bonuses and other incentives were seen much more important in committing key persons than in retaining them. All the five interviewees mentioned they use competitive

wages together with incentives to commit key persons. Giving more responsibility and new challenges, which were also mentioned as motivators, were seen as committing factors as well.

Some commitment modes emerging from literature did not come up during the interviews, for example the rebuilding of the psychological contract. Nevertheless, it might be more abstract of nature. When asked what kind of means they use in committing key persons, the interviewees stated the more obvious ones, such as incentives, giving more responsibility and communication. Moreover, the commitment of senior managers and feedback were not mentioned either. The guaranteeing of organizational justice was not mentioned in so many words, but at least a few interviewees mentioned that in order to commit employees in cross-border acquisitions it is important to communicate the new policies. This can be viewed as enhancing organizational justice, as communicate clear policies increases transparency. If the questions would have been set in the form of a multiple choice questionnaire instead of an interview other modes of commitment might have emerged as well.

The results implied that the interviewees use various means to commit key persons although they appeared to lay much more importance to bonuses and incentives than literature recommends. Though this research offers limited understanding of commitment in cross-border acquisitions and the cultural differences, it provides some understanding of the means of committing key persons. Furthermore, in order to commit key persons it is important to understand that there are various key persons. Depending on the nature of the key knowledge holder, whether he/she is a top manager or a technology expert or a key salesman, a combination of various commitment modes can be well suited. Furthermore, it is important to make the difference between key persons during and after the acquisition. The results showed that at least in smaller companies the top managers and the owner are the key knowledge holders and the acquirer usually wants to retain them in the company for one or two years. In these cases, incentives and contracts were usually used in order to retain and commit them. However, this research did not analyse how the acquired employees perceived the committing efforts of the acquirer. Therefore it is difficult to assess how effective these methods are. Although the interviewees appeared to have succeeded in retaining key persons, there is no evidence about the long term commitment of the acquired key persons. Future research could focus on both how the acquirer commits acquired employees and how these employees perceive these efforts in order to obtain a better understanding of how organizational commitment is developed during cross-border acquisitions.



## 5 The reliability and validity

This research has some limitations concerning validity. Validity can be analysed from three perspectives: construct, external and internal validity (Yin 2003, 34–37). This study was analysed concerning its construct and external validity. As the focus of the research was not a causal cause, internal validity cannot be tested. However, the validity of the instruments measuring the phenomenon has some limitations. First, this research is based entirely on one data source, namely interviews, and only top managers were interviewed. Literature has been concerned with the validity and the reliability of data collected from elite sources, i.e. top managers (Welch et al 2002, 614). Elite interviewees may answer in a guarded way due to fears that the answers would be used against them (Welch et al 2002, 621).

Moreover, there were some limitations regarding the suitability of the interview questions, as the questions related to commitment were partially poorly designed and did not provide all the information necessary. Thus the interviewees were sent an email afterwards in order to specify some questions. It has been suggested that post-interview cooperation with elite interviewees can be very beneficial to the research, and that usually the most effective feedback procedure is to send the final draft to key informants (Welch et al 2002, 616, 625). As the interviews were tape recorded, it permitted the verification of the data throughout the analysing process. Thus, although this research has some limitations concerning the construct validity, the interviews were able to provide answers to the research problems. Nevertheless, the results might have been different if both top managers and key personnel from both acquired and the acquiring company were interviewed. Furthermore, a single case study using both qualitative and quantitative methods would have given a deeper understanding of the phenomenon.

External validity refers to whether the findings are generalizable beyond the immediate case study (Yin 2003, 37). A general concern about case studies is that they are not providing a sufficient basis for scientific generalization (Yin 2003, 10). The number of cases should not be an issue in qualitative research, rather the versatility of the data. Moreover, if there are too many interviews the analysis may remain superficial. (Mäkelä 1990, 52–53.) Thus the fact that the data consists of only five case companies representing different fields of industry is not necessarily a limitation regarding this study. However, the results of this research provide little base for generalizability. First, the data collected was about Finnish firms and their cross-border acquisitions. Thus the results are not generalizable to all firms. These cases were chosen only based on the broad experience in cross-border acquisitions but not regarding the

industry or size of the company. The results may have been different if the industry would have been a criterion as well.

Reliability demonstrates that the operation of a study can be repeated, with the same results (Yin 2003, 33–34). In general the precise description of the research methods increases the reliability of the study (Hirsjärvi et al 2002, 214). Although this research has some limitations regarding validity and reliability, it has attempted to expand and generalize theory which is still very scarce in this field. Furthermore, although the research may be conducted in many other ways, the research methods used in this study answered rather adequately to the research problems of this study. Nevertheless, more academic research is needed regarding commitment and cross-border acquisitions and hopefully, this research will inspire others to enrich findings regarding this topic.

## 6 Conclusions

Acquisitions have increased dramatically during the past decades and have become part of the everyday business life. Acquisitions are made in order to create value, to generate something new and bring new opportunities. Usually, they affect the lives of all the employees, and bring considerable changes which require a great amount of adjustment. (Erkkilä 2001, 12.) Employees have often been labelled as the ‘forgotten or hidden factor’ in the success of acquisitions (Cartwright & Cooper 1992, 1). This research attempted to obtain a better understanding of the phenomenon of key persons in cross-border acquisitions. Much of the predominant focus regarding the loss of key persons during acquisitions is on the turnover of top executives (e.g. Walsh 1988; Cannella & Hambrick 1993; Krug & Nigh 1998; Davis & Nair 2003). This research focused on all the key persons, which have valuable knowledge.

In literature the risk of losing key persons count among the typical acquisition risks (e.g. Cartwright & Cooper 1995; Erkkilä 2001; Risberg 2001). One of the main findings of this research is that the results imply that losing key persons is not perceived as a risk. None of the interviewees mentioned brain drain as a risk when they were asked to define various risks related to cross-border acquisitions. Other problems related to strategic fit, integration, financial issues, cultural differences and the continuity of the business were perceived more important. Most of the interviewees did not experience the loss of key persons or they acknowledged only one such case. This result was unexpected as the interviewees came all from different fields of industry and business, and from companies, which had conducted several acquisitions.

According to the results key persons may be found in all organizational levels. From the point of view of the acquirer various persons appeared to be critical in the acquired organization. Six factors seem to affect who the key persons are: the size of the acquired company, the acquisition stage, the business activity of both the acquirer and the acquired company, the knowledge intensity of the industry, the knowledge available in the acquiring company and the motives and the nature of the acquisition. Although five cases do not provide sufficient base for generalization, it appeared that the top management, the CEO and the owner would be more critical in smaller acquisitions. In larger acquisitions employees closer to the core product or business activity seem to be more important than the top management. Literature provides limited understanding concerning the various key persons in acquisitions (see Hubbard 1999; Erkkilä 2001). Thus these results gave an interesting perspective on the phenomenon of key persons.

The interviewees described various ways to identify key persons, which could be found in literature as well. According to the interviewees identifying key persons was not perceived as a problem. In small acquired companies it might be rather self-evident who the key persons are. However, regarding larger acquisitions several techniques to identify key persons emerged during the interviews. These were personnel and management assessments, one-on-one discussions and meetings with the employees, meetings and discussions with the top management, the organizational position and the existing data bases. Sometimes several of these methods were used simultaneously, which is consistent with literature (Hubbard 1999, 150).

Although none of the interviewees had experienced loss of key persons during acquisitions, retaining the key persons was perceived important. The following methods to avoid unplanned losses of key persons were mentioned during the interviews: identifying key persons at an early stage, communication, involving key persons, new challenges and attractive bonuses. The interviewees emphasised the importance to reduce uncertainties by effective communication and by involving the key persons in the integration process in order to make them feel as a part of the new organization. In general uncertainties about the job and the future and changes in the working conditions, employee-supervision relationship and psychological contract may increase the level of stress and may lead to decrease in job satisfaction, which may in turn result in turnover (Herzberg 1966, 72–74; Ivancevich et al 1987, 20–24; Cartwright & Cooper 1992, 43, 48; Hubbard 1999, 27; Erkkilä 2001, 144; Krug 2003, 14; Lees 2003, 142–144).

When commitment is analysed in the context of cross-border acquisitions, the different types of commitment, work, career and organizational commitment have to be distinguished (Nummela 2003, 10). Acquisitions are

powerful events that have the potential to change the relationship between work and careers (Ivancevich et al 1987, 21–22). Employees with higher career commitment have also a higher propensity to leave the organization (Bashaw & Grant 1994, 52) and those who are strongly committed to the organization are the least likely to leave the organization (Allen & Meyer 1990, 1). Consequently, from the point of view of the acquirer it is important to understand the various commitments and to rebuild the organizational commitment

The interviewees used very specific methods in order to commit key persons: bonuses and incentives, promotion and giving new challenges, involving key persons in the new organization and personal conversations. Altogether, the results related to committing key persons were consistent with the existing literature, although they revealed that managers tend to emphasize incentives when committing key persons. However, there is no evidence of how the key persons have actually perceived these commitment efforts as the focus was on how the acquirer commits key persons of the acquired company. Thus it is difficult to assess how effective these modes of commitment are.

Concluding, the main findings of this research was that brain drain is not perceived as a typical risk in cross-border acquisitions and that there are various factors affecting who the key persons are in the acquired company. Moreover, the results regarding the modes to identify, retain and commit key persons were consistent with the existing literature. Both the research evidence and the literature suggest that all these measures should be undertaken at an early stage preferably during the pre-acquisition stage. According to the interviewees, in practice, it may be difficult to access the acquired company and its employees before the deal is closed and announced. However, by preventing and reacting quickly to the human resource problems related to the acquisition brain drain may be avoided effectively.

This research has some limitations regarding validity as the focus is in Finnish cross-border acquisitions and the number of cases was small providing little base for generalizability. However, the main objective was not to aim at statistical generalizability, rather to expand and generalize theory and to inspire more academic discussion in this field. The main purpose of this study is not to give guidelines but to provide a better understanding of the phenomenon of key persons and different options for preventing the loss of valuable knowledge. Nevertheless, this research provides little understanding of the cultural implications on organizational commitment. Future research could concentrate on the cultural implications on organizational commitment and the development of commitment during the acquisition process. There is still very little research done on the relations between stress, job satisfaction,

commitment and turnover intentions in the context of acquisitions. This research will hopefully induce more research in this field.

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# TRUST AND CONTROL IN CORPORATE INTEGRATION: A THEORETICAL ANALYSIS<sup>1</sup>

*Erkki Vuorenmaa*

## 1 Introduction

This study focuses on trust and control in corporate integration. Acquisitions are a common phenomenon in everyday business life. However, it has frequently been pointed out that more than half of all acquisitions fail (see e.g., Porter 1981; Young 1987; KPMG 2001; A.T. Kearney 1999). One of the most critical factors in their success is the integration process (Ravenscraft – Scherer 1987). Although there is a considerable amount of literature on this process, no precise reasons for failure or success have been established. Several reasons for failure have been put forward, including cultural distance between an acquired and an acquiring unit, increased confusion due to lack communication, lack of resources for implementing integration, personal conflicts, increased complexity arising from the acquisition, and the complexity of the integration process (see e.g., Haspelagh – Jemison 1991; Kitzhing 1967; Santala 1996). According to the literature, these factors could be classified as problems of control. There is evidence that establishing control over the acquired unit may cause wide organisational consequences (Jones 1985a, 1985b, 1986; Granlund 2003). However, earlier studies have focused only on accounting systems. The establishment of control over the acquired unit can be seen a critical success factor in integration, but the relationship between integration success and control has not been studied.

Trust has been described as being essential in social and economic life since it facilitates co-operation, lowers agency and transaction costs, and acts as a basis for interaction between people (Mayer et al 1995; Smith et al 1995; Jones 1995; Rempel et al 1985). It is a significant factor in the integration

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<sup>1</sup> The helpful comments of Kari Lukka, Niina Nummela and Pekka Pihlanto are gratefully acknowledged.

process because co-operation is needed in order to achieve synergy targets, uncertainty must be eliminated in order to continue business as usual, and resources are normally limited — not everything can be controlled. Earlier studies argue that building up of trust between the acquirer and the acquired is important (Buono et al 1985). However, its establishment and role in corporate integration has not been studied, although its role has been described as important.

The nature of control and trust is fruitful to study in the context of integration because some level of trust and control needs to develop between the acquirer and the acquired. Trust itself is a relevant object of study since it attracts controversial views. There are, for example, divergent views on its establishment. Some writers suggest that it only develops gradually over time (e.g., Blau 1964; Rempel et al 1985; Zand 1972), and only in interpersonal relationships (Mayer et al 1995). However, it has also been argued that very high initial trust may exist without any interpersonal contacts (McKnight et al 1998). There are also differing views on the relationship between trust and control. For one thing, trust itself is argued to be a control mechanism (Bradach – Eccles 1989). On the other hand, the relationship between the two is considered to be complementary, meaning that when trust increases, control necessarily decreases (Inkpen – Currall 1997; Leifer – Mills 1996). Lastly, the relationship is argued to be supplementary, meaning that increasing trust does not necessitate decreasing control: the two support each other (Das – Teng 1998). Given the gaps in the literature and the above theoretical contradictions, the aim in this study is to analyse and explain:

1. the relationship between trust and control;
2. how trust and control are established in corporate integration;
3. the role of trust and control in the success and failure of corporate integration.

The study is based on conceptual analysis.<sup>2</sup> The structure of this paper is the following. It begins with an analysis of the nature of trust, and continues by exploring the nature of control. Thereafter is analysed the relationship between trust and control. The critical factors in the integration process and the role of trust and control in its success are then examined, and thereafter some conclusions are drawn.

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<sup>2</sup> This research paper is based on the author's ongoing PhD study, and draws on the literature discussion of the thesis. The empirical part of the study analyses the integration process of two multinational companies.

## 2 Trust and control

### 2.1 The nature of trust

#### 2.1.1 The perspectives and components of trust

The theme of trust has been approached within various disciplines. The discussion has been very lively during the last decade because of the existence of new organisational forms, which is thought to increase the need for and challenges arising from trust. The wealth of discussion has not clarified the phenomenon, and has rather increased the variety of definitions and frameworks.

Trust in the broadest sense refers to expectations of another's behaviour and is the basis of our social life. Its complete absence would prevent us from getting up in the morning since we would be afraid of doing anything. Without it we would not be able to define distrust or take precautionary measures, since that would presuppose trust in other directions (Luhmann 1979). Thus we could conclude that trust is needed and is a self-evident fact of human life.

There is much variety in the definitions of trust, mainly arising from the presence of vulnerability, as Deutch (1958) defines trust as "*An individual may be said to have trust in the occurrence of an event if he expects its occurrence and his expectation leads to behavior which he perceives to have greater negative motivational consequences if the expectation is not confirmed, than positive motivational consequences if it is confirmed.*" Vulnerability is considered to be a key point in the difference between trust and confidence (Luhmann 1988). Definitions similar to the one proposed by Lewicki et al (1998), that trust means having confident positive expectations regarding another's conduct, are also widely used. Lewicki et al (1998) do not explicitly refer to risk in their definition, but they do include uncertainty, and like Luhmann (1979), suggest a common theme — predictability and being exposed to uncertainty. These two issues clarify what trust means, and put aside issues that are sometimes understood to mean exactly the same as trust, such as loyalty and goodwill. Next is discussed the sources and bases of trust. The base of trust can be defined as the ground for the decision to trust. The sources and bases of trust are gathered to Table 1.

Variety, on which the predictability of the trustee's behaviour is based, is different depending on the discipline. From the *calculative perspective*, expectations of another's behaviour are based on calculation that involves weighing up the costs and the benefits of certain actions to both parties. This perspective assumes that man is a rational actor and chooses the course of action that is likely to result in maximum utility, and is common in the agency

theory of the social sciences (Axelrod 1984; Coleman 1990; Dasgupta 1988). The idea is that someone has some information about the future behaviour of the potential trustee, but not as much as the trustor would like to have. Complete information would make trust redundant, and potential co-operation could be achieved by matching each other's resources to their respective interests (Simmel 1950). It has been argued that trust starts where calculation ends, but when we make decisions whether or not to trust someone, we usually first evaluate the risks of our trust decision and the factors that may lead those we trust to act according our expectations. Therefore, we could see calculation as one source of trust. Given that actors are not always rational, and that not all decisions can or need to be based on calculation, there is a need to establish other sources of trust.

*The transaction cost perspective* (Williamson 1975, 1985, 1993) is also based on calculation. This view differs from the calculative perspective in its behavioural assumptions and emphasis on the continuous use of control mechanisms. The key behavioural assumptions behind it are bounded rationality and opportunism. Potential partners deal with each other employing control mechanisms in order to make opportunism costly. If an agent expects the costs and benefits of opportunism or co-operation to be beneficial, he or she is willing to trust. Thus, trust is based on calculation and safeguards. Williamson (1993) himself argues that there is no trust in economic transactions: cost-effective safeguards are considered more effective in exchanges. However, given the definition of trust as predictability and being exposed to uncertainty, one could argue that in transaction cost theory, it is based on safeguards and calculation. Although Williamson (1993) argues that safeguards eliminate uncertainty, as long as prediction of behaviour is involved, uncertainty is present.

*According to the value-norm-based perspective*, trust is based on common values, and rational self-interest is rejected in favour of collective order. Parsons (1961) argues that trust cannot be developed unless individuals have the same values. For him, trust means the suspension of self-interest in favour of the collective good. Fukuyama (1995) supports this approach, stating: "*Trust comes out of shared values*", and emphasises commonly shared norms. However, empirical work does not support Parsons' views. There is evidence that trust can be built between people from different cultural backgrounds, and even between people who share no values beyond their narrow business goals (Lane 1998; Lorenz 1988). However, Granovetter (1985) argues that values and norms may enter into very specific relations or specific cultural areas, as he considers trust relations to be embedded in particular social relations and the related obligations. Thus common values and norms may develop in long-

standing relations in which trust develops gradually, but where value consensus emerges from the relationship.

Bradach and Eccles (1989) see norms as a basis of trust within and between organisations. These norms refer to the existence of 'some sort of community of shared values'. For Barney and Hansen (1984), the 'strong form of trust' is value-based. It reflects values, principles and standards that partners bring to the exchange. However, they do not explain how such trust comes about in relations between business partners. Child (1998) also sees norm-based trust as the highest form of trust to emerge in interpersonal relations. This also raises doubts. Bachmann (1998) argues that hardly anyone would trust another only because the social norm required such behaviour, and nor would anyone refrain from trusting because of a norm to remain suspicious in business relations. The same norms and values may predict the behaviour of others, but they are not necessarily the basis for trust. Some other elements are needed, such as common goals and incentives. Different values may hinder trust since they decrease predictability, as in the relationship between Finnish and Samoan people, although trust may still be present because of the existence of covenants or incentives. Norms and values as such cannot be regarded as sources of trust.

*Institutional-based trust and systems trust* are very close to each other. As the names suggest, the former refers to institutions, and the latter to systems as sources of trust. They are dealt with together here. According to Zucker (1986), trust is not dependent on interpersonal familiarity and common history. Institutional trust is based on a formal, socially produced and legitimated structure that guarantees it. It is likely to emerge when there is (a) exchange across group boundaries and therefore significant social distance between groups, and (b) exchange involves large interdependent, non-separable transactions. Luhmann (1979) argues that the acquisition of knowledge of shared structural properties overcomes the need for information, and hence supports the building up of trust. Structural properties, or institutions, form the basis of trust, or provide support for its development in complex societies in which a common history can no longer be assumed.

According to Luhmann (1979, 75), the cognitive basis of this form of trust lies in the notion that "*each trusts on the assumption that others trust*". Systems trust is built on continual affirmative experiences of using the system. Therefore, trust in a generalised medium of communication requires a genuine basis if it is to be sustained. Trust in the system does not require specific built-in guarantees, but it is more difficult to control than trust in persons. Controlling the basis of systems trust requires more expert knowledge than people who trust in the system usually have. Impersonal trust supports interpersonal trust.

Luhmann (1979) considers the system both the object and the source of trust in that, like legal regulation, its existence makes it less likely that the one who is trusted will behave in an untrustworthy manner. At the same time, he argues that modern society needs impersonal forms of trust that individuals bestow in the functioning of abstract systems such as the monetary system, as well as educational and legal systems. Individuals are considered trustworthy when they can be assumed to comply with rules guaranteed by the institutional order, when sanctions prevent them from cheating, and when the tacit 'structuration' of their expectations and actions so allow. This implies that the system is the object of the trust. The source and the object are closely linked.

Giddens (1990) argues that 'expert systems' such as air-traffic systems and, one might assume, legal systems, can generally be trusted because they are large-scale abstract social systems that can generally be expected to function according to universal rules regardless of whether or not an individual actor is cheating for some reason. However, he does not consider an individual actor totally irrelevant in terms of the object of trust. Individuals are important at the 'access points' of social 'expert systems'. They represent and regularly confirm the trustworthiness of the system. The functioning of an air-traffic system would be seen to be dependent on the interaction between the pilot and the air-traffic-control officer. Face-to-face contacts with people at points of access help to absorb the risk. These contacts are important in the constitution of trust, but the interaction is not sufficient to produce systems trust.

There is no worldwide common denominator of institutional trust. In countries with undeveloped institutional guarantors, the trustworthiness of business partners must be monitored in order to establish a workable basis (Humphrey 1998). This implies an element of calculation when institutional trust has not grown up, as in some less-developed societies. However, institutional trust may be low with regard to specific systems in modern societies too, as found in Italy where trust in the legal system was studied (Arrighetti et al 1992). This implies that institutional structures may be fragile even in modern societies, and that institutional trust thus does not ensure the functioning of society.

*Interpersonal trust* has been approached from several angles, including the psychological and the sociological. No single strong theory of how one person judges another's trustworthiness has yet been developed, however. Therefore, factors affecting interpersonal trust are gathered from various disciplines. Interpersonal trust has been said to depend on various factors (cf. McKnight et al 1998). First are the personal factors, how one has faith in humanity and is willing to deal with people as though they are well-meaning and reliable. Second are factors related to the contextual situation, meaning that if the situation is normal and the necessary structural assurances are in place, a trust



relationship is likely to develop, and third are one's beliefs about the other party. A trusting relationship is likely to develop if one party believes that the other is benevolent, competent, honest and predictable. Fourthly, one could evaluate this new relationship on the basis of earlier experience and knowledge. If the resulting categorisation is positive, a trusting relationship is likely to develop. Fifth, the development of a trusting relationship is based on how one feels that the interaction with the other party is functioning, and how one can influence the other party.

Interpersonal trust is argued to have fewer roles in current society because of the heterogeneity of individuals' backgrounds and the fewer opportunities for face-to-face contacts. It has also been argued that this type of trust requires a tremendous amount of time and effort in co-ordinating economic transactions within complex socio-economic systems, and that other types of trust are more effective. Personal trust can thus only fulfil a supplementary function, and cannot in any way be the only mode of trust production (Zucker 1986). Giddens (1990) considers interpersonal relationships important, but not important enough to produce systems trust. Personal contacts such as with friendly, smiling airline stewardesses and lawyers in black gowns appear at the 'access points' of the system that they represent, and thorough 'facework commitments' assure potential users or clients that these systems can be deemed trustworthy.

Table 1 reviews the sources and bases of trust. Fragility is rarely discussed in this context. There may be various reasons for this. For one thing, trust may be seen as morally good and as representing the characteristic of human flourishing, thus mostly positive. Second, there are very few empirical studies on trust, and as is well known, empirical studies rarely reveal the worst experiences. Fragility may emerge from the sources and bases of trust. Trust based on predictability is fragile when the trustee behaves in an unpredictable or inconsistent manner. Trust is also fragile when covenants cannot be made so that they fully direct the behaviour of the trustee or when they are too costly. Institutions do not always behave in a predictable manner, and sometimes assumptions are made based on how certain other institutions might act. Institutions do not behave in the same manner in all countries. If actors do not behave rationally, the illusion of knowledge or the trustee's behaviour will cause fragility. This may happen with institutional trust as well as with personal trust.

Table 1. The Perspectives of trust

Sources	Calculation Covenants or other contracts Institutions/systems and their influence Knowledge/illusion of knowledge
Bases	Consistency/functionality Structural assurances Benevolence, competence, reliability Earlier experience, illusion of control
Fragility	Unpredictability, inconsistency Non-directional or too-costly covenants Non-functional, unpredictable institutions/systems and unjust policies The illusion of knowledge and control

The discussion on trust has concentrated on its sources and bases. One stage that has been missed is what lies between the source and fragility. This could be considered in the context of the development of trust.

### 2.1.2 The development of trust

There is wide disagreement as to whether trust develops gradually or whether it can be high at the initial stage, based on no personal or other contacts at all. Empirical studies support both views. Interpersonal trust in business relations is rarely displayed spontaneously: on the contrary, it requires an extended period of experience. During this time, information about the potential partner is gathered either directly or through a reliable third party. Exchange partners gradually test whether each other is trustworthy (Lane 1998). The incremental expansion of trust entails that the object of trust and the level of risk are gradually increased (Ring – van de Ven 1992). The process of building trust may be shortened if boundary-spanning individuals who are in exchange relationships have regular personal contacts (Bradach – Eccles 1989), if the auditing of exchange is accepted, and if unilateral investments (Barney – Hansen 1994) or pre-commitments are made (Sako 1998).

The gradual development of trust is based on the assumption of the relevance of increased information. As more information gradually accumulates and trust develops, a trustor is willing to take more risks. Tomkins (2001) produced a trust-development model based on the relationship between trust and information. The model is inverse U-shape. During the early stages, there is a low need for both trust and information since commitments are lighter than they are later. When the relationship matures, then there is a positive association between trust and information

since trust itself cannot be increased without further information being given. As trust becomes established at a higher level in later stages of the relationship, there is less need for information to sustain it. Therefore, there is a negative association between the need for information and trust during the later stages.

This model is built on the assumption of a rational way of life. As people start to evaluate a potential partner, they gradually deepen their relationship by receiving and allowing more access to information. The model also assumes that relationships have time to develop and that they exist on various levels. It assumes, too, that the development of trust is a linear process, which a trustor may stop at a certain level and decide how to continue. However, life is not that simple or linear. Time is not an unlimited factor. The model therefore gives only an idealistic rationalistic picture of trust development. Neither does it take into consideration the costs of acquiring information, or that people do not always make rational decisions. Additionally, as discussed above, trust is not limited to interpersonal relationships, and there are other sources that may guarantee it. Lastly, the model does not account for the fact that trust may be very high at the initial stage of a relationship. This is discussed next in another approach to the development of trust.

Recent empirical studies indicate that there may be a high level of trust at the initial stage of a relationship (Berg et al 1995; Kramer 1994). Personal characteristics affect how one builds up trust. It may be very high if the trustor has faith in humanity, meaning that one relies on one's basic beliefs about human nature in specific situations when there might be no reason to do so. Initial trust may be considerably high if one is willing to rely on others even if they are untrustworthy. Situational factors may affect the level of initial trust, and when one feels comfortable and the situation is normal, one may be ready to trust. Structural assurances may also provide enough assurance to provoke high initial trust (McKnight et al 1998).

When one believes that the other party is benevolent, competent, honest and predictable, one is likely to be ready to trust him or her. Individuals are likely to categorise new acquaintances according to earlier experiences, and a positive grouping will tend to produce high levels of trust (McKnight et al 1998). People in uncertain situations also tend to take small actions in order to assure themselves that things are within their control (Langer 1975). This results in inflated perceptions of personal control (Taylor – Brown 1988), which Langer (1975) calls the 'illusion of control', and on the basis of which individuals tend to make judgements regarding others' trustworthiness.

The realisation that trust may be high at the initial stage of a relationship brought some realism into the discussion on trust development. The notions that trust is morally good and that people are cautious, with time to develop a

relationship, are outdated and possibly were never true. However, sometimes people may be able to build up relationships according to Tomkins' (2001) model. Nevertheless, initial trust may be either fragile or robust, and does not necessarily lead to more vulnerability than trust that is built up gradually. Fragility is often the consequence of a lack of time, unstable relationships, complexity and a lack of resources, and may be conscious or unconscious.

Previous research on trust development has ignored the instability and complexity in the world. The notion of initial trust brought some realism into the argument, but the focus was on why it may be high, and the fact that we sometimes need to make decisions based on trust rather than knowledge, given a lack of resources and time, and because of complexity and instability, was not considered. These factors in the trust decision may lead to *an imbalance in the relationship*. This means that we do not have enough information to assess the predictability of the other party in conditions of uncertainty, but we must nevertheless behave in a trusting manner.

A lack of *resources* refers to not having enough money or employees to acquire information about the other party, for example, or capability to process the information received. We just continue the relationship if it is important, or for some other reason. Some structural assurances may direct the behaviour of the other party, but without the necessary resources we cannot be sure. Nevertheless, if we believe in the predictability of the other party, we have trust, but we would like more information. *Time* is sometimes critical, for example in gaining competitive advantage or in sustaining client satisfaction, therefore it is sometimes impossible to process and evaluate all of the information, and thus to consider all possibilities, before the decision is made. There may be structural assurances, belief in the other party's benevolence and or competence, or the considered assumption that the party has no reason to behave other than as predicted. These issues may lead to trusting behaviour even if the trust relationship is not considered complete.

The situation may also be so *complex* that it is not possible to acquire the information felt needed, or that it would be too costly, or only acquired in part. Complexity may arise when a decision involves many parties who need to enter the relationship at the same time or almost at the same time. One party cannot fulfil the task alone. Complexity may also arise when there are certain expectations involved that cannot change, or if there is joint influence among the parties that cannot be known beforehand. *Instability* means that the relationship or the requirements of the party continuously change and therefore it is hard to predict behaviour. If the relationship is such from the start that it is not known exactly why it exists, then it is impossible to know what type of information should be acquired and what the requirements of the relationship will be.

A trust relationship tends to continue even though we may not be satisfied with the information or the other requirements, including the competence of the partner. In social interaction with others we tend to ignore evidence that is contrary to our beliefs (Good 1982). We also tend to interpret ambiguous or incomplete information in a way that agrees with our existing beliefs (Kahneman – Tversky 1973). Violations of trust could be seen as unique exceptions or as a personal quirk (Sitkin – Roth 1993; Zucker 1986). Being around others increases favourable beliefs about them (Good 1988). This causes a self-sustaining circle of trusting, since people who have positive beliefs about others are not likely to decrease their interaction (Darley – Fazio 1980; McKnight et al 1998).

The building up of trust and of a trust relationship is more complex than implied in previous research. Trust may develop gradually, it may be based on initial fragility or robustness, it may be unbalanced from the beginning or become so later. If we are close to the other party, or we find it convenient, or we think trust is robust, or we think that everything is under control, then we may not improve our trust relationship although it might be possible. An unbalanced relationship is complex and may be impossible to improve, and even if it is not, the improvement may make it even more unbalanced.

## 2.2 Trust and control

### 2.2.1 The forms and nature of control

The discussion on organisational control has been vivid in organisational science and management literature, and a considerable number of frameworks have been constructed. However, it has concentrated on three mechanisms: market/output, hierarchy/bureaucracy, and trust/clan (e.g. Williamson 1975; Ouchi 1977, 1979; Merchant 1985). These control mechanisms are introduced below in the light of this paper.

*Market/output/result control* means that individuals are controlled by the results they achieve. The aim is to affect an individual's behaviour by controlling the outcome. This form of control is used when an actor's behaviour itself cannot be directly controlled or is not totally known. The mechanism is used to define desired or undesired levels of performance, to measure performance on defined dimensions, and to give rewards or punishment in order to encourage or discourage the behaviour. It is feasible when knowledge exists as to what results are desirable, when the desired result areas can be controlled (at least to some extent) by the individual(s) whose actions are being influenced, and when the controllable results areas can be

measured effectively. In order to provoke appropriate behaviours, the measures should be precise, congruent with organisational objectives, objective, timely and understandable (Merchant 1985; Ouchi 1977, 1979).

*Hierarchy/bureaucracy/behaviour/action control* means that the behaviour of the actor is guided and monitored. In order to apply this form of control, the organisation must have at least agreement, if not accurate knowledge, about means-ends relationships. The process through which inputs are transformed into outputs must be known before the rational guiding and monitoring of behaviour can take place. Behavioural control is exerted by defining what actions are acceptable or not acceptable, by tracking what happens and by rewarding or punishing deviations from the defined limits. From a broader perspective, it also involves constraining an individual's performance in order to avoid harmful action. Constraints may be physical, such as locks and passwords, or administrative as in the centralisation of decision-making and the separation of duties. Harmful effects may be avoided by conducting pre-action reviews, which involve observing the work or plans of the individual before the activity is complete, and making adjustments as necessary (Merchant 1985; Ouchi 1977, 1979).

The third control mechanism is the *clan/collaboration/personal* form. This means that when neither the behaviour nor the outcome can be measured, the only things left are rituals, values, culture, social mechanisms and trust. In order to apply this mechanism, the organisation must have common values, beliefs and the necessary skills, and emphasis is placed on the selection of individuals, training and building common values. Its functioning depends on social power and self-motivation. Social control may evolve naturally in work groups, or may be imposed by superiors forming particular groups and encouraging a certain type of organisational culture. Social pressure may also be exerted from the bottom up as superiors are pressured to meet subordinates' expectations. Self-motivation is based on the assumption that individuals know and do what is best for the organisation. Individuals have internal motivations such as deriving self-satisfaction from doing a good job and seeing the organisation succeed. This type of control mechanism is argued as being based on trust (Merchant 1985; Ouchi 1977, 1979).

### 2.2.2 Trust in control

According to Williamson (1991), it is possible to conduct economic transactions by leaning only on markets and hierarchies. However, according to later discussion on transaction costs, trust is seen as the third element of control. Bradach and Eccless (1989) modified the transaction cost approach.

First, they argue that the risk of opportunism is not always present in transactions. Second, they adopt the sociological approach of economic exchange, which allows for the development of trust in two distinctive contexts: where exchange partners share common values and norms that have grown out of a long process of association, and where economic relations are embedded in personal relationships of friendship. Thus they call trust the third mechanism of social control, which is functionally equivalent to the market and the hierarchy, and complements them. This view contradicts the conclusions concerning value-norm-based trust, according to which values and norms alone are not enough, and different values and norms do not hinder trust.

Social control and self-motivation, which are primary mechanisms in clan/personal control, cannot be considered trust control. In fact, trust is not control. *"Good control means that an informed person can be reasonably confident that no major, unpleasant surprises will occur"* (Merchant 1985, 10), and trust does not regulate anyone's behaviour, therefore it cannot be termed a control mechanism. Social control and self-motivation rest on outcome and behavioural control mechanisms. Even if at the time the individual is fulfilling a task, his or her behaviour cannot be monitored, and the outcome of the task cannot instantly be evaluated, he or she is under control but not totally in trust. Let us take as an example Ouchi's (1979) categorisation of the clan control that is imposed in a research laboratory. Although the ultimate success of the research laboratory may not be seen before perhaps 5-10 years, there are certain milestones by which it can be evaluated. Individuals are selected very carefully and their actions are evaluated continuously. As their salary is probably based on success according to some milestone measures, they do not have any more reason to deviate in their actions than individuals who are under outcome control. In the laboratory environment the supervisor knows quite well how the subordinates are behaving and how the research is progressing. As he or she is responsible for the unit, he or she will use mechanisms to direct the subordinates' behaviour. Clan/social/personal control is different from outcome and behavioural control, but does not mainly lean on trust.

However, trust appears in all control forms. As no control system is complete, and as several are used concurrently, there are situations in which, consciously or unconsciously and voluntarily or not, we give trust a role. The role that trust may have in various control mechanisms is discussed next.

As *market/output/result control* is used when an actor's behaviour is not known, this form of control may rely significantly on trust. The challenges to trust are heavy since there are several dysfunctional sides to this control mode. Result control may be exerted when control systems are not properly in place

so that individuals act according to control-system goals rather than to organisational targets. Gamesmanship is common, meaning that actions are taken in order to improve measures of performance without producing any positive economic effects. Two main forms of gamesmanship are the creation of resource slack and data manipulation (Merchant 1985). Trust is also challenged by the functionality of control systems. Data may not be precise because systems are not in order, or feeding data into the system is not conducted properly. Organisational changes occur in that figures are not totally comparable, so that trust is relied on more than normal.

The *hierarchy/bureaucracy/behaviour/action control* is activated when the resources and knowledge are insufficient to control the process or the knowledge of issues that is desirable or undesirable in terms of the success of the process. Although this form of control should be complete, when the hierarchy and/or distance increase, it may happen that individuals cannot be monitored as well as before and that the process becomes different. This may mean that the control system becomes one of outcome control, but it may not result in a better solution. Some production processes are dependent on tacit knowledge developed at work, which no foreman can acquire, and therefore these processes are difficult to monitor. When the decision-making is centralised, at least in a large organisation, those at the centre do not have the best information about the processes, and they are dependent on the information that is given to them. As some limits are given, in terms of acceptable investment-payback times, for example, it may be that there is some level of gamesmanship. This sort of phenomenon can never be avoided, but the implication is that this form of control is not complete. The size of the company may mean that work rules, policies, and procedures are not standardised in the different units, and that these things cannot be controlled from the centre. In the end, the centre depends quite heavily on trust that policies are in order in the various business units. The relationship is usually unbalanced in these circumstances.

The *clan/collaboration/personal control* dimension, as discussed earlier, offers another perspective on trust, which is not unproblematic. If social pressure, or self-control based on incentives, does not direct behaviour towards organisational goals, it challenges organisational control just the same as when it takes a long time before the outcomes of an individual's behaviour can be measured. Usually there are milestones in a long development process that predict the efficiency of it. Although selection, training and value may affect the outcome of the process, the main factor is the motivation of the individual, and that is usually based on incentive systems. As argued earlier, this dimension has its roots in hierarchical and market control, and the same problems apply as in the other dimensions. We could conclude that trust itself



is not a control mode, but that it is present in every one either overtly or covertly.

### 2.2.3 The relationship between trust and control

The relationship between trust and control has been widely discussed, and three different views have been presented: trust is itself a control mechanism, the relationship is complementary, or it is supplementary. These three views are discussed below, and a new more comprehensive perspective is presented.

The idea that *trust is itself a control mechanism* is based on the clan/collaboration/personal control dimension discussed earlier. Bradach and Eccless (1989) argue that trust is the third governing mechanism in transactions, and Merchant (1985) suggests that self-control is based on trust. Moreover, according to Sohn (1994), social knowledge could be considered a social-control mechanism given the evidence that it may be a substitute for a formal mechanism. Trust has been seen as a necessary control tool, especially in new organisational forms (Sydow 1998; Sheppard – Tuchinsky 1996). In view of the fact that control is meant to regulate an individual's behaviour, which trust does not, trust is not a control mechanism. As control systems are not complete, there is a requirement for trust, and increasingly so in the complex environments that new organisational forms create. In any case, trust is not a control mechanism because in itself it does not lead anyone to behave in a certain manner: there is a need for guidance, and also usually for monitoring, rewarding and punishing.

The second view is that *trust and control are complementary*: the more trust there is, the less need there is for control, and vice versa (e.g., Inkpen – Currall 1997; Leifer – Mills 1996). There are two approaches here. First, as building trust and control is costly, there is an investment decision to be made. Investment in control systems is costly, and monitoring needs a continuous flow of resources (Simons 1991). Trust is not free either: establishing it is a planned activity that consumes considerable organisational resources over time (Das – Teng 1998). Secondly, trust and control are seen as different sides of the same analytical coin: at one extreme is the zero-trust organisation structure, in which discretionary work content and behavioural autonomy are totally excluded, as opposed to the other extreme, the total-trust structure (Fox 1974). The implication is that there cannot be considerable amounts of control and trust at the same time: increasing the level of trust means decreasing the level of control. This has its merits; if there is complete control there is no need for trust because there is no behavioural uncertainty. However, trust does not prevent the use of control. It depends on how it is used whether or not it

has negative consequences. If it signals distrust, an individual may start to behave accordingly. This is called 'a spiral of distrust' (see Luhmann 1979). In any case, co-operation may not be beneficial if there is considerable suspicion regarding the partner's behaviour.

Control can be exerted in such a way that it does not arouse any negative feelings, or it may even help to build up trust. Institutionalised control such as quality control is depersonalised, and so it is accepted as a normal activity and is not experienced as personal distrust (Luhmann 1979). Control may also increase trust. According to Goold and Cambell (1987), a subordinate with a history of meeting targets earns the confidence of his or her superior. Secondly, superiors' reactions to deviations create their track record for softness or toughness, and also reveal how they understand their business. If the business appraisal is non-adversarial, concentrating on improvement rather than on finding fault with past performance, it will build up confidence in the superior. Thirdly, the control process creates an opportunity for clear personal feedback. It may reinforce trust on the institutional and on the personal level.

According to the third perspective, *the relationship between trust and control is supplementary*: meaning that increasing trust does not necessitate decreasing control: the two support each other. As there is trust there is no need for control, but in contrast to the complementary approach, trust and control jointly and independently contribute to the level of confidence in partner co-operation, which may vary greatly for different partner firms. Higher levels of trust do not automatically dictate the lowering of the control level, and vice versa. A partner in a relationship may, if necessary, seek to change both trust and control simultaneously and in a parallel fashion without any zero-sum complementary constraints. The extensive use of control systems, however, indicates a lack of belief in oneself and in one's competence, resulting thereby in a damaging effect on relational trust (Das - Teng 1998).

As most relationships are based on a mixture of trust and control (Bachmann 2001), the supplementary perspective seems to describe the relationship between the two. Bachmann (2001) argues that the choice between trust and control is not arbitrary since both have their side effects that contradict the supplementary perspective. Moreover, the supplementary perspective does not account for the fact that some control mechanisms are institutionalised and form the basis of institutional and systems trust. Examples include the legal system, hierarchies, and trade associations. Thus, *trust and control are intertwined*. As we evaluate the robustness of institutional trust, we in fact in some cases evaluate the thoroughness of control systems.

Another issue that has not been considered in the discussion of trust and control is *unbalanced trust* — the concept developed earlier in this paper. As suggested, situations may arise when resources, time, complexity and instability lead to imbalance in the trust relationship. This, in turn, may also cause *an imbalance in the relationship between trust and control*, meaning that although there is not complete trust, control is not or cannot be increased to balance the relationship. Although it is known that there may be some holes in the control systems, there are not enough resources to check or fix them. The lack of resources may lead to trusting-like behaviour of lack of further control. The lack of time in some situations also means that it may not be possible to gather all the necessary information to make an informed decision, and that the decision that is made is based on incomplete knowledge. There is not always enough time to devote to control, and therefore there has to be reliance on trust.

In a complex environment it is not always possible to define control systems that are complete without incurring enormous costs. Given that such an environment is hard to predict and control, it is likely that the relationship between trust and control is often unbalanced. When the environment or relationship is unstable, then control systems may not provide comparable information, and/or may not focus on relevant issues. For example, it may not be possible to compare situations or to predict the future because of constant changes. There is usually reliance on trust, because control systems cannot be comprehensive. If there were total reliance on control systems, trust would be based on faith and would have no real basis. Trust and control would be unbalanced in either direction.

Control systems may build up trust and even become institutionalised trust mechanisms. However, the relationship between the two may be unbalanced, and the tough use of control systems may eliminate trust. Based on the discussion in this section, the relationship between trust and control is best classified as intertwined.

### 3 The roles of trust and control in integration

Acquisitions have been widely studied, and one of the main conclusions of previous research is that the integration process is the main reason for failure or success. However, thorough analysis of earlier studies on integration shows that the factors that affect its success or failure have not been identified. Success in this context could be defined as achieving the targets of the integration, and failure as not achieving them. As corporate integration concern business life, the focus of the discussion should be on how it affects

business performance. What follows is a review of the factors affecting success and failure in integration, and a discussion of the role of trust and control in its success.

*Organisational culture.* The integration process of two organisations with their own cultures has been described as longitudinal (see e.g., Sales – Mirvis 1984; Buono et al 1985). Lack of cultural fit between the acquired and the acquiring company is argued to be a significant factor in acquisition failure (Nahavandi – Malekzadeh 1988). Managers in both companies may have different cultural frames of reference, and it may take time before they understand each other thoroughly (Shrivastava 1986). Although there are many studies claiming the importance of culture in integration success, we do not have evidence that culture affects the success. The most well-known study is that of Buono et al (1985), which has been widely cited, but it showed no link between integration problems and integration success. The most well-known culture framework for integration was drawn up by Nahavandi and Malekzadeh (1988), and was based only on conceptual analysis. No other studies have investigated the relationship between culture and integration success.

From the *people* perspective it has been stated that interfirm consolidations often cause lowered employee commitment and productivity, increased dissatisfaction, high turnover of managers, leadership and power struggles, and a general rise in dysfunctional behaviour (e.g., absenteeism, tardiness, sabotage) (Buono – Bowditch 1989; Jemison – Sitkin 1986; Schweiger et al 1987). The success of integration is argued to depend on the availability of talented managers who are able to anticipate the forthcoming changes and carry out the necessary transitions (Kitcing 1967). Corporations normally have a limited number of experienced managers, and they may have to incorporate integration into their other work (Lindgren 1982; Santala 1996; Granlund 2003). Competition between managers is said to interfere with the development of the acquired unit (Shrivastava 1986). None of the above studies evaluated the link between people and integration success. Jemison and Sitkin (1986) and Shrivastava (1986) are both well-cited conceptual studies, and what is amazing is that many studies are being carried out based on the assumptions made in them. Kitcing's (1967) study is based on interviews with single managers from acquiring companies.

There is nevertheless some evidence of a link between people and integration success. Duhaime and Schwenk (1985) found that managers may have the illusion of control over the acquired company. Such illusion affects unsuccessful acquisitions. Cannella and Hambrick (1993) found that the departure of managers had a negative effect on post-acquisition performance. They argued that executives from the acquired company are an intrinsic part of

it, and their retention is an important determinant of performance. Granlund (2003) found some evidence that continuous conflict between acquired and acquiring unit managers starts to affect the financial performance of the combined company. Common sense and the results of the last two pieces of research tell us that management knowledge and resources are important success factors in integration. In the worst cases they explain its failure, but we do not know how far they explain its success.

*Communication* has been said to be critical for the success of integration (e.g., Birkinshaw et al 2000). If there is unclear communication about the future of the acquired company, employees develop their worst-case scenarios, which then leads to even greater anxiety and confusion (Marks – Mirvis 1986). However, even accurate and honest information cannot totally prepare the personnel of the acquired company for integration (Buono – Bowditch 1989). Conflicts and communication problems may reduce the amount of time the acquired company's managers and employees can devote to the implementation process (Schweiger – DeNisi 1991). Unrealistic information and the breaking of promises lead to continuous distrust in the new entity (Buono et al 1985). Communication is seen as critical for success, but there is no evidence that problems in or lack of communication lead to lower performance and thus to integration failure. Buono et al (1985) found that unreliable communication led to continuous distrust in the new entity, but they did not report any evidence of related performance problems. As far as the acquired company is concerned, even if there is no clear communication, the employees still need to work and are still under pressure because of their performance targets. Orders are coming in, customers are calling — work has to be done regardless of whether there is communication or not. Communication is important, but it does not appear to dictate the success or failure of integration.

There are several views of how the integration *process* should be conducted. Failures are argued to be the result of a lack of systematic planning (Jemison – Sitkin 1986; Kitzhing 1967), and therefore the role of planning is emphasised in the literature. Problems may arise when an acquiring company imposes its own style of management on an acquired company without considering the suitability. Managers in the acquiring company automatically tend to think of themselves as smarter than their counterparts in the acquired company (Jemison – Sitkin 1986). Problems also surface when managers are only involved in the acquisition and not in the integration process (Cox 1984; Lindgren 1982).

There are contradicting views on whether integration-related changes should be made in the early stages or later on. The following factors favour early changes: the climate is better, the momentum of the business must be

maintained, and delay is costly. On the other hand, it may be better to wait because the cost of making decisions is high, more facts may be needed, and any decision made now may have to be revised later (Searby 1969). Haspelagh and Jemison (1991) argued that the personnel of the acquired company expect or even want the change in the early stages of integration, especially if the company has had an unsatisfactory financial record. This is, in fact quite ironic, since integration changes are normally cost-cutting exercises. It would be interesting to come across a company whose employees are enthusiastically waiting to be made redundant. Again, we do not have evidence about the real key factors affecting success or failure in integration. Common sense tells us that planning is important, and that imposing a management style that is not suitable will lead to failure, but there is no evidence from any real study that these are critical success or failure factors.

*Control* has been studied less than aforementioned ones in the context of the integration process. No kind of framework or theory, or operational model, has been developed. What evidence there is mostly concerns accounting systems. Previous literature is divided between the role of control in integration, problems of control, and changes in control because of acquisition and integration.

Control systems are used to change the organisational culture and power relations, as well as for teaching purposes. Long-range plans, budget approval and capitalised expenditure serve to define a parent company's expectations, in addition to limiting the freedom and power of senior executives in an acquired unit. Some acquirers use long-range planning as a means of inculcating some norms and beliefs that derive from the parent company (Jones 1985a). In most cases, the intensity of control increases in the acquired company after acquisition, as in the emphasis on weekly or monthly reporting (Jones 1985a). However, in the Granlund (2003) case, the acquired company was managed "hands-on-deck" and not by means of control based on systems. Re-engineering in those days was based on other information sources or intuition. All earlier research supports the notion that power is removed from the hands of managers in the acquired company to those in the acquiring company (Jones 1985a, 1985b; Roberts 1990; Granlund 2003). There are reasons other than pure financial control. Roberts (1990) found that one group used conferences to build up a common consciousness, to encourage employees to learn about the significance of their own and others' activities, and to integrate plans for the future. Furthermore, the conference technique has been used to clarify targets, to foster unity between various units, and to institutionalise strategy and changes.

Problems in establishing control in mergers and acquisitions are related to the lack of resources, and to resistance to change (Jones 1986; Granlund

2003). Some managers are unable to motivate subordinates and complete the necessary changes (Jones 1986). Establishing stability and control may sometimes be so difficult that, finally, after arduous attempts, the acquired units may have to be disrupted because the required control cannot be successfully established (see Jones 1986). In Olie's (1994) study, problems in international integration, sub-optimisation in decision-making, a lack of cohesion, defective internal communication, and the possibility of avoiding changes could all be seen as problems with control systems, or the lack of control systems. Kitzing's (1967) study was based on managerial interviews, and the main problems in integration reflected the lack and complexity of control, and changes in control. As mentioned earlier, Duhaime and Schwenk (1985) found that the illusion of control and the overestimation of one's own skills resulted in integration failure. Managerial and some academic research stresses the importance of social control: teamwork and common values, the absence of which creates problems (e.g., Shrivastava 1986; Buono – Bowditch 1989; Ivancevich et al 1987). However, there is no evidence one way or the other.

The acquiring company typically implements its own control systems in the acquired unit, and less emphasis is put on best-practice selection (Jones 1985a, 1985b; Granlund 2003). However, there are exceptions to this, as in a study conducted by Granlund (2003), when a controller from the acquired company was given the responsibility for designing accounting systems for a newly formed company. Effecting changes in control systems has typically been problematic, given the shortage of managers of change, difficulties with the style of management, personal clashes, the absence of planning and the expense of integration. Integration problems in management accounting systems have included group accounting procedures that curtail a responsive and intuitive style of management, as well as the over-formalisation of procedures for budgeting capital expenditure and planning. There have also been problems related to the changing rhythm of control, reduction in quality, and the sophistication and duplication of information (Jones 1985b). Different control systems in acquired and acquiring units have also caused problems in terms of knowing how the acquired unit is performing (Jones 1986; Granlund 2003).

It has been suggested that a new control system may require immense organisational cultural changes in order to function properly. Such changes may create a lowering of employee morale as well as a delay in the internal changes that occur when staff members accommodate themselves to new leadership styles. Changes may also cause personal conflicts and lead to power games, which in turn slows down the pace of change and also damages employee morale (see Jones 1986). Different decision-making modes and

cultures may also lead to clashes (Granlund 2003). There is sometimes fear that changes will inhibit organisational action. New reporting procedures implemented in acquired units may differ a great deal from the procedures that employees are accustomed to, and may therefore direct attention away from actually running the business (Jones 1986). Moreover, Jones (1986) found that resistance to change was embedded so strongly in some individual managers that they had to be replaced before any changes could be implemented.

It seems clear from this review that control may be a factor that affects the outcome of integration. We can hypothesise that the outcome of the integration depends on the control exerted in the acquired company. Earlier studies have not evaluated the role of control in this context, or how critical it is to the success of the integration. Empirical analysis is needed in order to fill the gaps.

Earlier studies have related *trust* to three factors: communication, co-operation between different parties, and post-acquisition change. Several of them have shown that providing realistic information about the potential effects of acquisition helps to maintain much more stable levels of commitment, satisfaction, trust and performance when information is withheld. Accurate and honest information about what is likely to come following a merger is likely to be the foundation of an emergent psychological contract for the combined entity (see e.g., Buono – Bowditch 1989; Schweiger – DeNisi 1987). On the other hand, unrealistic information, linked to the breaking of promises, may lead to continuous distrust in the new entity (see, e.g., Buono et al 1985). It is also argued that conflicts and communication problems may reduce the necessary commitment of the acquired company's managers and employees to the implementation of post-acquisition integration (Schweiger – DeNisi 1991).

Trust is seen as essential in fostering co-operation between parties in the integration process. It is argued that distrust of new managers and procedures may create tension in a merged company (Sales – Mirvis 1984; Buono et al 1985). Since acquisitions are a highly political process in which managers strive for position (Buono et al 1985), trust between the parties may not exist. The managers in the acquirer and the acquired companies may have different frames of reference, and it may take time before they understand each other completely. Accommodating different frames of reference may require the transfer of managers, the development of homogeneous decision-making procedures, the building of trust between managers, and the provision of consistent information to all managers through the development of standard management information systems (Shrivastava 1986).

Change-related problems also lead to a lack of trust between parties. The acquiring company integrating the acquired company quickly and insensitively



risks losing the trust and the respect of the remaining employees (Ashkenas et al 1998). Mergers and acquisitions, it is argued, disrupt the lives of individuals, inevitably destabilise the organisations involved, and cause organisational problems.

Trust-related problems reflect uncertainty and the tensions that are likely to cause underperformance. However, we do not have any evidence of low performance because of trust-related problems following integration. Although there is evidence of institutionalised distrust of management, no performance-related problems have been reported because of that (see Buono et al 1985). Our knowledge of the role of trust in integration is limited, given that there is no clear definition of trust, that trust has not been in the focus of studies, and that studies on integration have rarely been empirical. The above discussion offers some clarification, however.

Earlier studies have associated control-related problems with trust: unclear direction and accountability, unclear duties and uncertainty about the future, and confusion about responsibilities. Thus, it seems that a lack of control creates trust-related problems that have been reported in earlier studies. However, trust in the integration context is another side of coin of control. Those who acquire companies do rarely have any relationship with the other party. There is usually only little knowledge of the acquired company at first, and the relationship is likely to be based on trust, or on an unbalanced trust-and-control relationship. An unbalanced relationship is likely to form, since most studies point to a lack of time and resources, to complexity and instability. Control is likely to be based on outcome control, and current figures are compared to older ones. Trust appears to be based on institutional and systems trust, which tends to keep the business running thorough the control systems in place, the customers, suppliers and other stakeholders, and the motivation to perform (rewards, evaluation). Since no evidence has been produced of harm arising from having no trust, control systems and the normal running of the business constitute a rather normal work environment.

Trust and control seem to develop in an acquired unit with or without the introduction of control systems. This claim needs empirical analysis, but it can be conceptualised. Putting new control systems into the acquired unit does not necessarily reflect distrust in the current systems, but changing systems may help to develop trust in its functionality. Not changing the control relationship may reflect either trust in the current systems, or a lack of resources to change systems as long as there is trust in or an unbalanced trust-control relationship with the acquired unit. The emphasis on control systems in developing trust suggests that systems/institutional trust has an important role in establishing the relationship with acquired units, but there may be other explanations.

Imbalance may develop when there is just not the time or the resources to develop a comprehensive relationship.

Without empirical analysis there is no more to be said about the role of trust and control in integration than the following. Emphasising trust does not appear to be critical in integration, but the use of control is. Problems occur when there is no control. Systems and institutions apparently maintain the necessary level of trust in order to keep the business running, even though control is not complete. The social side of integration has been emphasised as the foundation of trust and common values, but there is no evidence of the influence of these factors on organisational performance.

Success in integration requires synergies that bring cost reductions and the integration of activities, not only in accounting. This could involve some damage-control problems and possibly even some trust-related problems, but these factors have not been studied, even though they are crucial in the integration process. Studying how synergies are achieved and what challenges these operations cause would provide more evidence of the success factors of integration, and would facilitate the critical evaluation of the results of earlier studies.

## 4 Conclusions

This study began with the review of the perspectives and components of trust. Then was analysed the development of trust. Earlier studies have pondered on whether such development is gradual or whether it becomes evident without any initial contact. On the discussing above, it may also be unbalanced, given a lack of resources and time, and complexity and instability.

There are controversial views regarding the relationship between trust and control. The discussion in this study suggest that all control forms depend to some extent on trust, but trust is not itself a control mechanism. As control involves trust, it can create trust, and the relationship between the two may be unbalanced: this relationship could best be referred to as intertwined.

Our knowledge of the critical factors affecting success in integration is limited. A considerable amount of the evidence comprises managerial literature based on no credible research, conceptual analysis without empirical analysis, research based on assumptions derived from non-credible research, and research having no link to the outcome of the integration. A thorough analysis of earlier studies indicates that only management knowledge, resources and control are linked to success in integration. This does not mean that there are no other contributory factors, but the aforementioned ones have

a credible link to performance. However, our knowledge is still quite limited with regard to how these three factors affect success in integration.

Trust does not seem to be a critical factor. In fact, trust-related problems reported in earlier studies seem to reflect control-related problems. The relationship between trust and control appears to be unbalanced, at least in the early stages, because of complexity, the lack of time and resources, and instability. There is no clear evidence of how trust and control are built up. However, it could be argued that trust is created by placing control systems in the acquired unit, and that it is based on systems and institutional trust. The trust relationship between the acquired and the acquiring unit may be unbalanced in terms of trust and control. However, further research is needed before conclusions can be drawn. It can be hypothesised that control of the integration process and of merged companies after acquisition is the main factor affecting the success of integration: how you make people accountable for the financial performance, how you allocate resources, how control systems are implemented and how they focus the behaviour of people. These seem to be key factors in successful integration. Softer factors such as culture and communication seem not to have a direct link to success in integration, thus implying that the emphasis should be placed on harder aspects such as control systems and accountability.

Further research on this topic is needed since there are many gaps in knowledge. Given that control is intertwined with trust, and that control seem to explain integration success, research should focus on both control and trust issues. It would be relevant to study how trust and control are developed between an acquired and an acquiring unit, and what factors affect that relationship. It would be interesting to focus on different organisational levels, and control in merged companies after the acquisition as well as during the implementation of integration-related changes.

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