Making an M&A work: equal strategic partnerships smooth the path

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1. Introduction

Merger and acquisitions (M&As) appropriately structured can generate significant value for both the acquirer and the acquired firms. Yet the outcome of M&As is most often not successful because acquiring and maintaining multiple businesses is both complex and complicated. The complexity arises from the involvement of several interrelated components viewed from different perspectives by several actors, while complication stems from the fact that some aspects of M&A are based on tacit knowledge, and unexpected events occur frequently. By empirically examining a specific segment of firms involved in such undertakings, i.e. knowledge-intensive innovative and entrepreneurial (KIE) firms, the current analysis enhances our understanding of the determinants underlying successful M&As. Success is here defined as meeting or exceeding the expectations of the deal. We focus on this subset because value destruction might have detrimental effects in more knowledge-intensive businesses, both at the firm-, industry- and national levels. Hence, our findings have relevance both at the management and policy levels.

Previous research has identified several factors related to poor post-M&A performance. One principal reason why 70% to 90% of M&As fall short of expectations is that acquirers incorrectly match the strategic purpose of the transaction and the specific needs of the acquired firm post-transaction (Christensen *et al.*, 2011). For example, a recipe for disaster occurs when an acquirer buys a KIE firm, dependent on a few key entrepreneurial employees and thereafter takes away the acquired firm's autonomy and implements new routines. This generally is a bad idea because it results in the loss of autonomy and disturbance of routines associated with the integration. In fact, integration hampers employee retention. The ability to maintain the skills of the acquired firm are based on tacit knowledge that depends heavily on the retention of personnel, especially those individuals who form the basis of the firm's competitive advantage (Ranft and Lord, 2002). The acquired firm's innovative capabilities run the risk of not just being disrupted but also of being lost if those key employees leave after the deal.

Another reason can be attributed to the principal–agent problem, also referred to as the agency theory. It refers to the problems arising from separating ownership and control. According to Eisenhardt (1989a), there are two types of principal–agent problems that can arise: The first is a conflict in desires or goals between the principal and the agent, and the second is a discrepancy in risk preferences between the principal and the agent. Whereas the former principal–agent problem arises as a result of the agent acting deliberately in self-interest or due to conflicting goals, the latter principal–agent problem arises due to different preferences for risk, which can be either intentional or unintentional.

A few studies have demonstrated that decentralization is a key component for successful M&As involving KIE firms because it allows the acquired firms to maintain their culture and it minimizes the disruption of the acquired firms' routines (Puranam *et al.*, 2006). It is also beneficial for employee retention and for preserving tacit knowledge within the portfolio

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company's boundaries (Ranft and Lord, 2002). Finally, in the optimal case, decentralization facilitates unanticipated knowledge transfer between the parent and the portfolio firms which can result in serendipitous value creation (Graebner, 2004). However, decentralization may be more prone to the principal–agent problem mentioned above and can result in coordination problems, as a consequence of giving the acquired firm autonomy and decision-making power. Additionally, excessive decentralization can lead to articulation errors, which is the gap between what the acquired firm expects to receive and what the acquirer provides.

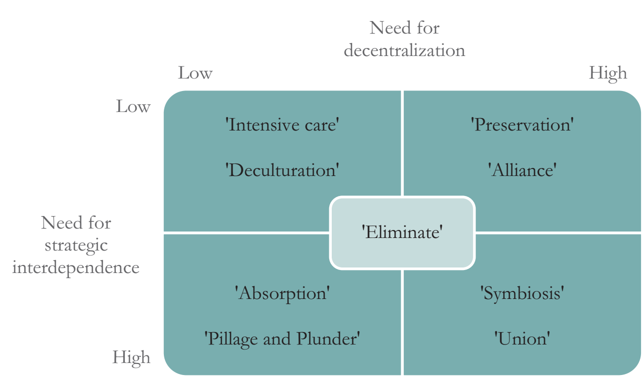
What is less clear from the literature is how decentralized firms that are involved in M&As with KIE firms manage such shortcomings and the impact on the acquired firms' entrepreneurial intentions. Through in-depth interviews with CEOs in eight Swedish small- and medium-sized enterprises (SMEs), we present new insights regarding factors that are critically important for the outcome of M&As. Four of the interviews are with CEOs from the acquiring side (the buyers), and four of the interviews are with CEOs from the acquired side (the sellers). Empirically, our study centers on Sweden for a few reasons. Sweden is characterized by having a comparatively strong and developed equity capital market, including a developed M&A market. For example, Sanandaji *et al.* (2023) found that compared to SMEs in other regions of Europe, Swedish SMEs' reliance on equity financing is higher. Sweden has a long-standing tradition of decentralized management strategies based on loose controls and trust (Håkanson and Zander, 1988). For example, Sanandaji *et al.* (2023a) found that compared to SMEs in other regions of Europe, Swedish SMEs' reliance on equity financing is higher. Sweden has a long-standing tradition of decentralized management strategies based on loose controls and trust (Håkanson and Zander, 1988; see also Sanandaji *et al.* (2023b) for a review of the evolution of the Swedish market model).

The subsequent sections of this paper are organized as follows: Section 2 introduces a conceptual model outlining various M&A strategies and aims to ascertain the strategies most relevant to KIE firms. In Section 3, we offer an overview of the empirical context, including a description of the data and methodology employed. Moving forward to Section 4, we adopt a balanced perspective that gives equal attention to both buyers and sellers, to determine the specific factors crucial to achieving a successful outcome. Lastly, Section 5 is dedicated to discussing our findings, presenting conclusions, and highlighting a number of potential research directions.

2. Conceptual model

Many different M&A strategic frameworks have been proposed in the past decades (cf. Angwin and Meadows, 2015; Haspeslagh and Jemison, 1991; Siehl and Smith, 1990). Ström

Figure 1 M&A strategies



Source: Adopted by Ström and Esmaeilzadeh (2023) and Esmaeilzadeh (2023) reviewed that literature and proposed a new, more detailed framework while focusing on the entrepreneurial abilities within the acquired firm, which originates from Schumpeter's view on entrepreneurial profit and abnormal returns. Altogether, four strategies have been identified which have been grouped into four quadrants in Figure 1. Below, we will now shortly present the respective strategy [1].

Both *Intensive Care and Deculturation* are characterized by a low need for autonomy and low strategic interdependence. Intensive care is the more severe strategy, as illustrated by being placed in the top-left corner, albeit both require substantial remodeling. These strategies create value mainly by changing the governance and the financial structure of the acquired firm to create superior processes and tight financial controls.

The strategies *Absorption & Pillage* and *Plunder* are characterized by the low need for autonomy but high levels of strategic interdependence. One can regard the Pillage and Plunder strategy as the harshest option, which literally entails taking what one wants and eliminating the rest, either through abandonment or divestment. These two strategies primarily add value by gaining control over poorly managed businesses, reducing duplicate activities, exploiting economies of scale and/or seizing ownership of critical products and services.

Turning to the third set of strategies, *Preservation and Alliance*, these are characterized by a high need for autonomy and low strategic interdependence. Preservation can be seen as the least extreme strategy, where the acquired firm's operations after the transaction can be labeled as "business as usual." Whereas the Preservation strategy creates value when the portfolio company realizes its long-term objectives, the Alliance strategy creates value mainly through supporting the acquired firm in realizing its long-term objectives and key results. Typically, this is organized through board representation and by creating superior incentive plans.

Finally, the *Symbiosis & Union* strategies are characterized by a high need for autonomy as well as high levels of strategic interdependence. Union, which symbolizes a formal fusion and legal contract that unites two previously distinct entities into one, making their future actions an intrinsic part of the other's, is the most extreme strategy. When fruitful, these strategies increase value chiefly by having a broader and more competitive product/service offering, creating lock-in effects and facilitating knowledge transfer between the involved firms.

There is also an *Eliminate* strategy which, as it is not constrained by the two parameters, is intentionally placed in the center of Figure 1. Although there is no asset transfer of any kind, this method is most comparable to the Plunder strategy. The aim of this strategy is simply to eliminate the competitor (i.e. the threat) by acquiring it and shutting it down, thereby preempting future competition and possibly getting access to some strategic assets.

Ström and Esmaeilzadeh (2023) concluded that the first two overarching strategies – *Intensive care & Deculturation* and *Absorption & Pillage and Plunder* – are not suited for acquiring and maintaining KIE firms for the reasons stated in the introduction (loss of routines, higher employee turnover, loss of tacit knowledge). Excluding the *Eliminate* strategy, where the objective clearly is not to acquire KIE firms and support them, the two remaining strategies – *Preservation & Alliance* and *Symbiosis & Union* – are best suited for acquiring KIEs, primarily because they do not eliminate the acquired firm's autonomy post-transaction.

Having identified the M&A strategies most suitable when KIE firms are involved, we will now present the data, method and findings. In addition, we will examine whether these two strategies conform with the actual measures in the M&A cases we are considering, confronting the views of sellers and buyers.

3. Empirical context: data and method

The empirical analysis takes an exploratory approach (Eisenhardt, 1989b) with the aim of developing an in-depth understanding of how successful decentralized managed M&As involving KIE firms materialize. We follow the definition by Malerba and McKelvey (2019) who defined KIE firms, as “new learning organizations that use and transform existing knowledge and generate new knowledge in order to innovate within innovation systems” (p. 564). A multiple case study, based on semi-structured interviews with open-ended questions was chosen to investigate the focal phenomenon we address. The sampled cases are Swedish SMEs and belong to different industries. The buyers were chosen because they followed a decentralized management philosophy, targeting KIE firms and being relatively new in the Swedish market while simultaneously having made several acquisitions in the last couple of years. This also implies that we are examining a specific sample of firms, where buyers as well as sellers are confined to one holding firm (Esmaeilzadeh Holding Inc.). This is likely to introduce selection bias in our sample, which should be considered when interpreting the results. Consequently, the buyers are four compounding firms, one specializing in IT/software, one in agency and media and the remaining two having a broader industrial focus. The acquired firms are then chosen from the compounders’ portfolio firms, based on when the acquisition took place and the availability of the targeted CEO. Our research ambition is thus to examine and shed light on the specific strategies implemented by this type of new firm, relevant for both researchers and practitioners in the M&A market. The interviewees were the CEOs of the respective companies (Table 1).

4. Results

From the empirical data gathered through transcribed interviews, four distinct themes emerged; buyer–seller fit, aligned incentives, long-term thinking and perpetual alliance. In analyzing the implications of these four themes for the M&A process, the role of the entrepreneur, or entrepreneurial function, is emphasized.

4.1. Buyer–seller fit

There are numerous characteristics that come into play in relation to what the buyers regard as key factors in their targeted firms. This includes, but is not limited to:

- revenue model, financial stability/predictability, barriers to entry;
- size, growth, operating margin, cash flow conversion, market outlook;
- customer base, customer satisfaction, customer churn rate/recurring customers; and
- ownership structure, key entrepreneurs, culture, brand.

Here, and related to strategies presented in Section 2, we concentrate on the one element that the interviewees argued matters most, the key entrepreneurs. The buyers claimed that these are especially important to the decentralized M&A strategy because that model entails letting the entrepreneurs continue to steer the ship the way they have in the past, in

Table 1 Sampled Swedish SMEs

Industry	*Founded*	*Side of transaction*	*Transaction year*	*Role*	*Interview length*	*Interview DATE*
Agency/Media	2021	Buyer		CEO	41 min	2022-05-31
Industry #1	2020	Buyer		CEO	40 min	2022-04-12
Industry #2	2020	Buyer		CEO	48 min	2022-06-09
IT/software	2020	Buyer		CEO	39 min	2022-04-14
Electricity	2018	Seller	2021	CEO	37 min	2022-04-27
Media	2008	Seller	2021	CEO	28 min	2022-06-15
Software	2003	Seller	2020	CEO	37 min	2022-04-27
Ventilation	1981	Seller	2021	CEO	41 min	2022–04-22

Source: Authors

conjunction with qualitative support from the buyer. They further believed that granting the acquired firms high levels of autonomy, and decision-making power, is the right path for long-term value creation when dealing with entrepreneurial leaders:

> To attract and retain exceptional entrepreneurs, you must give them freedom. Without offering this freedom, they can just as easily sell to an industrial player and get an employment number and an access badge. Besides autonomy, operational leeway is especially important. Our portfolio companies can increase their expenditure up to 30 percent without needing our approval – Buyer CEO, IT/Software.

From the sellers' point of view, one misconception is that they *only* care about the transaction price. Although some sellers arguably fall into this category, especially those who wish to depart from the venture post-transaction, not everyone does, particularly not the entrepreneurs who wish to continue leading the firm toward new heights. It became evident when interviewing the sellers that they especially considered retaining their autonomy post-transaction as a decisive aspect and that they did not see themselves embarking on this journey without such operational freedom. They stressed the advantages of the decentralized management philosophy regarding their employees' safety and well-being, as well as the possibility of keeping their brand. Put differently, they did not want any of their employees to feel that they do not want to continue working for their firm because of the ownership changes, and they believed the decentralized approach enabled them to achieve that.

4.2. Aligned incentives

Apart from giving the acquired firms a substantial degree of autonomy, the buyers also emphasized one other component that is essential for attracting new entrepreneurs, retaining them and making them perform at their best. This component is aligned (financial) incentives. As commonly done within the M&A realm, the buyers used the deal structure as a way to align everyone's incentives. Apart from having a direct up-front payment, a smaller part of the purchase price was normally based on the short- to medium-term performance of the acquired firm, usually over the subsequent three years after the acquisition date (earn-out payment). In addition to the earn-out payment, a smaller share of the purchase price is also commonly offered as a reinvestment opportunity in the parent company (the reinvestment sum).

The sellers claimed that decisions regarding how to incentivize the acquired firms' key entrepreneurs to perform at their very best can have a significant impact on the portfolio companies' long-term performance. They argued that when the buyers design and execute those incentives that align the leadership's long-term objectives and key results with the key entrepreneurs' day-to-day behavior, superior performance will be achieved. Moreover, both types of incentives were argued to motivate the interviewed entrepreneurs to outperform, as they are a competitive group of leaders and value becoming part of something greater, where everyone is working together toward the same goal:

> Like most entrepreneurs, I am competitive in nature, hence I am driven by beating the projected growth target communicated to the buyer. I feel very optimistic about investing in the buyer together with like-minded entrepreneurs. Everyone has skin in the game and is working towards the same goal – Seller CEO, Ventilation.

4.3. Long-term mindset

A central theme in the interviews with the acquired firms concerned the time sequence. It was stressed that what matters is the long-term view, not the next or the current quarter. The long view is necessary to make the necessary adjustments today that maximize the chances that the long-term objectives and key results will be reached. To achieve this end, the buyer firms were prepared to support the acquired firms in several ways. One element they emphasized was the importance of always being prepared for a C-suite succession, regardless of when one might believe that will occur. For example, the industrial group buyers had developed a leadership academy, with the objective of both making their current portfolio companies' leadership first-class and increasing the internal pool of potential successors. Thus, the exchange of knowledge and developing platforms for knowledge flows seems high on the agenda on the buyer's side:

> The purpose of our leadership academy is to gather the portfolio companies' C-suites, especially the CEOs, and discuss and share knowledge in relation to how to act, how to manage, and how to motivate. The purpose is also to allow other key personnel to participate and learn, both to increase their output but also to have a larger pool of potential internal C-suite successors – *Buyer CEO, Industry #1*.

From the sellers' perspective, one underlying reason they sold was to pave the way for accelerated growth, obtain a stronger competitive position in the market and become part of something greater. One reason for this is, of course, to become more profitable, but another, the less explicitly articulated reason, was to become more enduringly profitable.

4.4. Perpetual alliance

The buyers did not have any pre-decided, standardized post-acquisition strategy templates. What they did, and how they did it, was thus a function of the acquired firms' specific needs. One activity the buyers relied on to better understand the sellers' needs early on was to organize a workshop or meeting with the newly acquired firm two to four weeks after signing the share purpose agreement. In addition to this structured but tailored initial gathering post-transaction, the buyers expressed that it is mainly through board meetings they do most of the work, which corresponds well with the strategies defined as appropriate for M&As where KIEs are involved.

In addition to the meetings between the two firms, the buyer used other strategies to identify new opportunities, unlock value and to motivate their portfolio companies. One activity is the leadership academy mentioned above. Another example that some buyers had already implemented, and some were planning to, is management meets, which essentially is a whole day of presentations, workshops and roundtable discussions taking place between the portfolio companies and sometimes also invited experts. Management meets center around knowledge exchanges. Corroborating the decentralized management philosophy *Alliance*, activities like these are, of course, voluntary, and the interviewed CEOs described their roles in these activities as enablers and facilitators.

There was also an element of informal conversations taking place. How often these occur depends on the focal entrepreneur's preferences. The underlying need for these can be attributed to the fact that we live in the ever-changing knowledge economy which suggests that support might be called for in-between these parsed formal meetings. The buyers stated that the acquired firms can contact them whenever they want to, which typically occurs when they want support with a new potential business opportunity or when facing difficulties.

From the other point of view, the sellers said that everything was basically as expected post-acquisition. That is, everything operationally stayed more or less the same. An interesting remark, though. was, according to one of the CEOs, that some of the employees in one of the acquired firms expected things to be worse; however, after some open discussions and as time went by, these employees realized that previous routines and structures stayed the same. Concerning management meets and related activities, the sellers talked about these positively. They emphasized that making potential synergies and collaboration clearer was beneficial because they are so focused on their own (growth) agenda. And as one of the seller CEOs put it, once the value-increasing activity is identified, all that is needed is time and a whiteboard:

> The parent company has opened to dialogues between us [the portfolio companies] in relation to specific activities. The other portfolio companies are run by strong entrepreneurs, so only if we meet and are given a whiteboard, we can create new product offerings – Seller CEO, Media.

5. Discussion and conclusion

The objective of this article was to investigate how decentralized managed firms involved in M&As with KIE firms materialize, whether they promote entrepreneurial cultures and build value. The empirical data used to fulfill this objective is mainly based on in-depth interviews with CEOs in eight Swedish SMEs.

Our result suggests that the buyers, who in accordance with the conceptual model of different M&A strategies followed the *Alliance* strategy, overcome the limitations of M&As through four overarching measures; buyer–seller fit, aligned incentives, long-term thinking and perpetual alliance. It is clear from the interviews that the buyers acknowledge that granting the acquired firm a significant degree of autonomy is the right path for long-term value creation when dealing with entrepreneurially oriented firms. This is in line with the existing research (Puranam *et al.*, 2006). An important but overlooked aspect concerns the need for autonomy, which according to results is instrumental in concluding deals with KIE firms. Further, the buyers made synergies between their portfolio companies more available and tangible (via management meets), but stated that the ultimate decision to collaborate had to be taken by their portfolio companies. In agreement with existing theories about the organizational advantage over markets (Nahapiet and Ghoshal, 1998), the buyers focused on creating an environment that eased knowledge flows between their portfolio companies. This activity was appreciated by the sellers as they normally are self-focused.

Buyers and sellers were aligned in their thinking when it comes to the short- vs long-term vision. They argued the importance of winning the war rather than sacrificing the war to win the next battle. They used two strategies to make this become a reality. First, in line with the literature on M&As and financial incentives (Kaplan and Stromberg, 2009), the buyers used two financial incentive schemes to motivate their entrepreneurs and help to eliminate the problems arising from separating ownership and control. Specifically, the interviewed firms used both an earn-out payment and a reinvestment sum. Whereas the earn-out payment incentivizes the portfolio company to outperform in the short to medium term, the reinvestment sum has the potential to incentivize the portfolio companies to outperform in the long run. From the sellers' point of view, these financial incentive schemes were something that was valued highly as they align not only themselves and the parent company but also all other portfolio companies. Second, simultaneously as their portfolio companies have true autonomy and decision-making power, the buyers offered them the chance to participate in different types of value-adding activities (e.g. leadership academy, management meet) designed to increase the long-term value of their portfolio companies in a way that is not possible without the parent organization. More precisely, these activities arguably increase the likelihood of retaining key employees in the firm because of improved opportunities to advance within the boundaries of the firm as well as upgrading knowledge and human capital. This is an important consideration for decentralized firms involved in M&As (Siehl and Smith, 1990). Knowledge interaction is also a means to integrate firms more closely and to create linkages that are robust over time. In accordance with the absorptive capacity theory (Cohen and Levinthal, 1990), this implies an advantage of acquiring firms with similar although distinct knowledge bases. The complementarity in knowledge allows the involved parties to share knowledge effectively, strengthening certain value-adding activities across firms.

To conclude, our paper contributes to the M&A literature in the following way: Contrary to most papers, this study has taken an approach giving equal weight to both buyers and sellers. In doing so, we clarified the drawbacks of integration when involved in M&As with

KIE firms. The drawbacks primarily revolved around not eliminating the entrepreneurs' autonomy and their routines, but it is also partly related to letting them keep their identity (i.e. their brand) as well as retaining employees' trust in the new owner. Consequently, our results suggest that the decentralized managed firm involved in M&As with KIE firms promotes entrepreneurial intentions and allows value creation by having a buyer–seller fit, aligning the buyer–seller incentives, having a long-term mindset and having a perpetual alliance. This study is not without limitations, the most notable being the sample (size and scope). Therefore, we recommend future qualitative studies testing the validity of these findings as well as quantitative research investigating the relationship between decentralized management, KIE firms and subsequent innovation more thoroughly.

Keywords:
M&A,
M&A strategy,
M&A deals,
Decentralized management,
Entrepreneurship,
Innovation

Note

1. "See Ström and Esmaeilzadeh (2023) for details."

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