

# **Business Network Dynamics and M&As: Structural and Processual Connectedness**

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## **Abstract**

Our point of departure is business network dynamics and the phenomenon of mergers and acquisitions. We discuss both structural and temporal connectedness of business nets, where the merging firms are embedded in. Depending on the degree of structural connectedness (or overlapping) which can also be discussed with the help of position concept, the merger or acquisition will bring about more or less changes to the business network. In addition, the temporal connectedness deserves attention as it helps in understanding the change processes. We conclude the paper by noting that for managers it is essential to acknowledge connectedness (structural/processual) both in a pre-merger (planning) and integration (implementation) phase of M&As in order to analyse the potential performance and outcome.

## **1. Introduction**

A very common business phenomenon is that of acquisitions and mergers between business firms. The motives for entering into partly, or full, ownership over another firm are many. We can see motives of more expansive character such as wanting to co-operate on new business opportunities, often called forming partnerships for win-win situations, so called synergy effects are expected to materialise. The basic economic benefits will then come from the increased revenues. However, the more substantial reason for co-ownership, or even integration of two companies, seems to be the possibility to reduce costs regarding procurement, production and R&D. The research of the M&A phenomenon so far has largely focused on the two merging companies.

In our earlier works (e.g. Anderson, Havila & Salmi, forthcoming; Havila & Salmi, forthcoming) we have shown that mergers and acquisitions have important implications for the merged companies' customer and supplier relationships. For example, merging producers may want to increase their mutual bargaining power vis-à-vis their suppliers. Such behaviour does not emanate from a 'true' partnership with the suppliers and may even destroy the trust developed through previous business exchanges. We thus see that the merging companies do not always act as if they were actors in a network where all actors are connected and dependent on each other.

We have proposed that acquisitions have both planned and intended, and unexpected effects on external relations. The intended effects come from regarding relationships as any asset possible to take over. The unexpected effects are those that occur because the relationship also has an intangible interactive dimension, which is most often neglected prior to an acquisition. One reason lies in the character of the relationships: their continual development depends upon how the parties act and react within them. Several connected actors will act and react on the merger and acquisition activities which, in turn, may lead to changes in other parts of the business network. Thus, M&As have connected effects. Such connected relationships and effects deserve managerial attention in both the pre-merger and the integration phase of M&As.

The aim of this paper is to elaborate further on the dynamics within business networks emanating from mergers and acquisitions. More specifically, we discuss structural and temporal connectedness of business nets where the merging companies are embedded in. Earlier research on M&As has largely ignored (1) the structural connectedness of business relationships (Anderson et al. forthcoming), i.e. how interlinked and interdependent (overlapping) the business nets are and how connected actors, such as customers and suppliers, react to the merger or the acquisition. The other type of connectedness, (2) temporal, may also be an important factor influencing the outcome of a merger or an acquisition. A merger or an acquisition can be seen as a change process and the success or failure for each actor involved in the change has to be seen in the light of the M&A as a process embedded in other ongoing – long-term and short-term – change processes. How a single company in a merger or acquisition handles the dynamics of these processes becomes an important determinant of the outcomes for the company.

## **2. Effects of M&As due to Structural Connectedness of Business Relationships**

Business relationships can be seen to be structurally connected to each other as changes in a focal relationship affect not only the two parties directly doing business with each other, but also other connected parties.

### **2.1 The Framework**

To be able to discuss the degree of structural connectedness we will use the following concepts:

- *functions of relationships*
- *position and role of actors within a network*

### *Functions of business relationships*

Anderson, Håkansson & Johanson (1994, p. 3) distinguish between primary and secondary *functions of relationships*. By primary functions they mean the positive and negative effects on the two partner firms of their interaction in a focal dyadic relationship. In case of the M&A the relationship between the two (or several) merging parties will change per definition. How it will change depends on the type of the relationship they had before the merger took place, i.e. to what degree structural connectedness existed in the pre-merger phase. A situation when the parties did not have a relation to each other, for example, did business with each other or were direct competitors, is different from a situation when, for example, the parties have had a long-lasting business relationship with each other.

The secondary functions, in turn, concern a focal business relationship's effects on the connected parties. Connectedness of relationships means that there are always several parties who have made investments on the basis of the focal business relationship. A change in the focal business relationship, therefore, may affect also other, directly or indirectly, connected parties. Moreover, their reaction, in turn, may affect the focal relationship. Thus, changes initiated in the interaction between any two parties are likely to cause multiple actions and counteractions in its context. This means that effects of the M&A may spread to several connected parties and that their reactions, in turn, may affect the merged company. Here again, the degree and type of structural connectedness of the merging parties' nets in the pre-merger phase may affect the outcome of the merger.

To sum up, two types of situations owing to the degree of structural connectedness preceding an acquisition or a merger can be distinguished. First, the situation when the two (or several) merging parties' networks are highly connected. In the second possible situation the two (or several) merging parties' networks are totally different, i.e. the degree of connected parties, such as customers or suppliers, is low. In the case of high structural connectedness it is more probable that there will be a restructuring effect on the network in the meaning that relationships will cease to exist or new ones will appear.

### *Position and role*

Position is a well-established concept within the industrial network approach and it has been used when discussing business networks from a structural point of view. It has been paid particular attention by for example Johanson & Mattsson (1992), Henders (1992) and Anderson, Havila, Andersen & Halinen (1998). Johanson & Mattsson (1992, p. 211) define position as an important "measure" for the structure of a network: "Each actor is engaged in a number of exchange relationships with other actors. These relationships define the position of the actor in the network. Since positions can be defined for all the actors in the network, the concept can be used to characterise network structure and network distance between actors." Thus, each actor has a position in a network and the position is described through the relationships. The way to characterise or even measure the relationships are many. It can be the intensity within the relationship or the number of relationships, i. e. both quantitative and qualitative criteria can be used. An actor can according to the description of the relationships have different positions. They can show the horizontal dimension within the network meaning that an actor can be more central or more peripheral. In case of the M&A the merged party may get a more central position vis-à-vis the customers. The vertical dimension shown through customers and suppliers can also be seen in the network description. An actor can also be more powerful than another due to its position. In terms of network structure thus some actors may be more important than others. Regarding M&As often one reason for a merger is to get a more powerful position vis-à-vis the suppliers.

As Henders has noted in her study of change in an industrial network: “Most change was initiated by the changing activities and resources of actors already present in the network.” (1992, p. 107) This means that a position is changing continuously and it is the performance, an actor’s activity, that causes the change. The position as such is not a dynamic concept, but it is possible to describe change by comparing an actor’s position at time  $t_0$  and the time  $t_1$ . However, to be able to cover also the processual aspect of structural change the concept of position needs to be increased with the concept of role (Anderson et al., 1998) Change in business networks is partly explained by the activities an actor performs given its position and role within a network structure. The position exists as a result of activities performed between actors and describe the actors’ situation in the network structure. The position an actor has can be a reason for entering into a merger, e.g., if one actor is big on one market and the other on another market. Through a merger they can ‘both’ become big on both markets.

The role dimension represents the subjective and creative character of the actor; an actor has a position but acts in a role. Role could be seen as a concept for describing what the actors intend, how they construct meaning in their situation and how they want to change it. The M&A may change the merging parties roles vis-à-vis connected parties. One example could be the situation when the two merging parties with the same customer(s) co-ordinate their sales force so that one customer only gets visits from one salesman. This, in turn, may lead to a situation when the customer contacts (and starts to buy from) a new supplier to be sure that the price level is low enough. This means that changes take place not only regarding the position of the merged parties but also regarding their roles within the net. An acquisition activity can be initiated by one party wanting, e.g., the resources that the other has. Such a behaviour is role oriented.

## 2.2 The Effects

In this section we bring forward eight empirically inspired observations on structural connectedness in business networks emanating from M&As:

- Evaluation of relationships
- Difficulties in controlling and monitoring intangible market-based assets
- Creation of strategic partnerships as an aim for M&A
- Termination of relationships
- Changing positions on the market
- How to ensure maintenance of relationships?
- Consideration of external relationships of both merging companies
- Evaluation of the success of the M&A, i.e., performance

### • *Evaluation of relationships*

This relates to the difficult question of evaluating intangible asset more generally. In the pre-merger phase business relationships should be acknowledged as resources. When the company is seeking a company to acquire, it is essential to evaluate the business relationships the potential partner has, and furthermore, to evaluate them as investments in the same way as brand name and goodwill are given a price. External relations of the target company provide access to resources of other companies. Simultaneously, they may restrict its room for maneuver, since obligations in one relation may hinder access to others.

- *Difficulties in controlling and monitoring intangible market-based assets*

Often an aim of M&A is to get control of the resources of the target company. The usual assumption is then that intangible market-based assets i.e. relationships can be bought and sold (see Srivastava et al., 1998). Our argument is that this is not necessarily the case. Transfer of control may fail because, e.g., the acquiring firm is not perceived as a desirable partner, or people involved are not willing to interact. It is important to predict how likely it is that the suppliers and customers will react negatively to the merger. The suppliers may not think of a merger between their customers as positive as it could increase risk. In the same manner a merger between the suppliers to a company can be regarded as a threat, now we do not have an 'extra' supplier to turn to should the first one fail. If the merger is perceived positively by the persons involved on both ends of a business relationship it gives the relationship a high potential value.

- *Creation of strategic partnerships as an aim for M&A*

If explicit aim in M&A operations lies in building strategic partnerships, the issue of relationship management becomes crucial. A business relationship approach to relations stresses the mutuality of a relationship. Therefore one has to recognize that a strategic relationship can never be built on one part's conditions, a notion that has not been extensively covered in the literature.

- *Termination of relationships*

If certain relationships are explicitly intended to be terminated in connection with or as a result of M&A, it can clearly be done by one-sided decision. But in this case, connectedness of relationships becomes an issue; the change in focal relationships may have important network effects (Halinen, Salmi & Havila, 1999). How these in turn affect the merging companies is important to try to predict.

- *Changing positions on the market*

Any kind of M&A activity will have effects on how the companies are perceived by the market or more precisely by the other actors. It is the perception of the changing positions of the merging companies that will steer their behavior in turn (Anderson et al., 1998).

- *How to ensure maintenance of relationships?*

Ways to enhance this include, e.g., extensive information exchange, involvement of people from both ends; and motivation of personnel. All these are issues familiar from the integration literature: our point here is that these considerations should not be limited to the two merging companies, but may apply also to connected parties.

- *Consideration of external relationships of both merging companies.*

In a related merger, networks of the merging companies are probably highly overlapping. How to handle this becomes an issue.

- *Evaluation of the success of the M&A, i.e., performance*

Given the difficulties in controlling the relationships, it is important that the relationships are not damaged by M&A. That is, if aim is to keep the existing relations, and this happens, the company should consider this as a successful outcome in itself. There is also a general difficulty in measuring intangible assets that also relates to relationships.

### 3. Effects of M&As due to Processual Connectedness of Business Relationships

The discussion in the preceding section on the spread of change in business networks following M&As points to the arbitrary boundaries between an M&A and other ongoing processes in the network. In this section, we bring up for discussion six general strategic issues connected to these processual aspects: these are mainly empirically derived from our set of longitudinal case studies of M&As in various industrial sectors.):

- The *initial timing* of the M&A event in relation to *other ongoing network processes*
- The *timing* of the M&A in relation to the *long-term processes of change and evolution* in the network, including the history of other M&As
- The *handling of other network processes* in the context *during* the actual M&A process, including unpredicted *domino effects* of the M&A
- The handling of *sequences* and the *order* in which different steps in the M&A processes are taken
- The handling of the *speed* of the M&A process in the network
- The handling of the *continuity* of the M&A process

#### *Timing in relation to other ongoing network processes*

For each company in an M&A, the initial timing of the event can have far reaching outcomes for both the continued positioning of the companies and for their connected counterparts in the network. For example, two merging companies can at the time when the process starts be involved in ongoing processes of cutting down the number of suppliers or being in the process of outsourcing activities to external suppliers. Depending on how the merger process is handled, the connecting of such ongoing supplier change processes in the two companies will either be complementary, i.e. *amplifying* the processes or become contradictory, creating *inertia* in the processes.

#### *Timing in relation to long-term evolutionary processes*

Every M&A has a history. In some cases a central part of this history can be a sequence of other M&As. For the single company's long-term network positioning process it can be of crucial importance when a particular M&A takes place. Especially in mature industries, a "late" M&A can mean that the company's opportunities to reposition in the network via counterparts (which link the focal company to new suppliers and/or customers) can be blocked for considerable time.

#### *The handling of concurrent network processes and domino effects*

With the view that every M&A is an *embedded and longitudinal* change process, it can not be expected that an M&A will evolve undisturbed by other, concurrent, processes in the network. Hence, an important strategic issue for the single company is how to handle the process of either *relating* the M&A process *to* or *buffering it from* other ongoing processes of change in the network. A related issue concerns the way the company should handle any potential, unexpected *domino effects* of the M&A (Hertz 1998). In a tightly coupled and structured network, it can be expected that a merger can create radical changes (i.e. the necessary breaking of established alliances and co-operations on both sides of a dyadic merger). The spread of such changes can hit back on a merging company, and thus an important strategic issue concerns the development of a preparedness to act on such unexpected domino effects.

### *The handling of sequences and the consecutive order of actions*

The strategic positioning and the outcome for the single company of an M&A can be determined by the order in which the various merger steps are taken. For example, an important question concerns what logic that should govern two merging companies processes of merging units connected to the major counterparts, i. e. the suppliers and the customers. Should the units handling the customer relations be merged first? Or the units handling the suppliers? Or should these processes be handled concurrently? What could be the outcome for the companies' respective network positions of these choices? The issue becomes even more important and complex if also other connected counterparts are involved, e. g. strategic alliance partners on both sides.

### *The handling of speed*

Much anecdotal evidence from studies of M&As seem to suggest that the speed of the merger process can affect the network position process of the companies involved. Thus, it has been argued that the extension in time of a merger process often has direct negative consequences not only internally in the new company, but also externally in relation to suppliers and customers. Uncertainty about what the new, dominant policies should be for handling supplier contacts and/or customer relationships can lie behind such problems, sometimes creating severe disturbances and long-term negative effects. To avoid such uncertainties in the network, companies seem to either follow a high speed merger strategy or a very clear wait and see strategy (e .g. deliberately and openly working with parallel sales organisations during a long transition period in the merger process.)

### *The handling of continuity*

M&As are very rarely characterised by stability, i. e. by continuity in the actual change process. Some M&As can even be characterised by inertia, several stops, reversals in the process, and sudden jumps when the speed in the process takes off again. One important question is what such discontinuity in the actual process means for merging companies' continued network positioning? Another question concerns whether it can and should be avoided? It can be assumed that too much uncertainty in the actual process with too little structural stability emerging in the new relationships, can have negative effects on the continued network positioning processes.

To sum up, M&As can be seen as timed and localised social network changes which are produced and affected by many actors, individual and collective in the industrial network. This section has argued that along with the structural effects on the network of M&As, we need also to embrace the notion that the actual, longitudinal M&A processes to a large extent will determine the network effects.

## **4. Beginning to create a typology of M&A effects in Business Networks**

We propose that one has to involve the business relationships within both the pre-merger phase where strategic evaluations are made, and the integration phase of a merger. Crucial for the success of the purchase is to acknowledge that the potential positive economic gains depend on the willingness and ability of actors to develop further and exploit existing business relationships.

Because network processes are cumulative, not only short-term profit but also the future network positions in the long-term should be considered. Ford (1996, p. 560) puts this into an example: a decision to increase price to a particular customer has an immediate effect in that

relationship, but it may also have an effect on the relationship by altering long-term attitudes. Or it can affect the company's portfolio of relationships or the wider network.

In the pre-merger phase it is most important to focus on what connected relationships exist to both customers and suppliers to both parties. The value of their potential reactions must be considered as part of the acquisition or merger decision. In the pre-merger phase the processual aspects regard the perceptions of the connected actors. The (management) actions taken in order to handle the perceived effects of the merger are important. See Figure 1 for a summary.

	<b>Structural Effects</b>	<b>Processual Effects</b>
<b>Pre-merger phase</b>	The estimation of the value of connected relationships and potential reactions among Customers and suppliers.	The handling of actors' perceptions of new positions in business network.
<b>Integration Phase</b>	The estimation of change in relationships emanating from An M&A activity.	The handling of connectedness among actors, actions and speed.

Figure 1: Pre-merger and integration effects of M&As in business networks

For the integration phase it is important to estimate the changes in relationships that is likely to occur as effects of the actual acquisition or merger that has taken place. There are probably many customers and suppliers involved to both of the companies thus the likely effects in relationships are many and therefore difficult to grasp. The processual dimension in the integration phase deals with management of connectedness. Actions, speed and actors have to be handled in parallel.

In conclusion, we want to stress that many of the issues we are presenting here are not new as such for strategists and managers. What is new, is to extend the view from the two or more merging companies, to their connected actors. With our interaction approach these actors are not only reacting to changes but also pro-acting (e.g. a company may be involved in several independent M&As at the same time). That is, to broaden the view from a single integrating process to all relevant parties that may be affected, and in this way ensure the success of the acquisition or merger.

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