

The dissolution of business relationships in a demerger setting

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Abstract

In the paper, the literature on relationship dissolutions of a business-to-business relationship is used as to explore how a demerger process of two previously merged firms unfolds. Drawing on insights of a single case study, we show that a business dissolution perspective offers a procedural understanding for how the various antecedents for a demerger actually result in a demerger decision. We also find that the various resolution stages do not occur strictly in a pre-definable order, but that many of these stages are closely interrelated and occurring in parallel not at least due to the involvement of different stakeholders in the process. Applying a business relationship dissolution view in a demerger context also offers useful insights for the former literature; among others a more nuanced picture of both the disengagement stage and the sensemaking stage that might be divided in additional sub-stages.

Introduction

Mergers and acquisitions (M&As) are maybe the most important and observable strategic actions undertaken by firms in today's increasingly globalized and competitive business landscape (Caiazza and Volpe, 2015). Many M&A strategies, however, fail to meet their objectives with reported failure rates to be as high as 70% (Haleblian et al, 2009), which in turn results in divestments (Shimizu, 2007); i.e. firm dissolutions. Despite of the fact that separations of previously acquired or merged units are relatively rife; the phenomenon has hitherto not been given particular attention in neither the M&A nor the spin off/divestiture literature (Schweizer and Lagerström, 2014). Most importantly, there is a lack of understanding and framework of the dissolution process of two divorcing firms in an M&A relationship. A first aim of the paper therefore is to explore such a process by employing the framework of relationship dissolutions in a business- to business setting (e.g. Halinen and Tähtinen, 2002). We are aware of the fact that the nature of the relationship itself is the most important determinant for the types of ending processes to occur and for their characteristics (Halinen and Tähtinen, 2002), hence, the dissolution of a relationship of two previously merged firms is seen as a particular case of business relationship dissolution. Therefore, the second aim of the paper is to contribute to the literature on business relationship ending that up until now predominately has focused on buyer-supplier relationships (Tähtinen, 2002). In the paper we draw from insight of a single case study with the intent to answer the following question: How does the dissolution of a relationship between two previously merged firms unfold?

The paper continues with a theoretical section in which the still scarce insights from the divestiture/spin-off/demerger literature and research on the ending of business relationships are discussed. Thereafter follows methodological considerations, which are followed by a presentation of the case and a discussion on the findings. We conclude with contributions and call for further research.

Theoretical framework

In the divestiture/spin-off or demerger literature one aspect emphasized is the categorization of various dissolution forms (Böllhoff et al., 2007), and another is to detect various antecedents resulting in divestitures (Thywissen, 2015). External antecedents triggering divestitures are among others the level of competition, industry growth, environmental uncertainty, or changes in external factors such as regulations or the opinions of financial analysts (e.g. Powell and Yawson, 2005). Internal antecedents, in turn, are for example (too) low performance of a business unit, over-diversification, high debt levels (e.g. Haynes et al, 2003), changes of strategic corporate focus due to change of top management and ownership (e.g. Denis and Kruse, 2000; Hoskisson and Johnson, 1992), or changes in the power relationship among units (Xia and Li, 2013). In a similar vein, research on demergers has identified the

motive behind the demergers as an important antecedent for the subsequent implementation of the demerger. Böllhoff et al (2007) give a sum-up of different motives by distinguishing between firm internal and external motives. Firm internal motives can either be parent specific - e.g. focus on core activities; financial loss/difficulties of the parent firm; liquidation of parent; lack of managerial capacity; failure of previous acquisition/investment – or subunit (to be demerged) specific motives – e.g. lack of profitability; increased need for financial capital; end of product life cycle. External motives are e.g. superior cost benefits/synergies of competitors; an offer made by buyer often offering a better strategic fit; overcapacity in the industry, decreased markets, and requirements from competition law/authorities. Research on divestiture has also discussed the impact of inertia on the decision to demerge or not; i.e. the indolence in divesting a corporate component despite objective reasons to do so (Thywissen, 2015). Given the fact that an acquisition often involves a large commitment of financial and managerial resources, top management may be subject to strong inertial forces working against reversal of the initial decision (Shimizu and Hitt, 2005). Another area of interest has been the actual implementation of a divestment (Thywissen, 2015), where focus has been on communication, the choice of divestiture mode, negotiations with potential buyers and the eventual detachment of the business unit (e.g. Moschieri, 2011; Bergh et al, 2008). Böllhoff et al (2007) identify five major phases of the implementation; (1) decision-making process resulting in the demerger decision; (2) creation of dedicated demerger project teams preparing the demerger; (3) (legal) preparation/restructuring of the to-be demerged unit; (4) search for buyers; and (5) sell-off.

As argued in the introduction and shown above, the literature on demergers, divestitures and sell-off has so far not emphasized the process leading to the dissolution that subsequently results in such strategic actions. In contrast, since the mid 1990’s, marketing research - predominantly focusing on buyer-seller relationships – has gone beyond a sole emphasis on the reasons for or antecedents of relationship dissolution (e.g. Grønhaug, et al., 1999;) by highlighting the importance of the process resulting in the dissolution of business relationships; even though there are different views on what ending means, i.e. either a process where all activities between the parties are ended (Tähtinen & Halinen-Kaila, 1997), or a process where relationships may not completely dissolve due to e.g. personal bonds across actors in the dissolving firms and/or common connected relationships with external actors (e.g. Gedeon et al., 2009). Whereas some studies focus on specific stages of the business relationship dissolution process such as communicating the dissolution decision (e.g. Alajoutsijärvi, 2000) or the perception of warning signs (Grønhaug et al., 1999), others give a holistic description of a dissolution process of a business relationship (e.g. Halinen and Tähtinen, 2002; Tähtinen, 2000; Tähtinen and Halinen-Kaila, 1997) as outlined in Table 1.

Table 1: Relationship Ending Process [*actor levels involved*]

Stages	Description
Consideration stage	Involves actors’ decision-making behavior evolving around the question of continuing or ending the relationship; includes information seeking and uncertainty reduction. Several reasons for ending and or continuing the relationship can emerge. Important to note, it is the evaluation of these reasons (and not the reasons per se) that result in ending or continuing of the relationship. [<i>individual, firm, dyad and network</i>]
Restoration stage	Involves actions that are directed towards saving the relationship. [<i>firm, dyad and network</i>]
Disengagement stage	Actors’ bonds, activity links and resource ties start to weaken and eventually break down. This stage can be precipitated by a conflict between the firms or individuals. Deterioration of links can also occur due to changes in the network. Legal contracts might be annulled and joint planning and activities cease to exist [<i>firm, dyad and network</i>]
Sensemaking and aftermath stage	Includes all actions (often by storytelling) through which the individual and/or group actors make sense of what happened in the relationship often in order to mentally protect themselves (not being responsible for mistakes). Sensemaking behavior influences decision-making during the dissolution process and also after the relationship has ended. [<i>individual, firm, dyad and network</i>]

Enabling stage	Consists of all actions that aim at lowering the exit barriers or minimizing the attenuating factors. Enabling actions also include developing new relationships and securing network positions in order to minimize the risk for disruption of business. The stage consists of actions to destroy the barriers in order to make the ending possible. <i>[firm and network]</i>
Communication stage	Encompass communication about the ending or continuation of the focal relationship. By adopting an exit strategy the firm aims to terminate the relationship, whereas a voice strategy allows firms to restore the relationship. <i>[firm, dyad and network]</i>

Adapted from Tähtinen (2002)

Important to note is that the stages described in the table are a collection of possible stages that the ending process travels through and the order of the stages might vary from case to case. Also, some stages might occur simultaneously since actions might be performed by different actors. Tähtinen (2002) distinguishes between actions performed by individuals in the dissolving firms, the firms, the dyad itself and the network the relationship is embedded in.

Methods

In the paper, the literature on relationship dissolutions of a business- to business relationship is used as to explore how a demerger process of two previously merged firms unfolds. Hence, as stated in the introduction we aim to contribute to the demerger literature by offering a process description on the dissolution, whereas we contribute to the literature on relationship dissolutions of a business- to business relationship by widening empirical focus beyond buyer-supplier relationships. Because of the exploratory nature of the question studied, we have chosen a case study approach (Yin, 2014). Case studies provide a unique means of “sharpening existing theory by pointing at gaps and beginning to fill them” (Siggelkow, 2007, p. 21). Following the thoughts of Eisenhardt and Graebner (2007) on theoretical sampling and Merriam (1998) discussion on convenience sampling, the demerger between Cloetta and Fazer was chosen as study object. This demerger might have many traits similar to those of other demergers in at least similar industries and size, but the goal when choosing the Cloetta Fazer case was not to obtain the representative capture, but to gain a deeper understanding to facilitate the development of an analytic frame for the dissolution process resulting in a separation. This case study can thus be understood as an instrumental case study providing insight into an issue and the refinement of a theory (Stake, 1994). Another reason for choosing this case was that data were readily available, since we had access to data about the demerger between Cloetta and Fazer due to prior studies (Karlsson and Nordell, 2012; Thomasson and Janusonis, 2012). The case description is built on ten interviews with top managers all working at Cloetta Fazer AB during the demerger and many of those at either Cloetta or Fazer prior to the merger as well as a vast amount of secondary data (press releases, annual reports and news articles). Although the data collected is retrospective, triangulation (use of primary and secondary data) and multiple interviews on the same process reduced the risk of post-rationalization of previous actions and decisions as well as problems related to memory (cf. Yin, 2014). The collected data were summarized in a rich and broad chronologically structured case story of the demerger. Following the thinking of Merriam (1998), the case story was coded with the characteristics of the various stages discussed by Tähtinen (2002) (see Table 1) and relevant insights from previous research on demergers, which served as a base for the findings discussed later in this paper.

The case

A merger between Swedish Cloetta (with Swedish family Svenfeldt’s holding company Malfors Promotor AB as a majority owner) and Finnish Fazer (a family owned business established in 1891 by Karl Fazer) was first discussed already in 1973, but at that time resulted in a production agreement. It was not until 1999 a merger of equal agreement was reached and ensued to the creation of a leading Nordic confectionery firm with a 25 percent market share. Both firms had strong positions in their domestic markets and their brands served different complementary market segments, there was hence a perceived high degree of strategic fit. The larger size was expected to obtain higher bargaining power versus suppliers and customers, and consolidation of operations to lead to economies of scale. Already in 2001, the proposed synergy effects of close to 8 million USD were realized – not at least through

cutting costs within production, distribution, marketing, IT and procurement; and the company was underway to fully integrate through different management programs and projects. The Swedish and Finnish market organizations, however, remained relatively independent after the merger. Important to note is that in order to get the 50/50 balance of shares apportionment of Fazer Confectionery was made by OY Karl Fazer AB, in exchange for shares in Cloetta AB. The 50/50 balance was also put in place for the board of directors and group management. The agreement emphasized that Fazer should at the latest of July the 30th 2002, make a structural placement of B-stocks to institutional allocators, and would then after the gradual sales have 31.7 percent of the capital and 42.9 percent of the votes. This structural replacement had to be done in order to create the equal ownership structure agreed on. This deal, however, never occurred (see below) and after nine years of existence, the announcement was made as to separate the two companies into its original parts on the 16th of June in 2008.

Findings

Due to space restriction for this conference paper, we discuss our findings from the coding of the case story (see methodology) directly by relating to insights from the case.

Consideration Stage

In the Cloetta Fazer case, the consideration stage is by far much longer than described in the prevailing literature on business relation dissolution (e.g. Halinen and Tähtinen, 2002; Tähtinen, 2000; Tähtinen and Halinen-Kaila, 1997) The consideration stage actually started immediately after the merger decision due to the unsolved question of how to legally implement the merger of equals' vision behind the deal. At the time of the merger, 50 and 20 percent of the shares were owned by Karl Fazer (here Fazer) and Cloetta (or Malfors group), respectively, making 70 percent of the shares non-liquid. Therefore, an agreement was written in beforehand, aiming at balancing the ownership and reducing the level of non-floating shares. Cloetta claimed that the agreement was binding and that Fazer had accepted it, whereas Fazer claimed the nonexistence of such an agreement. Fazer sold its shares to related companies at the same time as family members held private Cloetta Fazer shares, in addition to the ownership through Fazer. When the legal conflict peaked in 2005, Fazer even placed a bid on the entire company with the intention to buy out the remaining shareholders. Even though the proposed synergy effects of 8 million USD were realized already two years after the merger and that the company obtained a good market position right from the start, legal conflicts related to ownership and power struggles emerged as reasons for ending the relationship. We explain the remarkably long consideration stage despite the existence of obvious reasons to dissolve the relationship earlier by the impact of inertia (cf. Thywissen, 2015). Because a merger often involves large commitment of financial and managerial resources, decision makers experience strong inertial forces working against reversal of the initial decision (cf. Shimizu and Hitt, 2005). Hence, the occurrence of strong inertial forces impacts the evaluation process resulting in a prolonged consideration stage.

Restoration stage

The restoration stage is in the Cloetta Fazer-case closely intertwined with the consideration phase, i.e. the various attempts to solve the ownership conflicts can be interpreted as the owners' actions directed towards saving the relationship (cf. Tähtinen, 2002). Besides these actions, Cloetta Fazer also tried to acquire Danish Toms – an attempt that failed due to owner struggles and that can be seen as a desperate effort to shift focus from the ongoing ownership conflicts towards a more future oriented growth focus. Interestingly, in contrast to the owners, the managers worked hard to make the merger function operationally by trying to integrate the two firms, activities that had a restoring impact on the existing ownership feud. We argue that the lack of a clearly marked restoration stage in the case is due to the fact that the main reason for the forthcoming demerger is an internal motive (cf. Böllhoff et al, 2007). It is thus reasonable to assume that if the antecedents for the dissolution had been external, e.g. overcapacity in the industry, decreased markets, and requirements from competition law/authorities, a more manifest and clearer restoration stage with activities aiming to save the relationship had been seen in the case.

Disengagement stage

Due to the above discussed conflict, activity links and resource ties between the two firms' eventually weakened as suggested by Tähtinen (2002). Managers began to realize that the ownership disputes were not solvable and thus started to act more as if Cloetta and Fazer once again were independent firms. An outcome of the polarized strained relationships, strategic decisions had to be made reciprocal between the brands in order to go through, resulting in financially irrational decisions (e.g. investment in two separate chocolate production lines). Joint planning and activities ceased to exist. Eventually, in November 2007, a planning committee encompassing the CEO from Fazer, one representative from Cloetta and two previous board members began to prepare a framework for the execution of the separation. The planning committee held weekly meetings for almost one year in order to ensure that concerned stakeholders interest were taken into consideration. The initial focus was placed on legal and financial issues. In contrast to the prevailing literature on business relationship dissolutions that predominately has studied buyer-supplier relationships (e.g. Halinen and Tähtinen, 2002; Tähtinen, 2000; Tähtinen and Halinen-Kaila, 1997), it is in the Cloetta Fazer case possible to see two sequential sub-phases during the disengagement stage. In the first sub-phase a relatively lengthy informal smoldering process played out during which the managers first believed in the merger of equal idea and tried to implement the integration plans. As time passed they thus started to realize that the merger was doomed and gradually began to act independently resulting in weakened links between the two firms. In the second sub-phase, the appointed committee actively and structurally planned and acted to cut the existing activity links and resource ties. Turning to the divesture and demerger literature the second sub-phase has been discussed (see e.g. Thywissen, 2015, Böllhoff et al, 2007), while the first sub-phase has not been acknowledge.

Sensemaking and aftermath stage

The sensemaking stage, in which individuals make sense of what has happened in the relationship (Tähtinen, 2002), can be divided in several sequential and interlinked sub-phases in the Cloetta Fazer study. In a first phase, focusing on the employees and managers' sensemaking, despite the constant disputes among the owners, in general the managers believed in the merger that indeed made sense strategically. This perception influenced their decision-making initially and surprisingly for a long time, and their activities and decisions aimed towards a successful integration of various functions. When it gradually became impossible to make sense of the merger idea, managerial activities were directed towards the assumed forthcoming demerger and resulted in weakened ties. The measure taken towards disintegration initially occurred under the radar, but as the demerger announcement was made more formalized and intense measures were taken. It is thus possible to observe differences between individuals' sensemaking and changes in sensemaking over time. Several top managers saw the dissolution decision as a financially irrational decision that destroyed more value than it created, and therefore also adopted a relatively critical attitude towards disengagement activities. In contrast, operative or administrative employees in general felt more pleased with a return to the previous structure with national owners. Many of the employees saw a definite end to the conflict between the owner families, a conflict that had been affecting the operations and the employees for many years. In line with the above, it is reasonable to argue that individuals that had invested time, resources and prestige in integrating the firms remained longer in the first sense-making phase and found it more difficult to accept the dissolution compared to the ones that had been more by-standers. This distinction is also noticeable on a functional level where functions that were more integrated differed in their perceptions compared to those who were less integrated. For example, marketing and sales that never really became integrated after the merger experienced the disintegration as smooth, while disintegrating the existing logistic functions were considerably more difficult as those had been successfully integrated in Cloetta Fazer. We thus propose that the degree of integration which in turn is determined by the motives for the merger (cf. Böllhoff et al, 2007) impacts the characteristics of the sensemaking stage of the dissolution between two previously merged firms.

Communication stage

In this stage communication activities concerning the ending or continuation of the relationship (Tähtinen, 2002) is in focus. In the Cloetta Fazer case focus was entirely on communicating an exit strategy as a result of the importance of the decision to demerge and the long preceding stages (cf.

Tähtinen, 2002). A finding was that various stakeholders were approached at different times. In January 2008, the Swedish Financial Supervisory Authority and the Nasdaq OMX Nordic Stockholm stock exchange were notified. In early spring of 2008, the planning committee informed the CEO of Cloetta Fazer about the decision to dissolve the relationship and that the decision was planned to be publicly announced in June. Managers and employees were subsequently informed after a few months, even though rumors already had been going around in the organization.

On the 16th of June 2008, the official announcement of the demerger decision was made at an extra board meeting together with a presentation of the overall structure of the demerger. Through the demerger, Fazer Confectionery once again became a division within Karl Fazer Oy, and Cloetta would be re-listed on the Stockholm stock exchange in December 2008. All brands and assets belonging to the two companies prior to the merger would now return into their possession. The legal split occurred by 1st of September 2008. The cooperation between the two firms did thus not completely come to an end as not all relationships were dissolved (cf. Gedeon et al., 2009). Cloetta and Fazer were both connected through their relationships with customers (discussed more in detail below). Certain functions, such as logistics and production, also had a different communication pattern with regards to the ending of the relationships than other functions. It was more based on a voice strategy (Tähtinen, 2002) which thereby offered a platform for continued cooperation.

Enabling stage

The execution of the demerger of Cloetta and Fazer on operative level began in August 2008, and initially focus was on who would take the different positions after the disintegration. All decisive decisions were in place in the end of August. In addition, all old contracts with suppliers and distributors were renegotiated, and prices and portfolios reshaped. On the 1st of September 2008, Cloetta Fazer AB ceased to exist and became two different legal entities, and could therefore due to Swedish regulations not share office space; however, the moving to new offices occurred only by 2010. The main priorities during the disintegration were to secure customers service, to minimize short time financial impact, and to make agreement in relation to all assets. As a temporary solution Fazer used capacity from Cloetta to handle market, distribution, and sales in the Swedish market until January 2010. Production in Sweden was not split up immediately. For Fazer it was important to have production of its smaller volume brands in Sweden, close to the market, and for Cloetta it was important to fill up their production capacity. The contracts were thus now based on market terms.

Fazer further had to renegotiate contracts to export to markets such as UK, Germany, Norway, Denmark and the Baltic countries, but eventually ended up choosing to continue to work with the same distributors as prior to the merger. The highly integrated supply chain operations were thus not changed, rather the cooperation between Cloetta and Fazer remained intact and common warehouses were kept in order to avoid an increase in fixed costs. But when it came to sales, the two brands returned to only market and sell products that had been part of their own product portfolios prior to the merger. The sales departments informed the customers that once again they were to deal with two different sales forces and two different terms, and that the products were to be delivered from two different warehouses.

The above actions seen as pertaining to the enabling stage (Tähtinen, 2002), are in the demerger and divestiture literature discussed as disintegration activities (Schweizer and Lagerström, 2014) or as implementation of a divestment (Thywissen, 2015). Similar to activities described to occur in the enabling stage, the disintegration/divestment literature discusses issues related to how to manage the disintegration, various phases during such a disintegration and various phenomena that occur on either an individual level (e.g. experienced uncertainty by employees), an interpersonal level (e.g. manager's reactions impact on employees' emotions) or on a collective level (e.g. cultural disintegration) (cf. Schweizer and Lagerström, 2014). Applying a relationship dissolution lens thus offers a more nuanced way to see that even in a demerger situation the relationship between two demerging firms does not come to a complete end. It is rather evident that at least some relationships remain, even if they adopt and continue in new forms after the dissolution which is seen as a key fact to understand the various disintegration activities.

Conclusions

In this paper we have used the literature on relationship dissolutions of a business- to business relationship in order to explore and create an understanding of how a demerger process of two

previously merged firms unfolds. The main conclusion is that the relationship dissolution lens is seen as a promising perspective to employ and it offers interesting contributions to the hitherto still relatively underdeveloped understanding of disintegration processes following a demerger decision between two previously merged firms. First of all, a business dissolution perspective offers a procedural understanding for how the various antecedents for a demerger that have been discussed extensively in the demerger and divestiture literature actually result in a demerger decision. Indeed, as mentioned by Tähtinen (2002), the reasons as such do not end a relationship; it is the various evaluations of these reasons by various stakeholders that might result in dissolution or not. In line with the thoughts of the business relationship dissolution literature, we also find in our demerger case that the various stages do not occur strictly in a pre-definable order, but that many of these stages are closely interrelated and occurring in parallel not at least due to the existence of different stakeholders. In the case studied, network stakeholders play a subordinated role.

Another finding is that the consideration stage is longer for demerger companies relationships compared to business-to-business relationships as they are described in the business relationship dissolution literature. The main argument found for this is assumed to be the high degree of inertia related to demerger decisions. We can furthermore conclude that applying a business relationship dissolution view in a demerger context offers useful insights for the former literature; among others a more nuanced picture of both the disengagement stage and the sensemaking stage that might be divided into additional sub-stages. Of course, this study faces the common limitations of a case study approach (Yin, 2014) and we call for further research studying other demergers with a point of departure in the business relationship dissolution literature.

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