

# Merger waves and contemporary internationalization of firms and markets

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## **Introduction**

In an article in the Swedish newspaper Svenska Dagbladet (January 3, 2000) the journalist introduces an article on developments in 1999 by the following sentences (my translation):

”The merger and acquisition hysteria in Europe was record breaking. Never has the marriage wave been so tumultuous and politically infected as in 1999. But the stock markets applauded.” Further down in the article the development is labelled ”fusionsyra”, and ”merger mania”. ”Bigger is better” is given as the major logic behind the development. Advice to stock market investors is to identify firms that are likely to be acquisition targets because such stocks will increase in value when rumours or bids come forward. However, in an article a few weeks earlier in the same newspaper, an article, referring to a study by a consultant firm, A.T. Kearney, showed that M&As most often turn out to be disappointing from a post merger performance point of view. Statistics show that the average value of the M&As have increased considerably during the second half of the 1990s and that ”megadeals” (several hundred billions SEK) are catching the imagination of observers.

Even if still most of the M&As involve firms belonging to the same nation, there is a considerable increase in international ones. It is the international ones that are discussed in this paper. The aim of the paper is to discuss explanations for and effects of international merger waves. In the concept of merger I also include acquisitions, and equity swapping strategic alliances. Furthermore, I concentrate on horizontal mergers, that is when firms belonging to the same "industry" merge.

Even if merger waves and international M&As are far from new phenomena they are taking place within a market system that is radically different from a decade ago due to previous and contemporary internationalization processes. International M&As now to a greater extent takes place between firms that already are considerably internationalized and in a market context where international strategic alliances and interdependencies within important supplier-buyer exchange relationships are considered high by involved firms. This context has been labelled ”alliance capitalism (Dunning, 1997) and the contextual development ”alliance revolution” (Gomes-Casseres, 1996).

Thus, international M&As by international and internationalizing firms operating in internationalized and internationalizing markets involve pre-M&A considerations and post-M&A effects that must take international interdependencies between firms and between markets into account. Network theoretical studies show that an MNC’s subsidiaries’ are dependent on differentiated supplier and customer network relationships for their

performance (Blankenburg-Holm et.al.,1999; Forsgren et. al, 1997). M&As that aim to influence such external relationships, e.g. by coordinating distribution systems or supplier networks between the merging firms, obviously will then change the nature of the pre-M&A relationships (Nyberg, 1994 shows this to be problematic) If there is an M&A-wave, major structural changes will spread throughout the market. Before arriving to discuss this rather complicated process I need to take up some basic notions about M&A, about internationalization and about the markets-as-networks view of markets and firm strategies in networks.

First, I will briefly refer to explanations of mergers and merger waves. Second, I will, also briefly, refer to explanations of internationalization of firms. Third, aspects of a markets-as-networks view will be identified. Then I will discuss how international merger waves and their effects can be explained within this conceptual framework. Some propositions will conclude the paper.

### **Explanation of mergers**

In their text book on industrial organization Scherer and Ross (1980, p.159) say that "mergers occur for a myriad of reasons and in any given case, several different motives may simultaneously influence the merging parties' behavior". It is possible to group the major general motives (given on pp 160-174) into

- to monopolize an industry
- to reorganize production systems to reduce production cost due to scale economies, specialization and development a more efficient plant structure through modernization
- to get synergy effects by more efficient coordination of complementary resources (production capacity, management skills, marketing, R & D etc.)
- to decrease cost of capital (correcting for market failures on the capital market)
- to save ailing firms or firms with management problems
- to speculate in stock value effects of M&As

As to the growth of international M&As during the last decades Dunning (1997 p 247.) has suggested that they are undertaken by strategic asset-seeking firms for five main reasons:

- rising costs of innovation and of entry into unfamiliar markets
- competitive pressures to be cost effective
- growing need to tap into complementary technologies and to capture expected economies of scale and scope
- desire to protect or advance global markets vis-a-vis oligopolistic competitors
- need to encapsulate the time of the innovating or market entry process

In addition to these more general ones a report by UNCTAD (1994) lists six forces driving M & As in the 1980s. :

- Growing competition, globalization and favourable government policies
- Higher efficiency in the face of growing competition and globalization
- Access to technology and reduced costs of R & D
- Response to the Single Market programme of the European Community
- Availability of low-cost financing options after financial liberalization in many countries
- New investment opportunities in developed countries during the boom period in the latter part of the 1980s

Most studies of the outcome of mergers show that they do not live up to expectations. One

type of studies examine stock price movements. Another type of studies checks company performance measures such as profitability, sales or market share. Generally the studies show negative effects of mergers. A third type of study is case studies of mergers. These are usually done with an organizational theory framework. Such studies invariably show the complexity of post merger processes put in motion in order to attain the objectives of the merger (Andersson, 1996)

In terms of international M&As it has been suggested that an increasing proportion during the last decade has been undertaken to acquire new ownership specific advantages rather than to exploit existing advantages (Dunning, 1997 p 9). Thus strategic asset seeking, as part of a global strategy, is considered as a major motive.

### **Explanations of merger waves**

The merger wave of the late 90s, alluded to in the introduction, is of course not the first such wave. Scherer and Ross (1980, pp.153-159) identify a number of such waves in the US economy, starting with the 1887-1904 wave inspired by the monopoly motive. Thereafter waves occurred in 1916-1929 (public utility firms, mergers for oligopoly, vertical integration and diversification), in the 1960s (mostly of a diversifying and conglomerate character, encouraged by financial innovations that could finance business deals and in 1980s (low stock prices, low USD exchange rate, hostile take overs)

In anticipation of EC 92 a merger wave swept over Europe. Not the least Swedish MNCs were involved in this. In an effort to interpret such a wave, Caves (1991) offers two types of explanations, both leading to a temporal concentration (a wave) of international mergers in response to European economic integration. The first is a competitive strategy model according to which merging firms complement their heterogeneous resources in order to improve their possibilities to benefit from the enlarged and changed opportunities on the integrated market. Such mergers will be temporally concentrated because firms perceive the number of alternatives to be few and diminishing over time as the wave rolls on. This strategy model accounts for interaction within the population of firms and is consistent with the well-known oligopolistic rivalry model presented 25 years ago by Knickerbocker (1973).

The second approach, suggested by Caves, is a non-strategy model according to which mergers are directly influenced by the enlargement (or prospect of such) of the market without any competitive strategic considerations by the firms. Also in this case temporal concentration occurs due to this common, exogeneous driving force.

In both models there could be wave due to common expectations, common "theories" and imitative behaviour. However the competitive strategy model calls for consideration of time based strategic behaviour (such as "first mover advantages", "preemptive actions" etc.) and a consideration of how the ordering of M&As in a population will result in different restructuring processes over time.

### **Internationalization of firms**

The well known *Uppsala model* emphasizes gradual commitment of resources to markets at increasing distance from the domestic base (Johanson and Vahlne 1977). The firm grows internationally to finally become a multinational company with subsidiaries and dispersion of functional activities in a large number of countries. The major dimensions measuring

internationalization are international extension to an increasing number of foreign markets and increasing resource commitment to each foreign market.

However, as many writers, including "founding members" of the Uppsala tradition, have emphasized, this model leaves us without means to analyse a situation where the firm already is highly internationalized. In such a situation subsidiaries have grown to become important entities in themselves. International integration of activities becomes an important dimension of the firm's internationalization process. Continued international growth is likely to be less in the form of greenfield investments and organic growth than in the form of M&A activities.

Neither does the basic Uppsala model consider that the context within which the highly international firm is positioned not only might be internationalized, but also that it might undergo substantial internationalization processes. International mergers represent themselves changes in the context. Since also the focal firm is engaged in M&A activities and since this takes place during a merger wave, there are strong reasons to take an embeddedness approach to the study of internationalization, i.e. we should consider how actors are related to each other and how such relations change. Arguments to consider *embeddedness* when both the firm and its context are internationalized ("International Among Others" case) are presented in Johanson and Mattsson (1988) and further developed to consider dynamic aspects in Mattsson (1998).

One approach to consider embeddedness aspects for further internationalization of highly internationalized firms is to focus on the internationalization of subsidiaries, "*internationalization of the second degree*" (Forsgren, 1989). This approach questions the ability of central management of an MNC to integrate activities across subsidiaries. It also shows that attributes of a subsidiary's *network connections* contribute to the subsidiary's performance and MNC-internal strategic influence (Forsgren et. al.1997). Other Uppsala studies (e.g. reported in Blankenburg-Holm et. al.(1999) also show that the network connectedness matters for MNC performance. The results presented in Arvidsson (1999) about MNC-internal transfer of "best practice" supports the idea that central management lacks information about subsidiary capabilities.

A *resource-based* approach to internationalization of MNCs that is of relevance to understand international M&As is presented by Andersen and Strandskov (1999). The competitive advantage of a firm is dependent on the resources it has access to and how these resources are controlled. The resources reside in the business system and the control in the ownership structure. The authors thus distinguish between international business system integration and international ownership integration. Both dimensions of international integration can be low or high. In the low/low situation, the firm internationalizes by developing its own resources and needs to internationalize gradually due to risk and lack of resources. This situation is consistent with the original Uppsala internationalization model. In the high/high situation internationalisation is of an integrative nature and aimed at globalisation of production, marketing and R &D. If business system integration is high and ownership integration low then the important driving forces for the firm's further internationalization is the nature of its exchange relationships with other firms e.g. customers and suppliers. If ownership integration is low, then ownership does not much influence the internationalization of the exchange relationships, and thereby not much resource access or resource development in interaction with other firms.

This distinction between the two types of integration is interesting for the analysis of effects

of M&A. A merger implies ownership integration between two firms. If a merger motive is to get access to and combine resources previously controlled by two separate ownerships, business system integration does not necessarily follow. First, one or both of the firms might have a low such integration in the pre-merger situation. Second, if both were high in this dimension, then the reconfiguration of networks, both as regards internal resources and resources accessed through exchange relationships in the network will likely be problematic, time consuming and costly.

In traditional, dominating and "hierarchical" explanations of the MNC, Dunning's *eclectic model* is the prime example of an effort to analytically combine the types of advantages that MNCs can enjoy, within an economic theory framework, compared to a market solution for coordination of activities. Ownership-specific advantages (O) have to do with a firm's assets, organizational skills, multinationality, product attributes etc. that differentiates the firm from competitors. Internalization advantages (I) refer to market failures. O-advantages are saved from being exploited by others by internalization of international growth. Location-specific advantages (L) refers to differentiation of conditions for specific activities in one location as compared to another location. The basic reasoning is as follows: O-advantages is the base for a firm's growth outside the domestic market. I-advantages makes it more effective to grow by international investments rather than by letting another firm carry out the relevant activities. L-advantages explains why a certain MNC activity is performed in a specific location (host country or home country). The eclectic model can be used to explain why two MNCs merge with reference to complementarities between their resp. O-advantages and L-advantages. I-advantages would then be a major reason why the synergy effect can not be implemented through arm's length transactions.

However, the embeddedness nature of internationalization is not captured by the above formulation of the eclectic model. In a move towards a more embedded formulation of the eclectic model, fitting the development towards "alliance capitalism", Dunning (1997) includes also alliance or network related advantages in all three dimensions. E.g. O-advantages includes access to customers, I-advantages includes also "quasi-internalization", L-advantages include also external economies enjoyed through in business districts or science parks.

The traditional view of MNC has been that it as a governance structure it "safe guards" the use of the firm specific assets rather than being a vehicle for acquiring assets and further developing them. The developments referred to above, i.e. the secondary degree internationalization, network effects of different kinds, resource based theory and the extension of the eclectic model open up for a stronger consideration of asset acquisition and access to resources and development through interaction within alliances and networks.

What seems to be lacking however in the above mentioned developments of "internationalization of the firm" frameworks is first, to explicitly consider international mergers as a major mode of further internationalization and second, to consider waves of international mergers and sequences of individual mergers within such waves.

Important aspects of the first phenomenon are that two or more firms' individual internationalization processes "merge", each influencing the future direction of the "new" firm and that "quantum steps" in internationalization are possible (even if it might be difficult to implement such changes). Important aspects of the wave phenomenon are the potentially

high speed of internationalization and reconfiguration of the market and the strategic interdependence between individual mergers.

Internationalization of firms are likely to be influenced by internationalization of the market. And, by definition, internationalization of a firm influences internationalization of the market. Thus, in a wave of international mergers, those mergers are influenced by internationalization of the market. Internationalization of a market then is to an important extent driven endogeneously.

It is estimated that of all international trade approximately half is intrafirm trade or trade within parties that engage in some cooperative relationship. The great bulk of trade (60-70 %) is supposed to be directly or indirectly connected to FDI activities (Dunning, 1997, p. 120). International merger waves will no doubt increase the intrafirm/intra-alliance share of international trade.

### **A markets-as-networks view**

As both firms and markets become increasingly internationalized, the interdependencies between the individual firm's strategic actions and its dynamic international market context becomes more important to understand. The following section builds on Mattsson (1998) which presents the idea of how dynamics of overlapping networks (e.g. internationalization of markets) are related to strategic actions by the international firm, and on Johanson and Mattsson (1991) that introduces some of the concepts concerning strategic actions.

In a markets-as-networks view the generic governance structure for production systems is networks of multidimensional exchange relationships between actors controlling heterogeneous resources and carrying out interlinked activities for production (including distribution and consumption). Actors in the network can be positively connected, implying a synergetic, cooperative relation as in an exchange relationship between a supplier and a buyer where resource interdependencies exist in the production system and a cooperative attitude exist between the actors. Actors can also be negatively connected because they compete to develop exchange relationships with a third party. More distant connections in a network are, from a focal actor's point of view, indirect and complex. The *sign of the connection* might change or become less distinctly positive or negative. Examples of sign changes are when two competitors merge (negative to positive connection) and when an alliance partner or agent is acquired by a competitor (positive to negative connection). The more there is a development towards internationally integrated production systems, towards "competition between constellations of firms" (Gomes-Casseres, 1996), towards "alliance capitalism" (Dunning, 1997), the more sensitive will the individual actor be to changes in the signs of connectedness in the network. (Hertz, 1999).

Each actor has a network *position* in a specified network. The position describes how it is connected to the other actors (to what external resources it has access and with which actors it competes) and the nature of its internal resources. *Strategic actions* are aimed at influencing network positions and thereby also how actors are connected to each other. Examples of such strategic actions are M&As, developing and breaking relationships to alliance partners or to suppliers, agents, customers, etc. The *strategic objectives* are defined in terms of desired future network positions of the actor and other actors, e.g. partners and competitors. One important *base for strategic actions* by a focal actor is its position in the network. Another important base for strategic action is the actor's *network theory*, i.e. the

actor's set of systematic beliefs about network and production system structure, processes and performance and the effects of its own and others' strategic actions.

Strategic actions are both constrained and facilitated by the network structure and by strategic actions by others. Networks are open, i.e. there always exist some connections or potential connections between two networks. Another way to express this is that networks are embedded in networks. The larger the number of network connections that are common to two networks, the more the two networks *overlap*. Positive connections through overlaps introduce variation and complementarities in a network, and opens opportunities to coordinate extended production systems. Negative connections imply that competitors from other networks exist, threatening actor positions. Through strategic actions overlaps might increase. I label such increases in overlaps as *overlapping* processes. An international M&A is an example of such a strategic action, changing the network structure and thereby affecting opportunities and restrictions for future overlapping and for changes in the production system.

### **International merger waves and network processes**

Some of the reasons for mergers and merger waves that were presented in the introductory sections of the paper fall outside of the approach I take here. That is the case for those that refer to financial markets and to government initiatives. That does not mean, of course, that explanations outside the framework are invalid (because they might be highly valid), only that they are not possible here to explicitly bring into the analysis. This leaves efforts by firms to improve their resource base and their ability to coordinate such resources to compete effectively in international markets as the reasons for mergers. Dunning(1997) mentions the need to be cost effective in production, to protect and advance positions in global markets, to handle increasing costs, time pressures and complementarities for innovation and market expansion.

International M&As comprise sets of strategic actions aimed at overlapping and at changes in how actors are connected to each other. Network theories and network positions influence strategic actions at each point in time. Because of the limited number of suitable opportunities available and due to changes in this opportunity set over time, actors' will consider the timing of an M&A activity to be important. (Caves, 1991; Andersson and Mattsson, 1999). To reduce the risk of missing suitable opportunities actors are trying to pre-empt competitors' M&A actions. In addition, each M&A action influences the network connectedness. Actors who experience that an important positive connection is changed to a negative, e.g. due to a partner merging with a competitor will react to this by efforts to find a suitable replacement. Thus initial changes in signs of connectedness will trigger further strategic actions in the network. Such processes can be viewed as caused by domino effects (Hertz, 1999).

An M&A defines an initial change in ownership but is actually aimed at changes in how actors are connected with reference to production system interdependencies. In the terms used by Andersen and Strandkov (1999) ownership integration is not necessarily linked to a corresponding business system integration. If we combine this observation with results from research on secondary degree of internationalization (Forsgren, 1999) it becomes very doubtful if ownership integration per se can lead to attaining the objectives of the M&A activity. This is especially so if we consider the importance for the performance of each of the merging firms of their pre-merger network connections. This would make it more

difficult, and perhaps dysfunctional, to reconfigure the networks to suit ideas about post-merger effectiveness.

As the merger wave continues, already merged actors appear in new such actions, either by divesting some resources that are acquired by others or by merging with others. From an ownership point of view there are thus new opportunities for overlapping and for changes in network connectedness between actors. Thus, there are during the merger wave serious problems to reconfigure networks for higher effectiveness, not only because that is difficult for each merger but also because of interdependence with efforts by other mergers to do the same.

To summarise my reasoning I present the following propositions:

1. International M&A waves are driven by actors' network theories about position changes for increased effectiveness.
2. International M&A waves speeds overlapping and increases international resource interdependence.
3. The sequence and speed of M&As during a wave depends on timing considerations by actors who judge the opportunity set diminish due to competitors' M&A moves.
4. The reconfiguration of network connections is to an important extent driven by "domino effects".
5. The more clearly actors in a network are either positively or negatively connected to each other, the stronger will these domino effects become and the more important becomes ownership control for international integration.
6. Actors' network theories lack enough consideration of problems and time to change network structures to attain effectiveness objectives of an M&A.
7. The international M & A wave leads to increasing use of network structure and processes within the new merged firm.

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