STRATEGIC CAPABILITY TRANSFER IN ACQUISITION INTEGRATION

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Strategic Capability Transfer in Acquisition Integration

This paper proposes that our understanding of acquisition integration can be expanded by viewing integration as a subset of the strategic capability transfer (SCT) process where strategic capabilities are transferred between firms to improve their competitive positions. A model of the strategic capability transfer process is proposed based on field research. The model suggests that for SCT to occur, certain enabling conditions must be met. In turn, these enabling conditions are affected by aspects of the actual process of SCT as well as contextual factors associated with both the acquisition itself and with the firms involved. Research propositions based on the model are suggested.

Strategic Capability Transfer in Acquisition Integration

The use of acquisitions to restructure firms and industries is one of the most pervasive yet controversial economic phenomena of our time. For strategic management scholars, a central question in this debate is how acquisitions actually contribute to a a firm's corporate strategy. More specifically, we know very little about how firms can be combined to yield a greater benefit than if they were operating separately. Traditionally, this question has been defined as one of acquisition integration, putting the firms together after the acquisition. But, prior study of this topic has not led to an understanding of what integration is or how it contributes to acquisition outcomes.

This paper proposes a framework for examining the transfer of strategic capabilities between firms or subunits of firms where the purpose is to augment the competitive position of one or both organizational units. Although a variety of methods are available to firms to improve their competitive positions (internal development, acquisitions, mergers, license agreements, joint ventures, etc.), strategic capability transfer will be explored here in the context of related business acquisitions where the espoused purpose is the transfer of skills, knowledge or resources between the parent and subsidiary companies. As such, acquisition integration, a key problem for many firms is seen here as a representative subset of the more general issue of strategic capability transfer.

The paper is organized in the following manner. First, the concept of strategic capability in the context of a corporate strategy is discussed. Next, a general model of the strategic capability transfer (SCT) process is presented. The model has three basic components: contextual factors that are both event- and organization-specific, a series of enabling conditions that allow SCT to take place, and a group of process based impediments that affect the organization's ability to satisfy the enabling conditions.

A series of research propositions accompanies the impediments. The model was developed in the context of a field study of a variety of firms undertaking related business acquisitions and is grounded in theory from a variety of disciplines whose concepts can shed light on the phenomena involved. Finally, implications of the model are discussed and the concept of SCT is argued to be essential in the strategic renewal process in firms.

CAPABILITY TRANSFER IN THE CONTEXT OF CORPORATE STRATEGY

Strategic Capability and Competitive Advantage

An essential element of a firm's survival and prosperity is its ability to develop and sustain a competitive advantage over time. For the purposes of this paper a competitive advantage is a characteristic associated with a firm, its products, or services that cause them to be preferred and purchased in lieu of competitors' products and services. It is important to note here that the capacity to both sustain and develop competitive advantages is necessary because of the ease of replication by competitors as well as erosion over time due to exogeneous environmental factors.

In this context, a firm's strategic capability is seen as its ability to use its skills, resources, knowledge, or ways of organizing to develop or sustain a competitive advantage. Most conceptions of strategy implicitly acknowledge the presence of such a strategic capability (Andrews, 1971; Schendel and Hofer, 1978; Porter, 1985). If this strategic capability is not present, the firm will not be able to defend or renew its competitive position and will eventually atrophy. Lenz (1980) was the first to propose the concept of a strategic capability. He suggested that the strategic capability of an enterprise was its capacity to successfully undertake action intended to affect its long term growth and development. The use of the concept here directly addresses strategic capabilities as a source of competitive advantage.

Reframing strategic capability as a source of competitive advantage may offer insights into the problems firms face as they develop or expand their activities as part of a corporate development strategy. Every organization requires a balance between the continuity provided by its existing businesses and renewal of those businesses. Because of the evolution of the business environment, most firms experience a natural decline in their base businesses and new activities related to strategic renewal must be developed. Strategic renewal can come from internal or external sources. Internal sources involve the development of new business activities or capabilities with the expectation that they will either be transferred to existing parts of the firm or be able to stand alone as relatively independent entities within the context of the firm. The process of internal development and its implications for strategic renewal are the subject of a growing body of research (Biggadike, 1978; Burgelman and Sayles, 1985).

External sources of renewal can come from many sources including acquisitions, mergers, joint ventures, technology sharing, and license agreements. Strategically, the general purpose of externally derived renewal is to bring new sets of capabilities into the organization or to expose the organization to situations where it can effectively use its existing capabilities.

This paper will concentrate on situations where acquisitions are used as vehicles for strategic renewal. In particular, the focus will be on related business acquisitions where the purpose is to transfer strategic capabilities (skills, resources, knowledge, ways of organizing) between the two firms. As such, we will focus our attention on the <u>process</u> of capability transfer, the <u>conditions</u> that enable it to take place, and <u>barriers</u> to the successful transfer of capabilities.

Acquisition Integration

Extant research in acquisitions has addressed this as the issue of acquisition integration in light of several different aspects of bringing firms together. Descriptions of post acquisition decisions and activities have been suggested by several authors (DeNoble, 1984; Graves, 1981; Lindgren, 1982; Shrivastava, 1985) and a variety of prescriptions for what managers should do after the acquisition have been offered (Howell, 1969; Leighton and Tod, 1969; Mace and Montgomery, 1962; Searby, 1969). Problems in making integration "work" have been related to a variety of factors including size (Kitching, 1967; Wicker and Kauma, 1974), people and cultural issues (Sales and Mirvis, 1985; Shirley, 1977; Sinetar, 1981, Walter, 1985), and the management style used after the acquisition (Bastien and Van de Ven, 1986; Davis, 1968; Hayes, 1979).

This body of research on acquisition integration has provided important and useful insights into the individual issues addressed. Collectively, the strength of this work has been its focus on particular issues and bringing those issues to the attention of researchers and managers. But, this issue oriented focus poses a weakness for further theory development because extant research has not yet led to a model of integration that could be a part of a broader theory of corporate strategic renewal.

The level of acquisition activity taking place today reflects a preference for acquisitions as a vehicle for corporate renewal. Although no precise data are available, it appears that a majority of related business acquisitions are made with the prospect of strategic capability transfer in mind (Salter and Weinhold, 1979; Grimm, 1985). This preference may be the result of several interacting motives. Acquisitions are a chance for managers to short-circuit some of the problems encountered in internal development projects such as long lead time, high risk, and lack of understanding at different hierarchical levels (Biggadike, 1979; Burgelman, 1983). They offer an immediate presence where one didn't exist before and

may preempt existing or potential competitors from gaining an advantage (Salter and Weinhold, 1979). Acquisitions also seem to have other added advantages: the firm does not share or relinquish control as it would in a joint venture; they allow the firm to bring in new, proven capabilities; and they can quickly position the firm to take advantage of major changes taking place in an industry or market.

Unfortunately, the record on acquisitions is mixed at best. Research indicates that benefits accrue to the shareholders of the acquired firms (Chatterjee, 1986; Jensen and Ruback, 1983; Singh, 1984) and to management of the acquiring firm (Muller, 1980). These same empirical studies have shown that shareholders of the acquiring firms do not benefit to the extent that shareholders of the acquired companies do. From the perspective of the acquiring firm, the effectiveness of acquisitions as a method of corporate renewal is in question.

In summary, related business acquisitions are a popular but uncertain method of strategic renewal. Many acquisitions are made with hopes of transferring strategic capabilities from one firm to another with the expectation of improving the competitive position of one or both firms. But there are few empirical results that demonstrate benefits to the acquiring firms. Problems in integration are frequently mentioned as a primary reason that the benefits don't accrue to acquiring firms (Jensen and Ruback, 1983; Lubatkin, 1983; Salter and Weinhold, 1979). But, while previous studies have provided important insights into individual variables associated with the integration issue, they neither present an overall view of how integration takes place nor show how the problems studied fit into a more general model.

This paper proposes a first step toward a comprehensive framework for studying acquisition integration. In doing so, a different approach is offered which suggests that the problem of acquisition integration should be redefined and subsumed under the more general question of how firms can

improve their competitive positions by the transfer of strategic capabilities. A model of the process of strategic capability transfer is proposed that offers a different, broader perspective of acquisition integration and that is intended to expand the debate over what transpires after an acquisition takes place.

Research Method

The lack of a theory of acquisition integration led to a qualititive method based on a series of field interviews. The model was developed using the grounded theorizing approach suggested by Glaser and Straus (1967). The research sites were five firms that had made related business acquisitions. After initial interviews with senior management to gain access and learn their perception of the key players, a total of fifty-two interviews were conducted across the five firms with middle managers and operating level personnel. These interviews were focused around three issues:
(1) Descriptions of how the firms came together after the acquisition,
(2) Descriptions of instances of individuals or parts of the firms working together or not working together, (3) descriptions of who was involved in these processes and why they were or were not effective. In addition to interview data, internal documents about the acquisition and the firms were made available to the researcher. (A detailed description of the firms and the method are available from the author.)

GENERAL MODEL OF STRATEGIC CAPABILITY TRANSFER

A strategic capability is a firm's ability to use its skills, resources, knowledge, or ways of organizing in ways that would lead to or sustain a competitive advantage. Two general choices are available to firms to renew their competitive positions: internally develop new strategic capabilities or bring those capabilities in from outside. In situations

where the new capability will not be isolated in an independent unit, a transfer of strategic capabilities is required between the part of the firm with the capability and the part requiring renewal. Accordingly, the strategic capability transfer (SCT) process becomes central to the entire strategic process in the firm and to its long term survival.

A comprehensive discussion of the SCT process would address these questions:

1. What is transferred?
2. What mechanisms are used in the transfer process
3. What happens as a result of the transfer?
4. Who is involved?
5. When does the transfer take place?
6. In what direction does transfer occur?
7. What is the source of impetus for the transfer?

However, an approach that addressed these questions individually and sequentially would not take into consideration the interactive nature of the phenomena and would be subject to the same problems discussed above plaguing extant research on acquisition integration. Accordingly, the general model of the forces that affect SCT proposed here addresses the independent questions above while at the same time providing a broad framework within which each question can be addressed interactively.

Figure 1 outlines the basic framework of the model. The ultimate outcome of the SCT process is seen to be dependent on a set of enabling conditions which, if met, allow the transfer of strategic capability between the firms to occur. In turn, these enabling conditions are influenced by event-specfic contextual factors related to the capability being transferred and by organization-specific contextual factors related to the firms or subunits involved. The contextual factors serve to condition and prescribe the enabling conditions. Mediating between these contextual factors and the enabling conditions are three process impediments that affect the ultimate outcome of the SCT process by limiting the existence of the enabling conditions.

...Insert Figure 1 Here ...

The key elements of the model that are unique and have not been addressed before are the enabling conditions themselves and the ways in which the process impediments mediate between the enabling conditions and the two sets of contextual factors. Accordingly the enabling conditions, the process impediments, and the interactions among them will be explored in detail. The event-specific and organization-specific contextual factors have not been separated as such before and as such their separation in this model may offer insights into the ways in which they operate in the SCT process. However, because the contextual factors have been the focus of a good deal of research, a detailed description of each is beyond the scope of this paper. Although this model may be generalizable to instances of SCT beyond related-business acquisitions, the data for this study are from related business acquisitions and the focus of this discussion will be in the context of acquisition integration for purposes of clarity and consistency of argument.

Enabling Conditions

The SCT process involves the transfer of skills, knowledge, resources, or ways of managing between two different organizational units. The anticipated outcome is an improvement of the competitive advantage of one or both of the organizational units. Four conditions are hypothesized to be necessary for SCT to take place.

1. Cause effect knowledge of how the benefits will occur.

2. Reciprocal knowledge by both firms of the systems and operations of the other.

3. The existence of a willingness and capacity to both transfer and receive the strategic capability.

4. Organizational slack

Cause-Effect Knowledge of Benefits

The raison d'etre of a related business acquisition is to improve the competitive position of one or both of the firms by the transfer of strategic capability between them. For this transfer to take place, the people involved must understand the:

a. Types of benefits to be gained and why they occur.
b. Method of transfer.
c. Predictability and timing of the benefits.

Types of benefits and why they occur. For the SCT to lead to a sustainable competitive advantage, the people involved must be able to understand how the benefits lead to a competitive advantage and be able to replicate those benefits over time. That is, they must understand the ways in which the skills, resources, knowledge, or ways of organizing lead to changes in the characteristics of their firm that will cause their products and services to be preferred over competitors' products.

Benefits from related business acquisitions are presumed to result from synergy, the ability to accomplish something as a result of the combined actions of the two firms that wasn't possible individually. This view is reflected in the acquisitions literature in various ways. Salter and Weinhold (1979) see the realization of potential synergies resulting in value creation through either an increase in the income stream or a reduction in the variability of that income stream. Jensen and Ruback (1983) suggest that increase in value comes from an opportunity to use specialized resources that arise as a result of the merger. Similarly, Bradley, et. al. (1983) suggest that acquisitions by tender offers are attempts by bidding firms to exploit potential synergies.

Synergy is an idea that is conceptually appealing but operationally difficult to articulate. As Table 1 indicates, types of synergy benefits from acquisitions are defined in a variety of ways. But, the common theme

is that synergy is the result of a transfer of strategic capabilities which improves the relative competitive position of the firm. For the purposes of this paper, synergy in acquisitions is defined as the benefits arising from the transfer or sharing of skills, knowledge, resources, or ways of managing that lead to an increase in one of the firm's competitive positions.

...Insert Table 1 Here...

Methods of SCT. Beyond an understanding of the types of benefits and how they occur, people involved must understand the ways in which SCT takes place. Three general methods of SCT are possible:

(1) Tangible resources (e.g., capital, production capacity) can be made available to or given to one of the units by the other.

(2) Resources, skills or knowledge can be shared between the two units.

(3) One party may teach the other a particular skill or aspect of knowhow that will allow them to operate independently.

Predictability of Timing and Benefits. A recognition and understanding of how the benefits are to be gained begs the question of the predictability and timing of those benefits. Those benefits from acquisitions that are predictable in outcome and timing when the acquisition is first made are usually associated with cost reductions due to the elimination of duplicate assets or personnel.

In contrast, it is more difficult to predict the outcome and timing of benefits resulting from the transfer of managerial knowhow and specialized skills. There are two related reasons for this. First, frequent interaction between provider and user will be required to understand how to transfer the more specialized knowledge. As Teece (1983) points out, the nature of these interactions cannot be specified *ex ante* because of the tacit nature of the knowhow being transferred.

The second reason that prediction is difficult is that working together may lead to discoveries of benefits that weren't anticipated as part of the original conception of the acquisition. Such discoveries usually occur at the middle management and operating levels where the two groups come together and the work actually gets done. These interactions can't be predicted beforehand because the acquisition analysis process is centralized at the senior management level with little involvement by middle and operating level personnel (Jemison and Sitkin, 1986).

In summary, the first enabling condition for SCT requires that the people involved understand how benefits from the acquisition are to be gained. Acquisition decisions are usually made on the basis of more predictable, quantifiable benefits. But, the process of gaining synergy from the acquisition is evolutionary. The more that the two groups interact, the more they can understand the possibilities present if they work because of the exchange of tacit knowledge. Understandings reached through this interaction are aided by the next enabling condition, reciprocal systems knowledge.

Reciprocal Systems Knowledge

The second enabling condition for SCT is that the two firms or subunits must understand the way each other operates to the extent necessary to work together and either benefit from or transfer a strategic capability. As such, this includes a knowledge of and appreciation for the organization-specific contextual factors including the other organization's motives, systems, methods of operation, history, and culture and provides an appreciation for the context from which or into which the strategic capability is being transferred.

It is not suggested here that the two parties must necessarily be coopted into the other organization's way of doing things and culture. But,

for a transfer of tacit knowledge to take place, the other party must be able to put that knowledge into its original context and understand how and why it works. Then, steps can be taken to insure that it can be applied correctly in the new situation.

This reciprocal systems knowledge suggests the presence of a two-phased learning process in SCT. Each party must first learn about the other and then about the strategic capability to be transferred. The depth of knowledge required of the other organization will depend on the type of capability to be transferred as well as the method of transfer. Regarding the method of transfer, "giving" requires little or no reciprocal knowledge because it presumes that the capability is essentially fungible and its successful use is context free. "Teaching" implies that learning that can be both retained and replicated must take place. "Sharing" implies that each party initially learns how to use the capability and then the two parties either use the capability together (e.g., a distribution system) or separately (capital, skill). In either case, before learning takes place, there must be an understanding of the other party.

When the strategic capabilities are based on tacit knowledge, there is a greater need for reciprocal systems understanding. But, the application of managerial skills and technical knowhow is often context-based and as such difficult to transfer from one organization to another. Within the framework of SCT then, the two firms must have an understanding of the others' operations to the extent necessary to put the capability to be transferred into context. This understanding is developed through either direct experience, modeling, or observation (Bandura, 1971). Experience seems to be the most necessary for the retention of tacit knowledge (Bandura, 1971; Nelson and Winter, 1982). Retention of tacit knowledge requires a reciprocal understanding of each others' organization to appreciate the context in which the knowledge can be applied.

However, this type of learning becomes more difficult the more tacit and people based the knowledge and skills are. The ability of the sending organization to teach may be impared by the tacit nature of the knowledge. As Polyani (1958) suggests, although people may be able to do something they may not be able to explain how to do it. For SCT to occur, a process of interaction involving trial and error may be necessary to develop a memory of this tacit knowledge (Nelson and Winter,, 1982).

Willingness and Capability to Transfer

Beyond cause-effect knowledge and reciprocal systems understanding, both parties involved must have the capabity to effectively contribute to the SCT process. Each must be both capable and willing to send or receive the skills, knowledge or resources to be transferred. If any of these are missing, the SCT cannot take place.

Capacity to transfer means that the capabilities to be transferred indeed exist in the organization (or its members) and are not a figment of someone's imagination. Capacity to receive implies that the group that will be improved has the requisite intellectual and organizational capacity to use the skills knowledge, resources, or ways of organizing once it has access to them.

Willingness to send or receive the capability is usually the real problem. People in the organization who are asked to transfer their capability may be too protective about what they have been asked to send, share, or teach. Often, they were not involved in the decisions to acquire and thus cannot see the strategic benefits. Their careers may be caught up in the particular capability forcing them to focus on a specific functional orientation (Dearborn and Simon, 1959), or they may presume that they might lose control over a scarce resource within the firm that gives them power (Pfeffer and Salancik, 1979). Correspondingly, people in the receiving

organization may be too protective of their old ways of doing things because of a link to the past, uncertainty over the implications of changing, or inability to conceptualize what the change is.

Organizational Slack

Organizational slack is the final enabling condition and is necessary for SCT in related business acquisitions at both the parent and subsidiary levels. The uses, however are different at each level. Slack must be available in the parent corporation to provide both protection and maneuvering room for the subsidiary where SCT is expected to take place. This means that there must be sufficient resources available at the total organizational level (i.e., available to the parent firm) to first provide the resources needed for the SCT. Beyond that, slack is needed to allow for unexpected events in all parts of the firm that could take away resources from the unit involved in SCT. In addition, the slack at the parent firm may be necessary to prevent a premature fixation on performance when performance of the new subsidiary doesn't immediately meet expectations.

At the subsidiary level, slack is necessary to provide maneuvering room for the middle managers actually involved in managing the SCT. This gives them the opportunity to deal with unanticipated events, smooth political problems (Bourgeois, 1981) and make side payments (Cyert and March, 1963).

Summary of Enabling Conditions

Four enabling conditions are argued to be necessary for SCT to take place: cause-effect knowledge of the benefits, reciprocal systems knowledge, willingness and capacity to both transfer and receive the SC, and organizational slack. These enabling conditions are hypothesized to be interactive and their relative importance will vary as a function of the event specific and organizational contextual factors.

Traditional research and prevailing wisdom regarding acquisitions have suggested that "integration" is necessary for benefits to occur. But, integration has always been described as a black box and a question that remains is "What is required for integration to take place?" The model proposed in this paper, the focus on strategic capability transfer directed toward improving a firm's competitive position, and the enabling conditions suggested here as necessary for SCT may provide insights into that question.

Process Impediments

In an earlier article, Jemison and Sitkin (1986) proposed a process perspective for studying acquisitions. This perspective suggests that the acquisition process itself is a potentially important determinant of both acquisition activity and outcomes. Aspects of the process dealing with analysis and negotiation of the acquisition agreement were the focus of that paper. In contrast, this paper focuses on aspects of the process that generally take place after the agreement is reached, activities sometimes referred to as acquisition integration.

The model proposed here suggests that the ultimate outcome of the SCT process is dependent upon the occurrence of four enabling conditions. These enabling conditions are in turn affected by contextual factors surrounding the acquisition itself and the organizations involved in the SCT. But, mediating between the contextual factors and the enabling conditions are three process-based impediments that affect the firms' ability to meet the enabling conditions.

These process-based impediments include determinism, value destruction, and leadership misdirection and are seen as a primary reason that SCT does not occur in acquisitions. Ironically, the roots of the process-based

impediments are deeply embedded in the same event and organization-specific contextual factors that affect the existence of the enabling conditions.

Determinism

THE ORIGINAL CONCEPTION OF THE ACQUISITION, THE DETATCHMENT OF THE SENIOR MANAGERS DURING THE ANALYTICAL PROCESS, AND THE MOMENTUM OF THAT PROCESS LEAD TO A UNITARY THEORY OF THE ACQUISITION'S PURPOSE. THE RESULT IS A FALSE SENSE OF SECURITY AND A DETERMINISTIC PHILOSOPHY OF SCT. WHEN CONFRONTED WITH STOCHASTIC EVENTS, A CYCLE OF CONFUSION AND FRUSTRATION SETS IN, LEADING TO AN INCREASING COMMITMENT TO THE UNITARY THEORY AND A REDUCED CHANCE THAT SCT WILL OCCUR.

Acquisitions are often initially imbued with the aura of a unitary theory of the acquisition's purpose and how value will be created. In related business acquisitions, this theory describes how competitive advantage will be improved via the transfer of strategic capabilities. This unitary theory of an acquisition stems from three sources: the original conception of the acquisition's purpose, managerial detatchment during the process of analysis and negotiations, and the momentum in that process. Although initially useful, this unitary theory reduces the ultimate chance of SCT because of an increased commitment to the theory brought on by a false sense of security as well as a reaction to stochastic events in the process. Figure 2 points out the dynamics involved in this impediment.

... Insert Figure 2 Here...

The original conception of a related business acquisition's purpose is often developed without an indepth knowledge of how the the transfer of strategic capabilities will take place. This is ironic because SCT must take place for a related business acquisition to fulfill its purpose. Managerial involvement during the process of analysis and negotiation is generally characterized by groups of senior managers who are cognitively and physically isolated from their organizations. This isolation and the lack of cause-effect knowledge leads managers to place more emphasis and reliance on quantifiable analyses. In addition, the lack of operating managers'

involvement reduces the chance for reality checks and a more realistic assessment of the possibilities available. When coupled with the momentum that builds in the process (Jemison and Sitkin, 1986), it is hypothesized that these three factors encourage the development of a singular perspective on how value will be created. As a result, the acquisition is conceived and approved with a particular purpose in mind, an initial purpose that will shape a variety of decisions about its future Tichy (1980).

This unitary theory is useful because it provides managers the opportunity to build commitment and offers others the chance to understand in general terms what the acquisition is all about. But, the unitary theory may also result in a false sense of security about the outcome and a resulting tendency to see the outcome as deterministic and predictable. A false sense of security clouds the managers' abilities to understand the cause-effect actually needed for value creation, reduces their perceived need to develop reciprocal systems knowledge, and to recognize that there are stochastic elements in the process. In addition, it creates a sense of comfort and single mindedness about the ways in which the transfer of capability will take place (Janis and Mann, 1977).

A deterministic perspective of SCT also emerges from the unitary theory of the acquisition. That is, the benefits of SCT are seen to be certain and predictable. This deterministic approach to SCT owes its origin to threee sources: a fixed cause-effect model; lack of consideration of the need for systems knowledge; and ambitious, overly-precise performance expectations.

The presence of a fixed cause-effect model of the benefits from an acquisition result from a unitary theory of the acquisition's purpose which causes managers to overestimate the benefits that exist or to impose them where none existed before (Fiske and Taylor, 1984). Once in place, this relatively fixed perspective channels behaviors to predetermined specifics e.g., cut out costs, merge product lines, transfer people. But, because these specifics were often developed without knowledge of how the other

organization worked, opportunities to develop new ideas about combining the firms capabilities are reduced.

The deterministic perspective is also reinforced by the lack of recognition of the need for reciprocal systems knowledge. Senior managers do not know how the acquired firm works because they did not delve into operating details during negotiations. Operating managers do not know each others' systems because they weren't involved in the analysis and negotiations for reasons of speed and secrecy (Jemison and Sitkin, 1986; Teece, 1983). Thus even though conditions may exist for SCT to occur, both parties must be aware of the opportunities and understand how they may gain through such an exchange for the transfer to take place (Kirzner, 1973). A deterministic philosophy of SCT inhibits this understanding.

Precise but unrealistic performance expectations that emerge from the acquisition negotiation also reinforce a deterministic perspective. Performance expectations are often established on the basis of estimates made hurriedly during the negotiations where the tendency is to rely more on judgements of savings and other assumed benefits made without in depth knowledge of the other system. Also, the relatively high premiums paid tend to force senior managers to demand a return on their investment more quickly than is often prudent. The resulting performance expectations for the acquisition are often overly rigorous and precise with little basis in fact. This leads to extremes of satisficing behavior by the middle managers responsible for managing the acquisition and may lock them into an expeditious way of trying to effect the SCT and meet performance hurdles. This quick fix has the tendency to become institutionalized because it offers a solution to the combined pressures of performance and SCT (Zucker, 1983).

A customary way to ease performance pressures is to offer a grace period during which the performance requirements are less stringent. But, promises of autonomy or grace periods are frequently forgotten as the

acquisition becomes a part of the firm and the senior managers now have other goals and parts of the organization that are a higher priority on their time. Additionally, middle managers striving to please or gain favor with their superiors often agree to give up their performance grace periods. These actions follow March's (1978) arguments that managers do not consider their future preferences for the consequences of their current actions because of pressures that they're facing at the moment.

Precise performance expectations also limit the amount of organizational slack available to managers who must bring about the SCT. These excess resources, which can be used for side payments and conflict resolution (Bourgeois, 1981) and as inducements to organizational members to participate (Barnard, 1938) are not available because of controls placed on expenses to meet performance requirements. Tight controls are often initiated by middle level managers, the corporate staff, or senior managers in the acquiring firm who weren't involved in the negotiation process. But, because their responsibilities often lie in bringing together organizational units through budgeting and planning processes, they are less likely to be sympathetic to a group who claims autonomy. Everyone wants something from them during the resource allocation process and there are no incentives to treat acquisitions differently from other parts of the firm.

Returning to Figure 2, the result of these three factors: a fixed cause-effect model, less consideration of the need for systems knowledge and precise performance expectations builds into the firm a deterministic philosophy of how SCT will be transferred, a philosophy which offers little room for experimentation and change.

While this deterministic perspective may exist among some managers, a series of stochastic events often calls it into question. These events include changes in the industry and competition, changes in other parts of the firm, and resistance to the capability transfer from organizational cultures. If the theory of the acquisition has been firmly embedded in the

managers' minds, they will be less likely to appreciate these events as important and will interpret them as anomalies. But, as the frequency of these events increases, a cycle of confusion and frustration will occur, resulting in an increased commitment to the unitary theory of the acquisition rather than opening up the organization to new ideas.

The most common and expected changes occur in the industry and alter the nature of the rivalries present (Scherer, 1971). Although these changes are expected, there is mounting evidence that managerial skills are not transferrable between industries and that effective management often comes from an appreciation and understanding of the subtleties of industry context. Thus, the changes caused by lack of industry knowledge often causes frustration and a retreat to past behaviors. In addition, a deterministic perspective belies a view of an acquisition as an event that is not affected by other parts of the diversified firm, a view that is in opposition to the nature of the operations of a divisionalized firm (Salter and Weinhold, 1979, Williamson, 1975). Not only do the vagaries of the industry affect it, but the vagaries of its sister divisions do as well.

Perhaps the most salient, yet most troubling stochastic event is that caused by the combination of the two organizational entities that are expected to affect the SCT. This is commonly referred to as the clash of cultures (Buono, et.al., 1982; Sales and Mirvis, 1985; Walter, 1985). But, the problems present go deeper than that. The combination of two different organizational entities causes a break with the past when both are asked to accept and develop new ways of doing thing. The result of this is the emergence of ideologies representing the values of the previously separate entities Geertz (1974). These ideologies often serve as focal points for resistance to change and rivalries develop between the two previously separate organizations. But, as Selznick (1957) points out, these rivalries are not merely ego exercises but instead can be interpreted as natural reactions where leaders are defending values with which they have been entrusted.

The net impact of these stochastic events breeds a cycle of confusion and frustration among managers at all levels in both organizations. Senior managers are confused and frustrated because their initial presumptions are being questioned, battered by exogeneous forces, or proven incorrect. The middle and operating level managers are frustrated by the inflexibility of the deterministic perspective encouraged by the senior managers and confused by the signals being sent. They are asked to make the acquisition work but within the original context from which it was derived and not within the realities of the situations in which they find themselves.

This confusion and frustration leads to increased commitment to the original theory of the acquisition, an action which is often the reverse of what might address the problem. Senior managers embrace the original theory because it is what they know and have hoped for. Middle managers embrace it because it's a way to place blame on others for their inability to deal with circumstances beyond their control.

The stochastic nature of the process is often denied because of past history and the human belief that control over chance events is pervasive (Langer, 1975). Commitment increases because of a variety of public and explicit promises and statements made about what the acquisition is expected to do. Although these statements are necessary to develop support among participants for the new organization, the fact that they are public and explicit increases the managers' commitment to them (Salancik, 1977).

The commitment to the initial theory follows Staw's (1976) work on increased investment following failure. Acquisitions are good examples of situations where there is uncertainty regarding a course of action, the behavior is irreversible (in the short term), and the process of choosing causes the firm to organize in a manner consistent with that choice. As a result, the acquisition entraps the managers and becomes an event which once started, is escalated beyond the bounds justified by the value placed on it (Schelling, 1960). The stakes are often raised so high that it is

irrational to play at all (Bentham, 1931). A spiral of resistance to change and increasing commitment begins. The consistency of their actions and commitment thus reinforces the belief in the unitary theory of the action and the managers become less able to alter their behaviors with feedback (Kiesler and Mathog, 1971).

In summary, managers develop an increasing commitment to a unitary theory of an acquisition's purpose based on a deterministic philosophy of how SCT will take place. This commitment results from a cycle of confusion and frustration as well as a false sense of security based on the original theory itself and reduces the chances of ultimate SCT. Table 2 suggests research hypotheses regarding this impediment.

Value Destruction

IN SCT ACQUISITIONS, THE SAME PEOPLE WHO ARE EXPECTED TO CREATE ECONOMIC VALUE FOR THE SHAREHOLDERS HAVE NONECONOMIC VALUE DESTROYED FOR THEMSELVES. THIS LEADS TO A SYNDROME OF SELF PRESERVATION, RESULTING IN AN INABILITY TO MAKE THE SCT PROCESS WORK.

An acquisition whose raison d'etre is SCT requires the involvement and commitment of a variety of people at different levels in both the acquiring and acquired firms. Economic value is seen to be created for the firm's owners through increases in the firm's stock price which is presumed to reflect the firm's improved competitive position as a result of the SCT. The benefits from SCT involve the transfer of skills, knowledge, resources, or ways of organizing and imply changes in the established order and pattern of activities at both the acquiring firm and its new subsidiary. Such changes breed uncertainty, fear, and a tendency for self-preservation on the part of the employees because of the destruction of economic and noneconomic value that is a byproduct of the SCT process. Figure 3 points out the dynamics involved in this impediment.

...Insert Figure 3 Here...

Economic value is destroyed for employees because of the loss of jobs, job security, or benefits as a result of eliminating redundancies and standardization of operating procedures. Destruction of noneconomic value for employees is more insidious and more subtle. It comes from the rumors, actions, and real or imagined decisions that have been taken that will directly affect the lives of the participants. Examples include loss of status associated with a particular organization, disruption of a career path (Reibstein, 1985), less job satisfaction, changed roles (Gill, 1978), and general uneasiness created by observing uncertainty among colleagues (Sinetar, 1981). These problems are exacerbated by differences in size of the two organizations (Kitching, 1967; Wicker and Kauma, 1974).

The destruction of noneconomic value causes a natural set of moves toward protection and self-preservation among the managers and employees expected to make the acquisition work. These manifest themselves as a reduction in commitment to the organization and to SCT, a reluctance to change, and a retreat to old norms. A decline in the individual's commitment to the organization is present because members perceive a qualitative change in the nature of the exchange relationship they have established with the firm (Emerson,1962). The inducements present at one time have in their perceptions have been dramatically altered in relation to the contributions they are asked to make. The resulting reduction in commitment discussed here is in dramatic contrast to the escalating commitment to the acquisition decision present among some key decision makers in the firm (Schwenk, 1986; Staw, 1976). Ironically, the disparities in these commitments may result in increased performance pressures on the operating managers.

This move to self-preservation also manifests itself in a reluctance to change and a desire to hold onto the old values present in the firm. The sources of resistance are different over time and manifest themselves in

many different ways (Buono, et. al., 1985). This resistance to change is consistent with Stinchcombe's (1965) argument that organizations often do not change in character and structure after a change in the environment. In effect, the acquired organization has had a change in its environment but has not changed itself.

In summary, the process of SCT is intended to create economic value for the shareholders of the acquired and acquiring firms. However, as was shown above, SCT only take place through people. Important elements of noneconomic value such as job security, promotion, career opportunities are often threatened, reduced or eliminated by an acquisition with SCT as its logic. Thus, the same people who are asked to create the economic value simultaneously have noneconomic value destroyed for them. This presents a substantial problem of moral hazard that reduces the prospect of creating economic value. Table 2 suggests research propositions to further test aspects of the ideas presented here.

Leadership Misdirection

TOP MANAGEMENT OF FIRMS ATTEMPTING SCT ACQUISITIONS WILL FOCUS MORE ON CONTENT AND PERFORMANCE EXPECTATIONS WHILE MIDDLE MANAGEMENT WILL FOCUS ON INTERPERSONAL LEADERSHIP. THE RESULTING VOID OF INSTITUTIONAL LEADERSHIP AND LACK OF CONTENT FOCUS AT THE MIDDLE AND OPERATING MANAGER LEVELS REDUCES THE CHANCES FOR ULTIMATE SCT.

An acquisition based on SCT is dependent upon putting two organizations together, each with separate histories, cultures, management styles, etc. This combination will naturally breed resistance and requires that the senior management take steps to enable the creation of a single, new organization, an amalgam, where two had existed in the past. But, creation of a new organization requires institutional leadership and protection, aspects of which are not present because the senior management is too focused on issues of content and performance and because middle management's time is spent in interpersonal leadership issues.

The top and middle management of firms attempting SCT often find themselves unable to bring about the SCT because of an inability to get the two different organizations to work together. This has generally been seen as a problem of differing organizational cultures (Sales and Mirvis, 1985) or management styles (Davis, 1978, Hayes, 1979). This paper suggests a different perspective and proposes that the difficulties arising in SCT often result from a misdirection of the leadership activities at both the top and middle management levels. Cultural and management style differences are only seen to be a part of a larger set of problems caused by leadership misdirection. See Figure 4 for a depiction of the dynamics involved here.

...Insert Figure 4 Here...

The general model proposed in this paper suggests that SCT will take place if certain enabling conditions are met (refer to Figure 1). These enabling conditions imply a need to focus on both the content of the SCT as well as the process aspects of the transfer. In many cases, there is a leadership misdirection at the top and middle management levels that reduces the chance that these enabling conditions can be met.

Misdirection in leadership occurs at both the top and middle management levels after an acquisition takes place. Top management focuses on content and performance related issues even after the acquisition agreement, at the expense of addressing the process aspects of institutional leadership. This content and performance focus comes from their perceived role of creating a strategic vision for the firm as well as pressures associated with the acquisition process. In contrast, middle management focuses in interpersonal leadership tasks and less on either institutional leadership or the content aspects of making the acquisition work. Middle management's concentration on interpersonal leadership results from heavy demands on them as the key people on the scene who must manage the multiple organizational disruptions caused by the acquisition.

In addition to a focus on the content aspects of the SCT, both institutional and interpersonal leadership are hypothesized to be necessary for SCT to take place. Institutional leadership is needed to allow the newly joined organizational units to define a common purpose within which they can work and interpersonal leadership is needed to smooth operating differences between the two groups. But, as Figure 4 points out, there is a void in institutional leadership during the SCT process.

At the time of an acquisition, two firms or parts of firms are brought together, each of which has its own history. Both of these organizational units are expected to embrace a new, often ill-defined concept involving them both that is intended to bring about SCT. Thus, there is a need for institutional leadership for the new group to help it define a role and mission and to become an organizational entity on its own.

Recent research points to the importance of the role of the individual during times of organizational transformation and creation (Kimberly, 1979; Miles, 1980). In this light, the role of the institutional leader takes on a unique character in SCT acquisitions. The leader must develop in the combined organizations the ability to find better solutions to the problem at hand and thus solve the content problem (SCT as envisioned by acquisition's purpose). In addition an identity for the new group, perhaps different from its previous identity, must be developed that incorporates the need for SCT.

But, the new concept or purpose causes a break with the past and as a result, the separate ideology of each organization emerges (Geertz, 1974). These ideologies represent basic values held by the organizations' members that are more or less assumptions about why people should behave in certain ways. The respective executives in each of the firms defends these values, not as an ego exercise but as a legitimate function given the values with which they've been entrusted (Selznick, 1957). Consequently, institutional leadership is necessary during SCT acquisitions to help these two groups to

build a combined ideology (Selznick, 1957) and to provide psychological safety for the group to understand that a change is needed (Goffman, 1951). But, this psychological safety is difficult to provide when there is a content and performance focus by top management instead of an emphasis on building a new institution and providing overall organizational safety.

This content and performance focus has several sources, each of which limits senior management's effectiveness in contributing to the SCT process. One source is senior management's perceived role that their mission is to create a strategic vision for the new organization and that detatchment needed to provide objective judgements about ultimate acquisition performance. In addition, particular performance requirements are more measurable and offer beacons for both the external world as well as people inside. This focus is often in response to outside pressures for performance from board members or the financial community. In addition, a content focus reflects the lack of knowledge that the senior managers have about each others' systems and procedures.

Aspects of the acquisition process are the other factor driving top management to a general content focus (Jemison and Sitkin, 1986). The division of labor necessary in the analysis and negotiation and the momentum of the process precipitate and encourage a perspective on the outcome that is very content and performance oriented, a perspective that doesn't include organizational considerations. Additionally, resolution of questions on key aspects of how to manage the acquisition are often postponed until after the agreement and are then delegated to middle mangers who weren't involved in the negotiating process. The combination of these factors is such that senior management is often far removed from an understanding of cause-effect knowledge of the capability transfer and reciprocal systems knowledge.

Middle managers at the new subsidiary should be the focal point for content related activity regarding capability transfer. Detailed involvement at their level is necessary to insure actions toward the purpose

of the acquisition. But, the pressures of trying to bring two disparate organizations together forces middle managers to focus primarily on process issues of interpersonal leadership. As a consequence, they often neglect content issues even though premature pressure is placed on them for performance.

The middle managers' emphasis on process comes from two separate but related phenomena. First, when a related business acquisition takes place, business as usual stops because of the uncertainty created for employees and managers about their futures. As a result, middle managers spend a disproportionate amount of their time on people and organizational issues until a new equilibrium is reached. This takes time because neither firm knows what it has gotten itself into. Second, the purpose of the acquisition is often vague with little reciprocal understanding present in the two firms. The expected capability transfer is presumed to be possible but the cause-effect details of it aren't known because of barriers in the acquisition process (Jemison and Sitkin, 1986). Consequently, middle managers then are forced into a position where they can't predict the outcome so instead they deal with the correctness of the process (March, 1981).

In summary, it is argued that the chances of SCT are reduced because there a misdirection of leadership at both the top and middle management levels. Less attention is given to the actual content of what should happen (how to bring about SCT) because the middle managers focus on process issues and neither middle managers nor senior managers provide institutional leadership that could allow the new organization to develop a sense of identity and begin the process of institutionalization.

SUMMARY

An integral aspect of making related business acquisitions work is the integration process. However, extant research has treated integration as a set of indeterminate processes in a black box. The capacity to "successfully" integrate an acquisition has been attributed to the ability to deal with a variety of the processes that took place within that black box (e.g., managerial styles, organizational cultures, control systems). But, because the interrelationships within the black box of integration have not been described, few advances in our understanding of the overall process have been made.

This paper suggests that insights into these questions may be gained if integration is viewed in a more general, instrumental way. This perspective sees the raison d'etre of related business acquisitions as the transfer of strategic capabilities that would lead to a comparative advantage. A model of the forces involved in this more general process was proposed within which the issue of acquisition integration can be subsumed. As such, the model may offer several advantages for research and practice over current conceptions of acquisition integration.

First, the model provides a broader perspective on the nature of how firms gain benefits from combinations with other firms. The model acknowledges that integration requires an understanding of the content of the SCT as well as the process by which it comes about and suggests that the process and content of integration interact to bring about the ourcome of SCT. In particular, a shift by researchers away from the individual contextual factors in the model toward the enabling conditions in the model and the ways in which the process impediments interact with them may lead to insights into the nature of the SCT process. Research propositions accompanying the model suggest possible directions for exploring the questions in more depth.

Beyond the model developed here, the paper begs some interesting and important questions for strategic management research. Many firms seem to be choosing methods of strategic renewal that require the combination of firms in some way or another (e.g., joint ventures, license agreements, acquisitions, technology sharing arrangements). Existing theories of strategic management and organizations do not deal adequately with these hybrid combinations for several reasons. Hybrids often (1) have an immediate presence because of history or size, (2) have performance expectations that are rapid and externally imposed, (3) lack a common environment or domain, (4) must work together to bring about the anticipated benefits of the combination. The model of SCT proposed in this paper may provide insights into these issues of strategic renewal using hybrid organizational combinations beyond the realm of acquisition integration.

The transfer of strategic capabilities that will lead to a comparative advantage is at the heart of not only related business acquisitions but also a variety of other strategic combinations. It is hoped that the ideas proposed here will not only offer insights to those studying such problems but stimulate other exploration that will further elaborate and refine them.

FIGURE 1

transferring strategic capabilities
between units of the firm

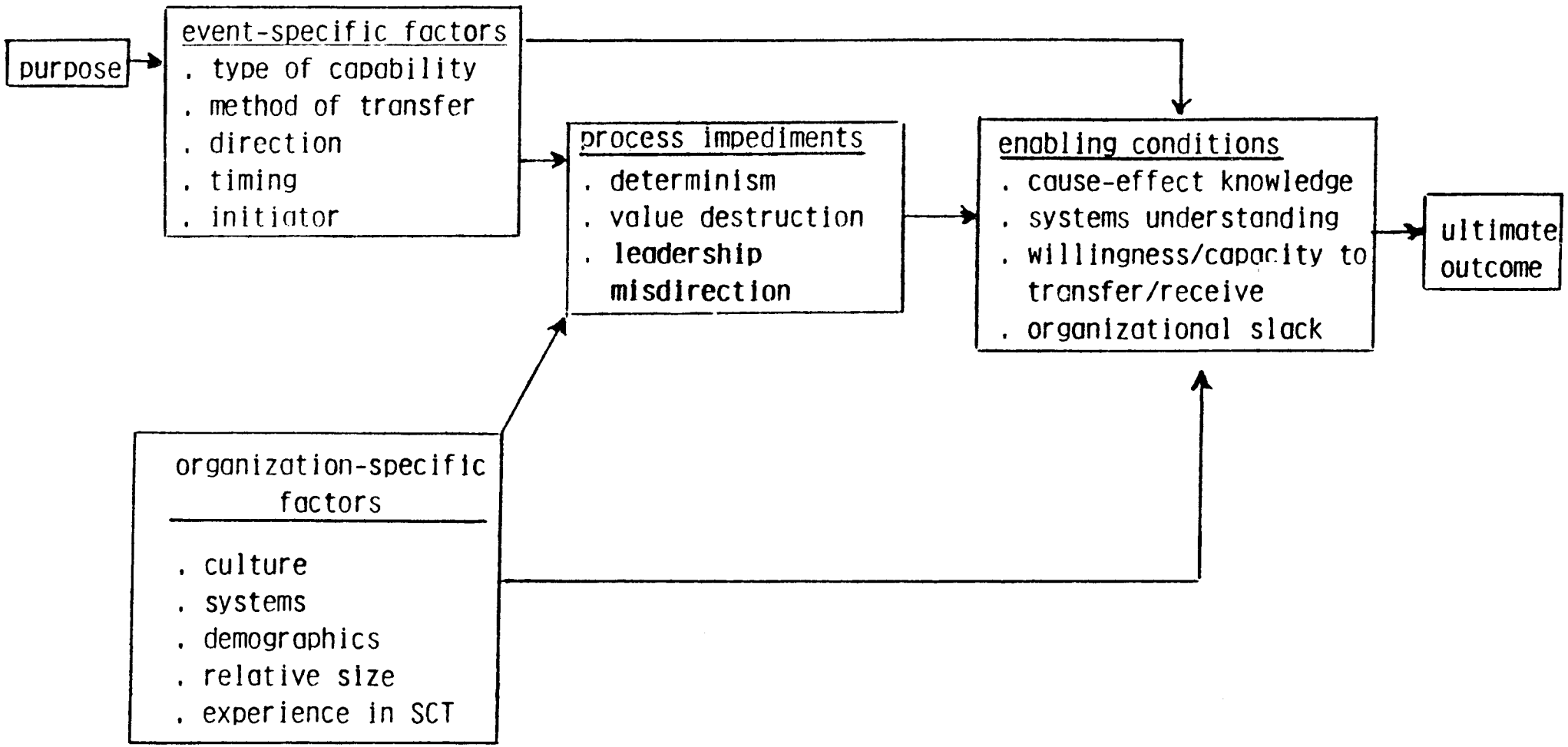

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figure 2

determinism

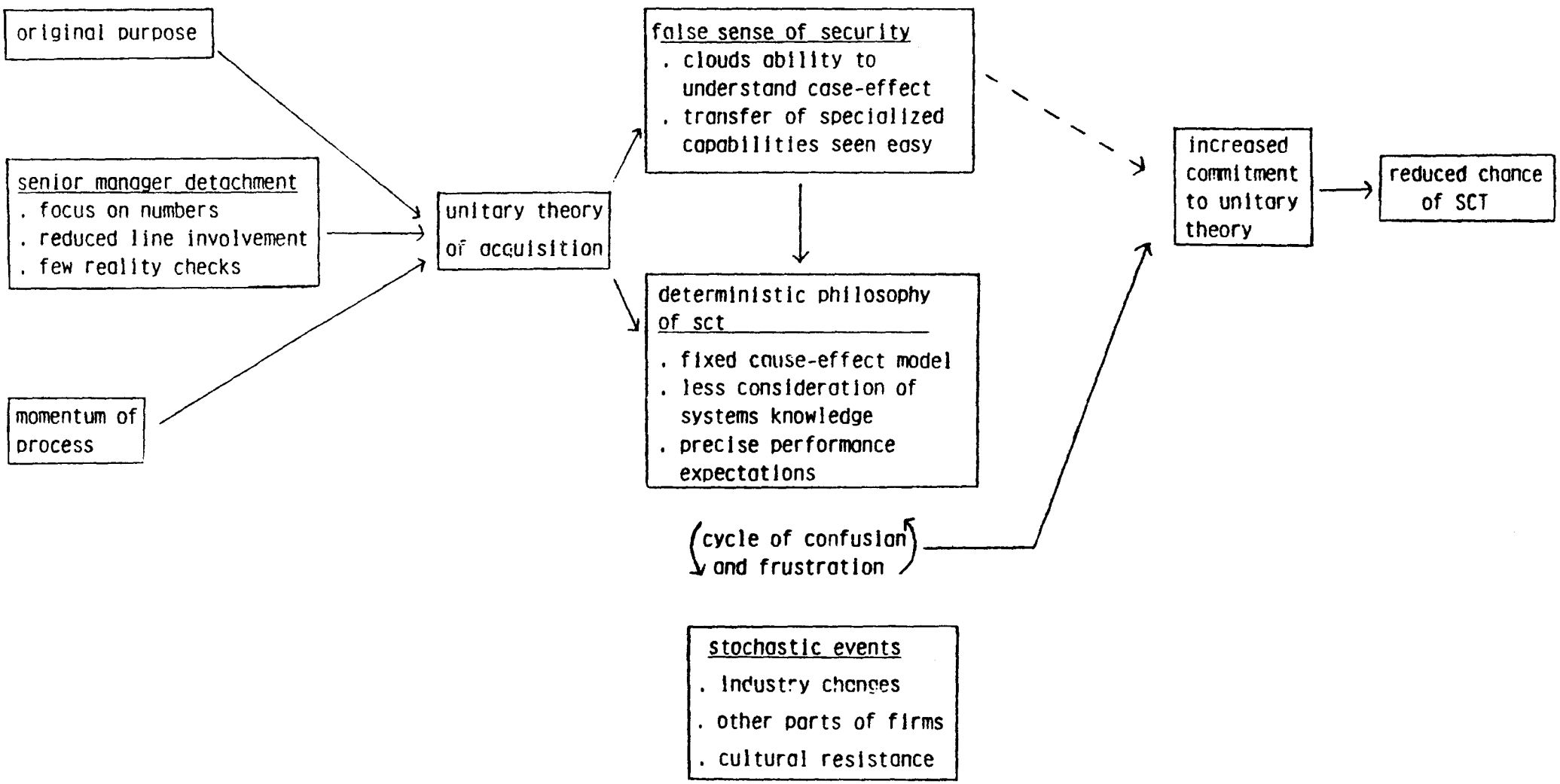

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figure 3

value destruction

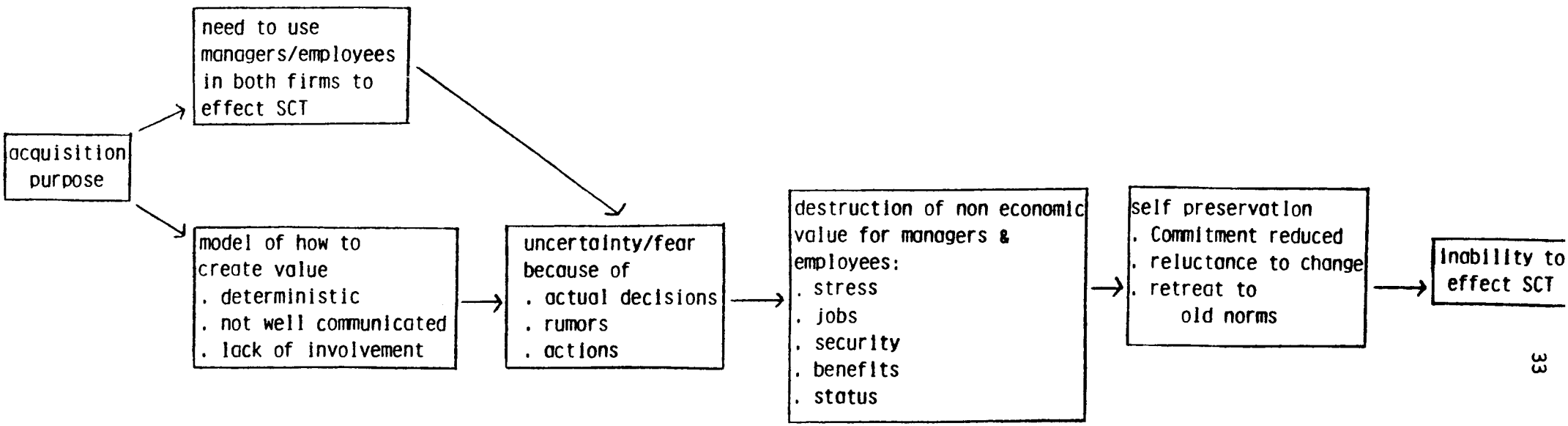

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Figure 4
LEADERSHIP MISDIRECTION

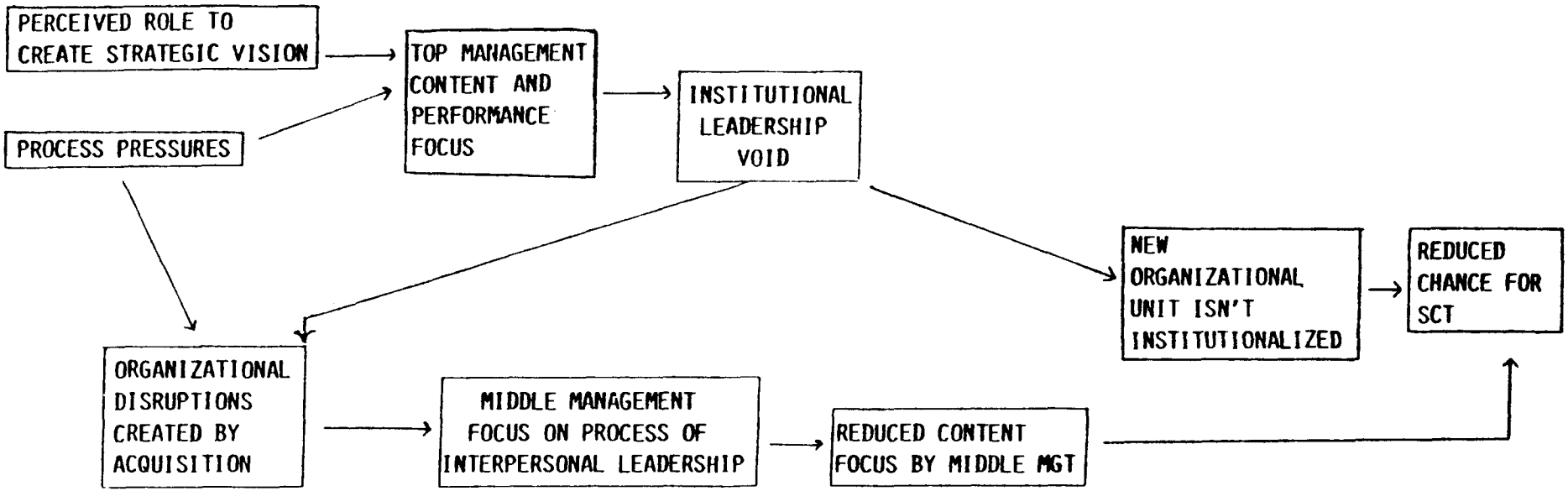

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Table 1

Types of Synergy in Mergers and Acquisitions

Lubatkin (1983)

Technical economies (reduction in average costs)
Pecuniary economies (market power through size)
Diversification economies (cost of capital related)

Chatterjee (1986)

Financial (reduced cost of capital)
Operating (reduced production cost, increased administrative efficiency)
Collusive (market power)

Bradley, Desai and Kim (1983)

More efficient management
Scale economies
Improved production technologies
Combination of complementary resources
Market power

Harris, et. al. (1982)

Market power
Scale economies
Management efficiencies
Diversification and life cycle phases

Table 2

Propositions Concerning
Process Impediments and Strategic Capability Transfer

Determinism

1. A unitary theory (singular perspective) will tend to dominate the thinking in an acquisition:

   1.1 The more senior managers are detatched during acquisition analysis and negotiations.
   1.2 The faster the acquisition is completed.
   1.3 The less line managers are involved in the acquisition analysis and negotiations.

2. An increased commitment to a unitary theory of an acquisition will reduce the chance of SCT:

   2.1 as the need for required, reciprocal knowledge of the other firm is increased.
   2.2 The less fungible the SC to be transferred is.

3. A deterministic philosophy of SCT will result from the unitary theory of the acquisition and a false sense of security pervading the unitary theory.

4. The impact of stochastic events on this deterministic philosophy of capability transfer leads to a cycle of confusion and frustration.

5. This cycle of confusion and frustration increases the participants' commitment to the unitary theory of the acquisition:

   5.1 The less related the businesses between which capability transfer is expected to take place.
   5.2 The greater the variability in the performance of othe businesses in the acquiring firm's portfolio.
   5.3 The greater the size differential between the two firms.
   5.4 The less fungible the capability to be transferred.
   5.5 The greater the cultural differences between the two firms.

6. An increased commitment to a unitary theory of the acquisition will lead to:
   6.1 A decrease in the perceived need to gain evolutionary cause-effect knowledge
   6.2 A reduction in the perceived need to develop reciprocal systems knowledge.
   6.3 A belief that precise performance measurements of the SCt benefits are appropriate.

Leadership Misdirection

1. Senior management of the acquiring firm will focus their attention on the content aspects of the SCT rather than the process aspects.

2. Senior management's content focus will lead them to reduce their attention to the institutional leadership needs in the SCT.

3. Senior management of the acquiring firm will focus relatively more of their attention on content and performance issues and less on interpersonal issues:

   3.1 The more fungible the strategic capability to be transferred.
   3.2 The faster the acquisition took place.
   3.3 The less related the two businesses between which SCT is expected.

4. Middle managers attention will be drawn away from content aspects of the acquisition (the details necessary to make SCT happen) by the need to act as an interpersonal leader dealing with the personal disruptions among employees resulting from the acquisition.

5. Middle managers will:

   5.1 Focus initially on interpersonal processes designed to limit disruptions among the employees caused by the acquisition.
   5.2 Only begin to deal with content aspects of the acquisition after the employees' personal disruptions are settled.

6. Personal disruptions requiring interpersonal leadership from middle managers will be:

   6.1 Negatively related to the fungibility of the capability being transferred.
   6.2 Positively related to the magnitude of the cultural differences between the two firms.
   6.3 Positively related to the speed with which the acquisition took place.
   6.4 Negatively related to the involvement of middle managers in the analytical process.
   6.5 Greater the sooner results are expected from the SCT.
   6.6 Negatively related to the relative size where acquisitions of more equal size will have greater disruptions.
   6.7 Related to relative size in a U-shaped function with acquisitions of least equal size and most equal size having the fewest problems, the former because of the absolute domination by thhe parent and the latter because of a need to reach an accomodation between the two firms.
   6.8 Greater the more ambiguity is present after the acquisition agreement.

Value Destruction

1. Managers and employees affected by an acquisition will experience an uncertainty and fear of the future as a result of the acquisition.

2. This uncertainty and fear will lead to tendencies for self preservation including reduced personal commitment to their firm, reluctance to change, retreat to old norms and practices, and opposition to the acquisition.

3. These tendencies toward self preservation will limit their ability to contribute to SCT.

4. The degree of uncertainty and fear of the future among the mangers and employees expected to bring about SCT will increase and their tendencies for self-preservation will increase:

   4.1 The less information they have about the acquisition's purpose.
   4.2 The more fungible the capability to be transferred.
   4.3 If the acquisition is a hostile takeover.
   4.4 If the capability to be transferred lies in proprietary processes that must be willingly shared between the two parties.
   4.5 As managers or employees perceive themselves as redundant.
   4.6 The greater the differences in benefits packages for the managers and employees between the two firms.

5. Tendencies toward self-preservation among those expected to bring about SCT will be attenuated if:

   5.1 They have a good understanding of the other firm and its methods of operation.
   5.2 The two groups are brought together to solve a common external problem.
   5.3 The managers responsible for running the acuisition were involved in the negotiation and analysis.
   5.4 The capability to be transferred is to be given from one to another rather than either shared or taught.
   5.5 There is organizational slack in the acquiring company that is used to provide both protection and maneuvering room for the subsidiary managers in the acquired company.

6. Destruction of elements of nonecomic value wlll be more important and lead to self-preservation tendencies:

   6.1 The longer the employee has worked for the firm.
   6.2 The higher the individual's level in the firm.
   6.3 The more psychologically committed the individuals are to the capability to be transferred.
   6.4 The less fungible and more tacit knowledge based is the capability to be transferred.

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