

## MANAGING THE PRECOMBINATION PHASE FOR ENHANCED MERGER AND ACQUISITION SUCCESS

**Andrej NARALOČNIK\***

IEDC Bled School of Management, Slovenia

**Andrej BERTONCELJ**

University of Primorska, Slovenia

**Abstract.** The aim of this paper is to investigate the precombination phase of merger and acquisitions (M&As). The study of two implemented M&A cases in Slovenia shows that the precombination phase and related groups of success factors highly contribute to overall success with M&A. The proposed paradigmatic model may serve as an additional reminder when companies join forces. Study results show that precombination phase considerations lead to the notion of compatibilities and complementarities between combining companies; commonly referred as strategic, organizational and financial 'fit' and that indicated groups of strategic, financial and organizational success factors can be classified towards such 'fit' areas.

**JEL Classification:** E 22, D 23, G 34

**Keywords:** mergers and acquisitions, precombination phase of M&A, strategic intent, strategic fit, financial fit, organizational fit, Slovenia

### 1. Introduction

While 2014 was a record-breaking year in terms of mergers and acquisitions activity (hereinafter referred as M&A) in excess of US\$ 3.5 trillion worth of transactions, forecasts point toward an even higher level of M&A activity for 2015 (Thomson Reuters, 2014). Empirical studies suggest that more than half of them fail to produce results at best they are break-even situations (Schraeder and Self, 2003; Bertoncej and Kovač, 2008; Hassan et al., 2007). Billions of euros are spend on M&A with diminishing results.

This study examines two M&A case practices being adopted in the pre-combination phase of an M&A – 'a period that typically has not been utilized by leaders to put deals on the track toward success' (Marks and Mirvis, 2015:1). The focus of

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\* Corresponding author. Address: IEDC Bled School of Management, Prešernova cesta 33, 4260 Bled, Slovenia, Email: andrej.naralocnik@siol.net

the paper is pre-combination M&A phase; 'it encompasses strategizing, scouting, assessing and selecting a partner, deal structuring and preparing for eventual combination' (Marks in Mirvis, 2010:53). Precombination phase is understudied and thus appealing to M&A scholars and practitioners (Very and Schweiger, 2001; Hubbard, 2001; Bruner, 2004; Harding and Rouse, 2007). Underlying presumption is that thoroughly prepared, effectively organized and competently led acquirers can better obtain, accumulate and apply essential M&A related knowledge throughout the transaction. As such, they can continuously improve and build on their corporate M&A capabilities. Being able to proactively build such strategically vital capabilities, at best, greater than those from emerging competitors, implies distinctive competitive advantage. As a result, sought for strategic objectives are more likely to be achieved and distinctive M&A related core competencies can be developed.

The research objective was to identify what were the most important groups of strategic, financial and organizational success factors in the context of pre-combination phase and how acquirers' strategic motive-intent (Bower, 2001) for M&A factored in. More specifically, study aim is to identify the most relevant groups of strategic, financial and organizational success factors in the context of precombination phase. Such precombination considerations lead to the notion of compatibilities and complementarities between combining companies; commonly referred as strategic, organizational and financial 'fit' (Lee and Pennings, 1996; Clemente and Greenspan, 1998; Harding and Rouse, 2007; Sirower, 1997). Acquirer's strategic M&A intent (Bower, 2001; Hubbard, 2001; Marks and Mirvis, 2010) with accompanying strategic objectives predisposes most suitable level of 'pre-combination fit' in above mentioned areas (Naraločnik and Bertoneclj, 2015). Related complexity of postcombination integration challenges (Naraločnik and Bertoneclj, 2015; Hubbard, 2001) are the result of the foregoing.

This paper is structured as follows: first, the development of a research based conceptual model for developing M&A capabilities in precombination phase is discussed. Next, the research methods used are described, including the selection and properties of the sample, data collection method and the technique of qualitative content analysis. Third, the analysis and results of the study are presented and, following that, in the concluding section, the findings and their implication are discussed.

## **2. Pre-combination M&A capabilities and competences**

### ***2.1 Precombination M&A leadership capabilities and related competencies***

M&A processes are organizational change processes that demand powerful M&A leaders and fully engaged followers (Jackson and Parry, 2011; Ladkin, 2010; Haslam et al., 2011). Pre-acquisition organizational formation and specific M&A related leadership competences are crucial for increasing the success rate of M&A deals (Dunbar, 2014). Implementation of M&A initiatives cannot come to life if the leaders fail to influence and motivate numerous organizational followers toward such a high reaching purpose and goals (Porter and Mc Laughlin, 2006). Particular leadership behavior–style can affect the level of successful completion of M&A organizational change processes. Already in precombination phase, the characteristics of both leaders (of combining companies) need to be addressed through the perspective of the possibilities for reaching agreement. Whether both leaders possess traits of mutual incompatibilities, such as for example extreme arrogance behaviour on each side, this kind of risks needs to be taken seriously and negotiation strategy adjusted accordingly.

Sometimes the incompatibility can be shown as simple as to disagreement of who should get the top jobs (Stahl and Sitkin, 2002). By doing so, we can identify early on, which higher level leaders and also middle level managers of both companies can be retained after the deal and which leadership competencies must be consolidated in the integration phase.

## **2.2 *Precombination corporate M&A capabilities and related competencies***

M&A work context requires specific organizational capabilities and resultant competencies. In order to effectively conduct M&A related projects, a team of M&A knowledgeable employees need to be identified and called upon early in the process (Marks and Mirvis, 2010; Uhlander and West, 2011). Whether such individuals exist and such specific M&A knowledge is institutionalized (being transferred) throughout the organization it can become organizational core competency-its strategic strength. According to Connerty and Lavoie (2014) it is very unusual for a company's core competencies to overlap with the competencies required for executing M&A related strategies. Companies typically do not consider M&A related knowledge as an intended core competency, so the rarely institutionalize it into organization. The skills that frequent acquirers develop and that give them M&A advantages are related to the ability of effective translation of the acquisition strategy to their own operations and personnel. Such preparation accompanied with institutionalized learning (supported by M&A policy, procedures and guidelines), accelerates the development of a distinctive core competency.

## **2.3 *Precombination strategic intent and related objectives***

Strategic intent (Bower, 2001) has to be well defined already in a preparation phase of a combination and related business cases supporting or arguing against the deal need to be taken into consideration (Marks and Mirvis, 2010). Strategic intent of a combination is the rationale for the combination thus presenting the objectives for the newly created-integrated organization. The results set a direction for increased growth, profitability, and market penetration or diversification opportunities (Hubbard, 2001). With regards to strategic intent selection (Haspelagh and Jemison, 1991) acquirer has to ensure, that the proposed acquisition support the company's overall corporate renewal strategy. Giving limited information and the need for secrecy and speed such process entails, the development of a meaningful justification for 'the right' acquisition is even more demanding. In practice, there is an on-going search for appropriate balance between strategic (buying) opportunism and detailed planning of the integration process that follows.

## **2.4 *Precombination analysis of strategic, financial and organizational fit***

Possible effect of strategic, financial and organizational compatibility-and-complementary; i.e., fit between combining companies on mergers-and-acquisitions-outcomes is crucial for understanding the evolution of the newly created organization (Marks and Mirvis, 2010; Haspelagh and Jemison, 1991; Sirower, 1997; Lee and Pennings, 1996; Clemente and Greenspan, 1998; Bruner, 2004; Herd and Perry, 2004). According to Sirower (1997:19), 'many acquirers do little precombination planning and even those that do, achieve rather limited synergetic gains'. Managing for synergy or synergetic gain is thus in many ways like managing a new business. Based on such notion, relevant groups of strategic, financial and organizational fit factors

should be identified and assessed already in the precombination phase. By identifying and assessing their positive and negative implications toward the achievement level of predefined M&A objectives, 'factors can become a useful tool that can be controlled by management' (Bertoncelj and Kovač, 2008:216).

### 3. Integrated conceptual framework

The conceptual framework was developed in which it is emphasised the importance of interconnectedness between the case specific strategic M&A intent (Bower, 2001; Weber et al., 2011) and the degree of required and achieved level of fit between combining companies.

Figure 1: Conceptual framework for developing M&A capabilities in precombination phase

Degree of Required and Achieved Integration				
Strategic intent and associated risks	Developing M&A Capabilities	A	B	C
		Strategic Fit	Financial Fit	Organizational Fit
	A particular case study M&A intent	Degree of required and achieved FIT	Degree of required and achieved FIT	Degree of required and achieved FIT

Subsequent post-combination integration challenges (Hubbard, 2001; Haspelagh and Jemison, 1991; Duncan and Mtar, 2006) correlate with the level of sought for and (likely) achieved fit in the strategic, financial and organizational areas (Marks and Mirvis, 2010; Sirower, 1997; Lee and Pennings, 1996; Clemente and Greenspan, 1998; Cartwright and Cooper, 1995; Bruner, 2004). Well-organized acquirers should strive to pre-design a fit (i.e., match) between combining companies and efficiently execute the integration process that follows (Marks and Mirvis, 2010). Induced M&A capabilities and resulting competencies should be pre-developed and institutionalized throughout organization (Connerty and Lavoie, 2014).

Comprehensive estimates that derive from conceptual framework suggest the possible lack of required fit and point to the consequent risks areas (e.g., organizational culture incompatibility (Marks and Mirvis, 2010; Weber et al., 1996) and resulting cultural clash. With such a comprehensive considerations, a well-organized acquirer can take precautionary steps and thoroughly prepare for the challenges ahead.

Our argument is that deep understanding of the strategic intent of the acquirer as well as serious examination of the corresponding strategic, financial and organizational fit factors between the companies serves as a road map, to guide the combination and show how it might work. We want to further emphasise that M&A processes substantially differ from one another depending of the pre-combination strategic intent of the acquirer and associated complexity of post-combination integration challenges.

## **4. Methodology**

In order to examine the object of study - positive or negative contributions of precombination phase and related success factors to M&A success, inductive - qualitative case study research approach and related roadmap for building grounded theory was applied (Yin, 1984, 1981; Eisenhardt 1989; Mintzberg and McHug, 1985; Harris and Sutton, 1986; Pettigrew, 1988; Hesse-Biber and Leavy, 2004). Multiple case study (and comparison) of two Slovenian M&A cases, one representing an M&A within the finance (insurance) industry and the other M&A within the food processing (coffee) industry was used. This approach was chosen because of small number of executed M&A deals in the territory of Slovenia (10 in 2014, 7 in 2013 and 14 in 2012) (ATVP, 2015). Furthermore, access to the data of such complex processes is highly restricted to outsiders. We had the unique possibility to reach the highest level executives involved in the chosen cases and have used it to explore the precombination phase M&A activity.

### **4.1 Sampling method**

The sample for this study was drawn from the population of two implemented M&A cases between insurance (Case 1) and food-processing (Case 2) companies during the 2005-2006 periods. A combined and extended dual case study approach was used. With respect to the extended nature, the focus was on a very deep dive into each case. The dual refers to the two case studies developed which afforded comparison and contrast of the data enriching our ability to analyse the data. Moreover, the cases came from different industries, and while similarities were certainly present, the differing nature of the industries also diversified the data we were able to work with. In both cases, acquirers had similar strategic intents such as to roll up competitors through consolidation in relatively maturing industries and the initial intention to fully integrate acquired companies (i.e., by means of horizontal integration). To avoid possible sample bias, no individuals that were relevant to the research topic were excluded. The sample was intentionally purposive and restricted to only those executives and acquisition project managers who had been included in the M&A process from the very beginning and were aware of most relevant factors that determined the implementation. This screening procedure resulted in a sample of 30 interviewees, of that 25 interviewees confirmed their participation in the study. In this way, we executed 14 interviews to collect data related to the M&A of Case 1 and 11 interviews related to Case 2. Considering that the performance of acquisitions is generally viewed as an extremely sensitive topic, the response rate of 83-percent is considered very satisfactory.

### **4.2 Data Collection Method**

For the purposes of study and finding answers to research questions we used the semi-structured interview method. It allowed us the ability of creating framework topics and questions (i.e., interview-protocol), we intended to ask the interviewees (Yin, 1984). We tried to avoid possible biases of studying past events (collecting retrospective data) by applying the structured nature of interview protocol instrument that allowed respondents to freely speak about the events from their own perspective. Conversations with informants were aimed at understanding

the views and experiences the informants gained through their direct involvement in the studied M&A cases. The interview protocol was thus comprised of 28 questions, which were divided into 8 topics. Adjustments were made with regards to the preliminary interviews findings (Harris and Sutton, 1986). The first set of questions was designed to obtain general information about the research participants and the observed M&A case. They were followed by questions about the characteristics and structure of the team in the observed M&A case. The third set of questions was about strategizing about possible combinations. In particular, we asked the research participants to evaluate the earliest phases of the M&A process and describe the sequence of events in this phase. With the fourth substantive set of questions we wanted to identify and assess the influence of incentivizing and disincentivizing factors to the success of the precombination phase of the M&A case. The topic of the fifth set of questions was focused on the interviewee's assessment of levels of integration in the area of strategy, finance and organization. In the sixth set of questions, we asked the informants about the realization of the objectives of the combination. With the seventh set of questions we were looking for answers regarding the acquired knowledge and experience and documenting these. The final set of questions was focused on the abstraction of informants' opinions about the value/impact of precombination phase in future M&A projects.

Individual, oral, face to face, open type of investigative-semi-standardized-design of interview was applied (Lamnek, 1995). Interviews were recorded, notes were taken. Additionally and to enrich our findings, our aim was to analyse data from companies' dossiers, resulting from documentation, created during preparation and implementation of discussed M&A cases. In total 215 pages of documents were examined. Such multiple data collection methods (triangulation) provided even stronger substantiation of constructs (Eisenhardt, 1989).

### **4.3 Qualitative Content Analysis**

The main objective of qualitative content analysis was the creation of concepts, hypotheses and explanations, namely a grounded theoretical formulation, which reads like a narrative (i.e., story) about a phenomenon, namely the object of study. The central part of the qualitative content analysis was thus the process of coding within which the meaning (by attaching concepts and categories) of individual segments of collected empirical material is interpreted or defined. The primary purpose of the analysis was the clarification of the research phenomenon by identifying and explaining the relationships among qualitative data and designing of theoretical formulations (Saunders et al., 2007; Hesse-Biber and Leavy, 2004). We achieved this by dividing the entire process of data analysis into several steps or phases (Stirling, 2001), which we summarized after (Saunders et al., 2007): processing of material, defining of topics and units of coding, open coding, attributing concepts to empirical material, agglomeration of related concepts into categories, axial coding and analysis of characteristics of concepts and categories, selection and definition of relevant concepts and categories, summarizing thematic networks or designing of a paradigmatic model and creation of interpretation or final theoretical formulations.

## 5. Results

In the context of planning and implementation of precombination phase we note that integrations of Case 1 and Case 2 were fairly similar. In both cases the nature of primary motivators was strategic (i.e., strategic synergies in the context of strengthening market share and expansion of distribution channels as well as stronger product portfolios and resulting enhanced reputation) and in both cases pre-combination phases were not comprehensively and systematically pre-planned. They were also not conducted in accordance with theoretical concepts that define methods of their preparation / implementation (Jamison and Sitkin, 1986; Galpin and Herndon, 2000; Connerty and Lavoie, 2014; Ahammad and Glaister, 2013). We found out that both studied companies were not thoroughly prepared for such an undertaking and struggled to fully realize pre-combination stated objectives in a timely and cost efficient manner. As such, they were unable to amplify the benefits arising from them.

Figure 2: Degree of required and achieved level of fit

		Full Horizontal Integration			
		Precombination Fit' integrated Perspective			
Level of existing (pre-combination) and achieved fit (after full integration)		Strategic Fit	Financial Fit	Organizational Fit	
The Geographic Roll-up M&A	M&A Case 1	Existing	Extreme	Low	Low
		↓	Uneconomic multi-year long post-integration activities		
		Achieved	Extreme	Medium	High
	-----				
	M&A Case 2	Existing	Extreme	High	Low
		↓	Fast and Efficient Integration Activities		
Achieved		Extreme	High	Medium	

Here we note that the decision for M&A in Case 1 and Case 2 was a direct 'echo,' namely an intuitive impulse of doing business. They did not do their due diligence. Synergy studies, namely evaluations of potential risks of integrating two companies,

were also not done. An inadequately managed precombination phase negatively impacted financial (Case 1) and organizational factors (Case 1 and Case 2) influencing the process of integrating the two companies. Expectations on strategic fit, such as complementarity of markets, distribution channels and product portfolio were successfully met in both studied cases. We found out that the reason why pre-combination phase was not implemented was caused, on one side by a hostile method of acquisition (Case 1) and overreliance on previous 'success' with acquisitions (Case 2). On the other hand, it was a result of a lack of M&A experience and knowledge by key decision-makers / stakeholders involved in the purchase and integration. In Case 1, the precombination phase was not implemented and there were also no studies of potential (negative) synergies in the area of finance. The aforementioned are the reasons why during first attempts at integration there were no positive synergies in the financial area. Above all, the failure to execute a precombination phase resulted in a need for a multi-year rehabilitation of the organizational area. Although it seems at times that having a strategic fit is the most important aspect of studied M&A cases, and that (lack of) financial and organizational fit between acquirer and target are merely a consequence or an adjustment to the strategic fit, we conclude that all three areas are interlinked and therefore require systematic and integrated treatment during precombination phase of M&A processes (as indicated in Figure 1).

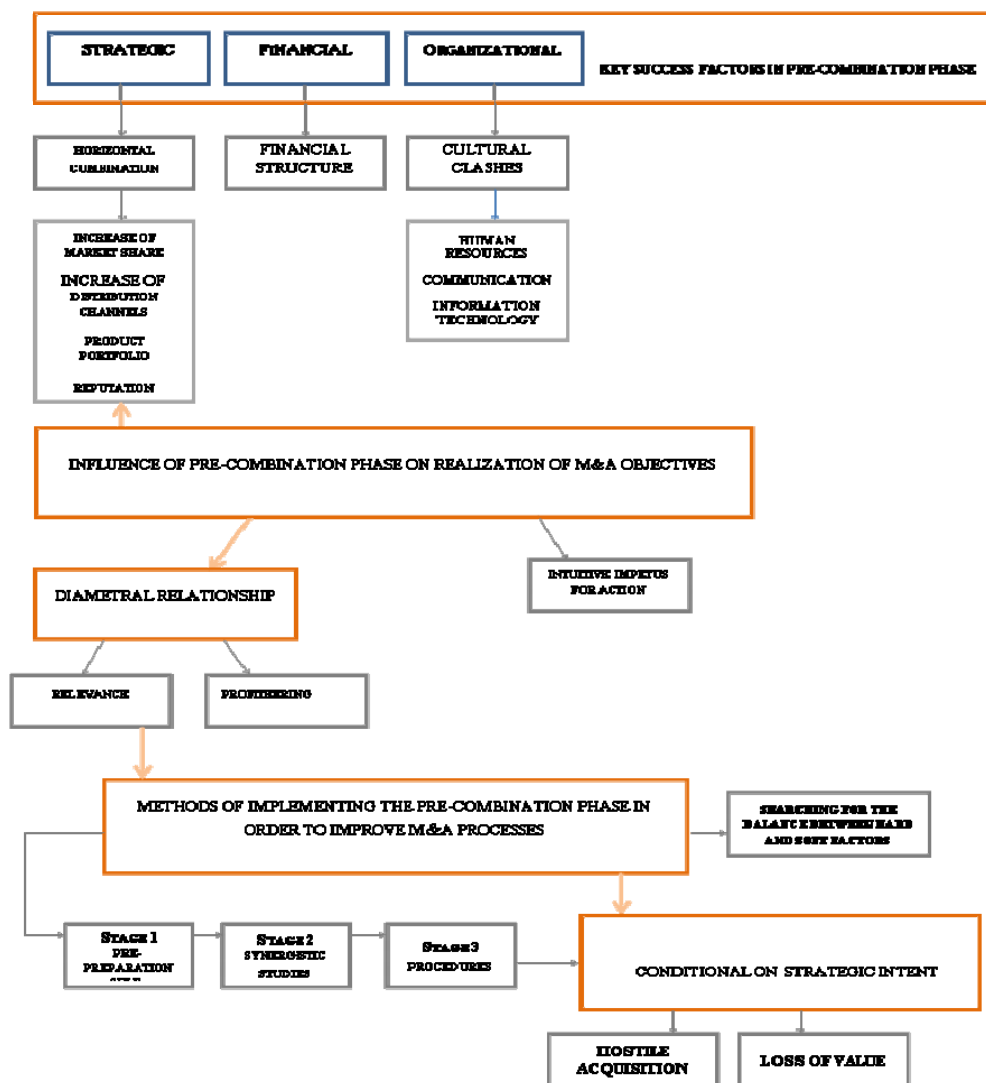
### **5.1 Tripartite paradigmatic model for improving M&A performance**

Adoption of assumptions that implementing a precombination phase in an M&A process represents a specific capability (of acquirer), and that pre-combination phase positively impacts the successful realization of M&A objectives is, in our opinion, conditional with how exactly a precombination phase was implemented. Drawing on the analysis of empirical material in order for pre-combination phase to improve successfulness of M&A, it should itself be designed in stages. The first stage would be focused on the importance of preparing the acquiring company for potential M&A processes in advance. It is a process of self-assessment of acquirer and / or self-assessments of companies that 'wish' to be sold. It means that a company conducts an internal audit of its own structures in order to identify strengths and weaknesses related to M&A processes. The second stage is tied to performing synergistic studies. In doing so, we note that synergies should be evaluated gradually. Evaluation of synergies should primarily focus on verification of acquiring company's and target's existing business plans. In this segment an evaluation of company's past financial performance, its sales structure, structure of its profitability in relation to product groups, markets or market units. Such getting to know oneself enables identification of potential synergistic fits between acquirer and its target.

Connecting the categories was done in a way that we determined their position within the resulting paradigmatic model (see Figure 3). We emphasise that interpretation of data (results), presented in the next chapter, is contextually bound; this means that it is a middle range theory, which only applies in specific environments or under specific circumstances (Yin, 1984).



Figure 3: Tripartite paradigmatic model for improving M&A success by implementing precombination phase



## 6. Discussion and managerial implications

Interpretation of the impact of precombination phase on successfulness of achieving M&A objectives highlights a diametric attitude regarding the relevance of precombination phase in M&A processes. It is assumed that realistic synergy studies or assessments of strategic fit cannot be performed during precombination phase, because at this stage one does not possess all the relevant information. However,

based on our study which enabled us to become aware of the correlation between insufficiently (or not at all) implemented precombination phase and indirect (and often unfavourable) consequences for the realization of mainly organizational synergies, we lean toward confirming the thesis that the impact of precombination phase in order to effectively achieve intended strategic, financial and especially organizational objectives is not negligible.

Precombination phase is important in terms of showing systematic scenarios or strategies as well as in terms of evaluating potential risks associated with M&A processes. Every company deciding to initiate M&A processes should have a clear strategy and implement their M&A activities in line with that strategy. A well-executed precombination phase increases quality and reduces cost of M&A processes, because during precombination phase a company can perform an audit and remedy the negative aspects of M&A processes. In order for precombination phase to improve successfulness of M&A it should be designed in stages.

The first stage should be focused on the importance of preparing the acquiring company for potential M&A processes in advance. It is a process of self-assessment of acquirer and / or self-assessments of companies that 'wish' to be sold. It means that a company conducts an internal audit of its own structures in order to identify strengths and weaknesses related to M&A processes.

The second stage is tied to performing synergistic studies. It is important that synergies are evaluated gradually. Evaluation of synergies should primarily focus on verification of acquiring company's and target's existing business plans. During the second step of estimating possible synergies an assessment of areas where there are synergies between individual companies within the planned M&A processes is supposed to be performed. The second stage of precombination phase is also intended for finding a balance between soft and hard factors of integration, since they both affect how long the realization of M&A processes will take.

The third stage of evaluating synergies is the evaluation of identified synergistic areas, which are supposed to provide an improvement over 'stand-alone' positions of companies. The preparation of synergistic studies is crucial in terms of valuing a particular company during precombination phase of M&A processes. This is due to the fact that the valuation is a starting point for determining the exchange ratio between two companies. It is meant for a precise definition of 'project tasks or procedures' in two respects. After identifying key stakeholders during the third stage of precombination phase, project teams should be established and stakeholders, who are responsible for specific functional areas which are subjects of synergies and for which it is estimated they will become subjects of synergies, should be defined.

The strategic intent of M&A can affect the manner in which the precombination phase is implemented, as well as the degree of integration fit of companies engaged in M&A in strategic, financial as well as organizational areas.

## **7. Conclusion**

Companies should learn from their past mistakes as well as successes in a way that enhances their awareness of what it takes to outdo competing acquirers in the acquisition game. (Ashkenas et al., 1998 as cited in Marks and Mirvis, 2010).

Based upon this study, and with respect to the above, the preacquisition organizational formation and explicit M&A related competences are crucial to the achievement of comprehensive M&A success. Our findings further suggest that it is the experience curve by which the magnitude of organizational learning from numerous M&A projects is deployed, positively contribute to such success. Those companies that missed the opportunity to invest sufficiently in their M&A knowledge and becoming acquirers themselves unintentionally grow into the M&A targets.

The M&A activity should be supported by organizational routines and implementation procedures that derive from accumulated M&A knowledge and continuously benchmark best practice M&A cases. Related distinctive M&A organizational - vocabulary 'needs to be enforced'. The design parameters provide strong control over M&A processes, reducing uncertainty and potential risk of neglecting the obvious. To be efficient in such a risky endeavour, a great deal of complacency is needed. However, the score of pragmatic and systematic approach is more favorable. Radical improvements of M&A outcomes are not a result of combining companies resource exploitation, but rather exploration of new opportunities.

The study advocates the notion of Prahalad and Hamel (1990) that companies' ability to identify, cultivate and exploit core competencies that make growth possible will be the most powerful way to prevail in global competition. Such core competencies are the collective learning in the organization, communication, involvement, and a deep commitment to working across organizational boundaries (Prahalad and Hamel, 1990). Their specific is that they do not diminish with use or like physical assets deteriorate over time, they are enhanced as they are applied and shared. They need to be nurtured and shared.

M&A activity is still young in emerging market of Slovenia relative to longer running market economies. Our research was limited to the active acquirers and associated (only) two implemented M&A cases in a very small Slovenian economy. As previously noted, 'the number of M&A has not significantly increased in 2014 (10) comparing to the previous year (7) (ATVP, 2015:15) and remains much lower from the number that was common before financial (economic) crisis'. However, with respect to on-going intentions of Slovenia to sale of state-owned companies (SDH, 2016), the over-indebtedness of Slovene companies and related number of non-performing loans which are for sale (DUTB, 2016) and recent economic breakdown of large Slovenian consolidators, it is expected that the number of M&As will likely increase in the future. In order to build economies of scale and scope, successful companies might search for consolidation possibilities, rolling up competitors and consolidating their markets-industries.

A further limitation is that the measurement of the construct is biased by the ex-post rationalization of respondent's actions and no possibility to directly measure the construct by the use of the secondary data. Despite these limitations, the study results will help to better understand which fit areas and related success factors are dealmakers or breakers in the eyes of executives, industry experts and practitioners. Nevertheless, the research was extensive, further research into the discussed phenomena of high failure rate of M&A activity is required. To date and by our current knowledge, no comprehensive research about discussed pre-combination aspects of the deal making was conducted in Slovenia. We consider presented Conceptual Framework to offer numerous research questions to be answered and various hypothesis to test. An interesting question to be addressed is: 'How can an

organization enable and coordinate emerging M&A activity dynamics, without suppressing their adaptive, learning and creative capacity-fostering M&A based innovation possibilities'? Or: 'What is the creative value of M&A activity based tension - 'we versus them' antagonism'?

The study results reflect the above mentioned limitations and further research is recommended to be done in developed market economies and by using not only qualitative but also quantitative methods and techniques and also over longer period of time.

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