Corporate Governance and Turnaround: Lessons for International Acquisitions of Distressed Firms
The case of Krenholm, Estonian textile manufacturer

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Upphovsrätt

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Abstract

Title: Corporate Governance and Turnaround: Lessons for International Acquisitions of Distressed Firms. The case of Krenholm, Estonian textile manufacturer

Authors: Elena Shabrova & Juan Manuel Figueroa Bolaños

Supervisor: Jörgen Ljung

Background: In the context of rapid market development and globalization, the role of corporate governance has become crucial in determining firm’s direction, control and performance. No substantial investigation has been made to explain the role of corporate governance in the context of widely used strategy for organizational growth – mergers and acquisitions (M&A). Acquisitions of distressed firms represent a particular area within the field of M&A. Distressed firms are characterized by existence-threatening decline in financial performance, and therefore, require special attention from corporate governance actors in turning the company around from bankruptcy and resuming its normal operations. Despite the fact that a substantial body of literature has been developed on turnaround theory during the last four decades, researchers have mostly been focusing on the content of turnaround strategies and have been studying the cases of single firms.

Aim: The purpose of this master thesis is to provide a better conception of the role of corporate governance mechanisms in managing the turnaround process in the context of a distressed firm after its acquisition by a foreign company, and the necessity for corporate executives in initiating post-acquisition integration between these merged companies.

Definitions: Corporate governance is defined as the interaction among various corporate claimants in determining the direction, control and performance of a company. International acquisitions are described as the cases, when “the control of assets and operations is transferred from a local to a foreign company and the former becoming an affiliate of the latter” (UNCTAD, 2000, p. 99). Distressed firms are threatened by impending bankruptcy or forecast a future decline in performance. Turnaround is the recovery of a company’s performance following a period of organizational failure by moving away from the crisis to a sustainable success or eventual death. Post-acquisition integration refers to “the interactive and gradual process of strategic and administrative combination of acquiring and target firms, in which individuals from the two organizations learn to work together and cooperate in the transfer of strategic capabilities” (Chakrabarti and Mitchell, 2005, p. 3).

Methodology: We conducted a comprehensive case study of the Estonian textile manufacturer, Krenholm. In order to collect necessary data for our empirical investigation, primary data in the form of semi-structured interviews and secondary data in the form of company’s and personal documents and mass media outputs were used.

Completions and results: A model of corporate governance within the context of international acquisitions of distressed firms was designed. According to the model, corporate governance mechanisms should assure close communication, clear leadership and its continuity, vision and proper choice of the corporate governance actors. Moreover, corporate governance should reinforce post-acquisition integration between the distressed company and the acquirer. It is important to find a proper level of integration according to each particular case. The major focus in international acquisitions should be on managerial and socio-cultural integration. Consequently, proper post-acquisition integration can facilitate the turnaround process and gaining synergies from combining two organizations.

Keywords: corporate governance, turnaround, international mergers and acquisitions, distressed firms, post-acquisition integration.
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<tbody>
<tr>
<td>AB</td>
<td>aktiebolag (joint-stock company)</td>
</tr>
<tr>
<td>CEO</td>
<td>chief executive officer</td>
</tr>
<tr>
<td>e.g.</td>
<td>exempli gratia (for example)</td>
</tr>
<tr>
<td>EEK</td>
<td>Code for Estonian kroon</td>
</tr>
<tr>
<td>et al.</td>
<td>et alii (and others)</td>
</tr>
<tr>
<td>IFC</td>
<td>the International Financial Corporation</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>mergers and acquisitions</td>
</tr>
<tr>
<td>n.d.</td>
<td>no date</td>
</tr>
<tr>
<td>NK</td>
<td>AB Nordiska Kompaniet (literally The Nordic Company)</td>
</tr>
<tr>
<td>OECD</td>
<td>the Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>research and development</td>
</tr>
<tr>
<td>SEK</td>
<td>code for Swedish krona</td>
</tr>
<tr>
<td>U.K.</td>
<td>the United Kingdom</td>
</tr>
<tr>
<td>U.S. = USA</td>
<td>the United States of America</td>
</tr>
<tr>
<td>UN</td>
<td>the United Nations</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>the United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>WTO</td>
<td>the World Trade Organisation</td>
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1. INTRODUCTION

1.1 Background

In 1857 in the city of Narva, memorable for Swedes because of their most famous military victory, a great factory was build whose fate was to become Estonia’s biggest industrial group and one of the largest textile plants in Europe for many decades. Seeing an advantageous location and big potential of the industry Baron Ludwig von Knopp, a German industrialist, invested his capital to the enterprise, which name stems back to the German word Krähnholm meaning "crow island" (Narva, n.d). This was the origin of the company that went through many changes during the years of its operation and was a witness of the Second Industrial Revolution, the Russian Revolution, the First and Second World Wars, the foundation of the European Union, the dissolution of the Soviet Union and global financial crises.

Krenholm was an Estonian textile manufacturer with a fascinating history. During various historical periods the company belonged even to different states: the Russian empire, the Soviet Union and independent Estonia, which certainly left its mark on the enterprise. During the Soviet era the company was one of the largest and most highly respected textile enterprises in the Soviet Union. Indeed, in the late 1980s Krenholm employed more than 10 000 workers, being the largest employer in Estonia, produced around 220 million m² of fabric a year and had about 1200 very stable customers (Brown-Humes, 1999, Edström et al., 2003).

Because of the rupture of relations between Russia and Estonia after the dissolution of the Soviet Union, Krenholm was experiencing a survival-threatening decline in performance. In 1993-1994 the Estonian state conducted an active work on the privatization of Krenholm. Those efforts succeeded in 1995 in a deal with a relatively small textile company, Borås Wäfveri AB (further in the text - Borås Wäfveri), from western Sweden, and as the newspaper from that time highlighted: “Today the Swedes are back in Narva and once again David is talking to Goliath” (Brown-Humes, 1999, p. 1). At
the first stage of privatization Borås Wäfveri got 75.5% of the company’s shares and further on became the single owner of Krenholm.

“It is the most ambitious sell-off yet in the Estonian government’s fledging privatization programme and one of the biggest foreign investments in the country since independence from the former Soviet Union in 1991.” (Brown-Humes, 1999, p. 1)

The period after privatization is characterized by extensive work on turning Krenholm away from crisis and its transformation from planned to market economy. The most significant actions that Borås Wäfveri took were the appointment of a new CEO, the introduction of a new organizational structure, head count cuts, the search for new markets, the development of information systems and intensive training in marketing, management and languages (Andren and Öberg, 1996). The efforts were crowned with success and by 2001 the revenue of Krenholm increased greatly in comparison with the time of takeover in 1995, when the company was on the edge of collapse. In the beginning of the 21st century Krenholm was again the largest industrial company and exporter in Estonia.

However, the situation changed when in 2002 Krenholm started to incur continuous losses. In order to turn the company around, the board of directors and top management team tried to take measures to improve the performance. Hence, all the manufacturing activity became concentrated in Estonia, but marketing and sales operations were entirely moved to Sweden. Moreover, several mills in Narva were closed down and the company started to outsource grey fabrics in Asia (Shabas, 2008). As a result, crisis in organizational performance led to massive layoffs. Apart from this, the CEO and many senior executives in Krenholm were changed and no further substantial investments were done to the company during the last years.

Bible Story of David and Goliath

The Philistine army had gathered for war against Israel. The two armies faced each other, camped for battle on opposite sides of a steep valley. A Philistine giant measuring six cubits tall and a span wearing full armour came out each day for forty days, mocking and challenging the Israelites to fight. His name was Goliath.

David volunteered to fight Goliath. It took some persuasion, but King Saul finally agreed to let David fight against the giant. Dressed in his simple tunic, carrying his shepherd's staff, slingshot and a pouch full of stones, David approached Goliath.

David said to the Philistine, "You come against me with sword and spear and javelin, and I am coming to you in the name of the Lord Sabaoth, the God of the ranks of Israel ... I will kill you and remove your head from you... and all the earth will know that there is a God in Israel".

As Goliath moved in for the kill, David reached into his bag and slung one of his stones at Goliath's head. Finding a hole in the armor, the stone sank into the giant's forehead and he fell on his face on the ground. And David ran and stood over him and took his sword and put him to death and cut off his head.

Source: Bible, 1 Samuel 17 based on Pietersma and Wright, 2007.
As a result, during 2003-2010 Krenholm was gradually reducing production volumes. The net loss of the company in 2007 was about 53 million Estonian krooni and by the end of 2009 only 550 employees were left in Krenholm. On the 3rd of November 2010 Borås Wäfveri decided to apply for the bankruptcy of its subsidiary (Narvskaya Gazeta, 2010). “The board cannot see any possibility of achieving a cash flow that would enable to continue activities”, the parent firm said in a press release published by the Swedish news agency (The Baltic Course, 2010). The company with more than 150 years of impressive history stopped the production of the once famous Baltic textile products and is left now in a very deplorable condition.

“There were no guard of honour, no gun volleys, no flags at half-mast and no grievous melodies. The leader was dying so long and painfully that everybody got used to the idea about it inevitable decease.” (Ivanov, 2010, p. 9 about the closure of Krenholm)

Figure 2. The picture of Krenholm in 2012 and in earlier period
Source: Fish, 2012a and authors’ correction, 2012.

The case of Krenholm, the largest Estonian textile manufacturer in former times, was our starting point for the present research. What has “sunk” the company? What has left Estonia without the biggest industrial enterprise? What has left hundreds of employees without their jobs complicating the social situation in the city? By conducting our detective investigation we intend to illuminate the mystery of corporate failure and the fall of the “big Goliath”.

3
Figure 3. The pictures of Krenholm in 2012

Source: Fish, 2012b.
1.2 Problem formulation and research questions

Nowadays, due to the rapid market development and globalization, companies face challenges of withstanding constantly changing business environment. As Whitney (1987, p. 49) states “in today's world, you have to earn your right to compete every day, day after day.” Following Whitney, Evans et al. (2002, p. xv) highlight that international competition affects all the business fields setting “ever-increasing requirements to do things better, cheaper, and faster.” In this context, the role of corporate governance as an integral part of strategic management becomes crucial in determining firm’s direction, control and performance (Cadbury, 1992).

In fact, there has been particular interest in corporate governance in the past two decades facilitating truly interdisciplinary research in the areas of economics, management, finance, law and accounting (Bebchuk and Weisbach, 2010). Indeed, contemporary corporate governance is a very broad term: it covers a number of issues and practices with a shared focus on the relationship between shareholders, the board of directors and top management (Keasey et al., 2005). These three levels of actors form internal monitors of corporate governance (Sudarsanam, 2000; Sundaram, 2004), which are of particular interest in this research. In practice, shareholders often referred as the owners or stockholders of a firm delegate their responsibility to monitor and supervise the investee firm to the elected members of the board, who in turn take a proactive stance and assure that the company is provided by the best management talent possible to perform day-to-day operations (Steger, 2004).

The main areas of corporate governance research have been scattered among the issues regarding the main corporate actors (shareholders, the board of directors and top executives), cross-country comparisons, cross-border investing and political economy of corporate governance (Bebchuk and Weisbach, 2010). While the literature is rich in each particular area mentioned above, it has been noticed that no substantial investigation has been made to explain the role of corporate governance in the context of widely used strategy for organizational growth – mergers and acquisitions (M&A). The scarcity of this research is striking because there has been a dramatic growth of M&A worldwide since 1990s. Indeed, Oliver Wyman (2008, p. 4), an international management consulting firm, claims that there has been about 30 000 acquisitions annually in recent years, which means that there are about 80 transactions a day.

It is generally recognized that many companies worldwide merge or acquire other businesses to develop new products and services, technologies, increase geographical scope and to consolidate within the market they compete in order to improve their current and strategic positions (Schweiger and Goulet, 2000). As Calipha et al. (2010, p. 2) cite “according to the Accenture and the Economist
Intelligence Unit global M&A survey of 2006, present-day corporate strategy is focused firmly on M&As as a tool for promoting future growth and creating sustainable value.” In particular, fundamental transfer of ownership from state owned companies to private enterprises was widely used by post-Soviet governments after the dissolution of the Soviet Union in 1991 (Estrin et al., 2009). Therefore, during the privatization process many state companies, as our case company, were acquired especially by foreign firms.

Acquisitions of distressed firms represent a particular area within the field of M&A. Distressed firms are characterized by existence-threatening decline in financial performance (Pandit, 2000), and, therefore, require a special attention from corporate governance actors in turning the company around from bankruptcy and resuming to its normal operations. Acquisitions of financially distressed firms are not a rare phenomenon, they occur regularly and the number of deals is currently growing (Bruton et al., 1994; Calandro, 2009). One of the reasons for buying firms that have problems is to turn those businesses around, and later sell them at a profit (Porter, 1991). However, in our thesis, we explore the cases when a company acquires another firm “with the hope of first turning it around and then gaining various synergies between that business and others in its portfolio” (Castrogiovanni and Bruton, 2000, p. 27). The focus here is then on long-term relationships and joint work.

In fact, the development of turnaround management has received considerable attention since 1970s stimulating research of various strategies for corporate recovery (Boyne and Meier, 2009). Pearce and Robbins (1993) remark that such manufacturing industries as steel, automobile and textile were the first to face turnaround situations, the threatening decline in performance is also extensively affecting the service industry. Within this context Whitney (1987, p. 50) affirms that “it seems that no one is safe. High-tech, low-tech, manufacturing, service, large, small - companies in every category are experiencing difficulty.” That is why, turnaround management has been of significant importance among scholars and practitioners (Boyne and Meier, 2009; Schmitt and Raisch, 2010).

Despite the fact that a substantial body of literature has been developed on turnaround theory during the last four decades, “an overwhelming emphasis [has been placed] on the content of turnaround” (Chowdhury, 2002, p. 249). The researchers mostly focused on the descriptions of different turnaround strategies to explain variations in performance results (Chowdhury, 2002). Moreover, most scholars explore turnaround cases of the single firms (e.g. Hambrick and Schecter, 1983; Robbins and Pearce, 1992; Barker and Duhaime, 1997; Rasheed, 2005). However, the deep appreciation for the context of turnaround is essential for the theoretical and practical foundation of managing distressed firms, which has been largely neglected. One of such contexts is referred to the turnaround of distressed firms in the post-acquisition period by a foreign company.
The role of corporate governance, in our view, is becoming especially important in turning around distressed companies after cross-border acquisition (note: the terms “cross border” and “international” acquisition will be used interchangeably in this master thesis). Distressed businesses differ from the regular ones in the level of attention required, necessity of special skills and competences needed to make drastic reorganization, turn around the company in crisis and make it profitable again so that it can bring post-acquisition value for both firms. In fact, distressed company’s “very existence is threatened unless radical action is taken” (Pandit, 2000, p. 37). However, researchers have not paid enough attention to the supposition that the role and requirements for corporate governance actors may differ from one context to another.

Nevertheless, few studies could be found related to this research problem. Fich and Slezak (2008, p. 226), for example, in their study of 34 companies from different industries filed for bankruptcy, analysed “how different corporate governance characteristics affect the probability and the predictability of a distressed firm ending up in bankruptcy court”. They argue that governance structures that fit well in one situation could be ineffective in other set of conditions. In spite of valuable contribution to the corporate governance field, the authors focus generally on the variations in the structure and compositions of the board of directors (size and proportion of insiders/outsiders), and board ownership. Another research, which was made by Castrogiovanni and Bruton (2000), studied a sample of 46 distressed firms. These scholars highlight that turnaround strategies may differ across various types of businesses – single firm or a business acquired unit under the direction of parent company. In particular, Castrogiovanni and Bruton (2000) state that retrenchment strategy (reduction of scope and size of the business) cannot be seen as an essential stage in the turnaround process. Thus, “desirability of particular turnaround actions or processes may vary from one context to another” (Castrogiovanni and Bruton, 2000, p. 25).

Therefore, we claim that a more contextual understanding of corporate governance mechanisms, rather than “one-size-fit-all” approach is needed, and, hence, this study focuses on managing turnaround processes after international acquisition of distressed firms. With the aim of better understanding of this particular context, the following research question was formulated:

**RQ1: What is the role of corporate governance mechanisms in managing turnaround processes after an international acquisition of distressed firms?**

The post-acquisition period is further complicated by the need to harmonize the management practices of merged organizations. This interactive and gradual process has been known in M&A’s literature as post-acquisition integration (e.g. Shrivastava, 1986; Chakrabarti and Mitchell, 2005; Mtar, 2010). Pablo (1994, p. 805) defines integration as the acquirer’s actions “taken to secure the efficient and effective direction of organizational activities and resources toward the accomplishment
of some set of common organizational goals”. The integration process can transform companies’ systems, policies, structures and even organizational culture. In fact, the majority of researchers and practitioners point to inadequate post-acquisition integration as a major cause of acquisition’s failures to achieve synergistic effects between the companies (Shivastava, 1986; Pablo, 1994; Calipha et al., 2010).

After the purchase of a distressed business, the attention of corporate governance actors in a parent company is mainly concentrated on turning an acquired firm around because of its existence-threatening financial performance. However, the post-acquisition integration phase cannot be omitted from the executives’ agenda. This research therefore explores the interplay between the turnaround and post-acquisition integration processes: we would like to investigate the necessity and the effects of post-acquisition integration in the process of turnaround of a distressed firm. This leads us to the second research question:

RQ2: What is the relationship between turnaround and post-acquisition integration processes in managing international acquisitions of distressed firms?

To answer the above mentioned questions, thorough investigation is needed to be conducted in the form of academic literature review of corporate governance, turnaround and post-acquisition integration fields and in-depth analysis of the case company – Estonian textile manufacturer Krenholm – particularly after the year it was acquired by the Swedish firm Borås Wäfveri in 1995 up to the year of Krenholm’s bankruptcy in 2010. In finding the answers to the research questions this master thesis contributes to a better understanding of corporate governance issues within the context of turnaround process following international acquisitions of distressed firms for developing synergetic businesses.

1.3 Research purpose and contribution

Given the pervasiveness and growth of M&A deals, especially acquisitions of distressed firms, concluded worldwide and the volume of capital involved, it is critically important to get a better understanding of the corporate mechanisms that can facilitate the development of synergetic businesses. Therefore, the purpose of this master thesis is to provide a better conception of the role of corporate governance mechanisms in managing the turnaround process of a distressed firm after its acquisition by a foreign company, and the necessity for corporate executives in initiating post-acquisition integration between these merged companies. Moreover, the aim of this thesis is to design a model of corporate governance within the studying context that can contribute to the theoretical and practical levels of academia. Conducted interviews as well as the analysis of secondary data within
the case study hold an inquiry into the real-life business practices and can help in answering the research questions mentioned above to extend the existing body of knowledge.

The empirical part of this thesis is based on the case study of Krenholm – Estonian textile manufacturer – which is briefly presented in the background section. The Krenholm story is a case of failure. A failure case hardly seems like a desired object of study, however “we often say that we learn more from our failures than from our successes” (Carnall, 2007, p. 301). Moreover, as Edmondson (2011, p. 49) confirms “the wisdom of learning from failures is incontrovertible. Yet organizations that do it well are extraordinary rare.” Therefore, we consider that the importance of analysis and reflection in our case study lies on the opportunity to learn from past mistakes, actions and decisions that will contribute to the knowledge of tomorrow. Our understanding of corporate governance effectiveness can be enriched by examining the causes of actions to forestall the failures of M&A.

By conducting an in-depth study we intend to contribute to the theory building in three ways. First of all, this thesis aims to extend the existing academic knowledge about the role of corporate governance actors in different contexts particularly with regard to the current cross-border wave of M&A in the corporate sector. Despite the growing interest in this topic and recognition of its importance, many managers and investors are unclear about the role of corporate governance. By having sufficient knowledge about the essence, role and structure of corporate governance in specific contexts will allow managers and shareholders to run their business more effectively.

Secondly, over several decades a number of scholars have explored M&A from various angles. Yet, the findings “indicate the need to continue to research in depth and in breadth the parameters that influence the overall M&A deal success” (Calipha et al., 2010, p. 2). This master thesis contributes to the knowledge of corporate governance in a specific type of M&A – cross-border takeover of a distressed firm – conducted in order to obtain a synergy of merged businesses. In addition, many studies note the importance of top management decisions during the phase of post-acquisition integration (e.g. Angwin, 2004). Furthermore, understanding the logic of M&A activities, the proper actions needed to manage post-acquisition turnaround process and their human resource implications is becoming one of the core competences required to be possessed by global managers (Evans et al., 2011).

Thirdly, we investigate the process of turnaround not just of a single firm as it was mainly emphasized in the existing theory (e.g. Robbins and Pearce, 1992; Barker and Duhaime, 1997), but within the context of merged companies. This master thesis is based on the statement that “while companies facing near-bankruptcy, market losses, or substandard performance are increasing in frequency, strategy researchers have provided little help for the managers charged with turning
around deteriorating performance” (Winn, 1993, p. 48). Therefore, provided recommendations are aimed at assisting distressed firms to recovery and work efficiently within the merged company’s business portfolio.

It is worth mentioning that this master thesis has its delimitations. First of all, as the research on corporate governance is truly interdisciplinary, attracting attention of scholars from the fields of economics, management, law, finance, ethics and others, this thesis explores the issues of corporate governance in the light of management theory. Secondly, our research focuses on the cases when a company acquires a distressed firm not to turn it around and sell it at a profit but rather for building a long-term relationships and gaining synergies between the businesses. Moreover, investigation is made within related cross-border acquisitions (between companies within one field). The strategic purposes underlying them is achieving economies of scale by merging the resource base of two companies or economies of scope by performing product or market extensions (Ghauri and Buckley, 2003). While unrelated acquisitions can help the company to spread risks or open up possibilities of entering a new attractive industry, usually they do not have the intention of sharing resources (Shrivastava, 1986). Within the empirical study, this master thesis focuses mainly on one company – Krenholm, but when needed it provides information about its parent company – Borås Wäfveri, and explores the case in a limited time period – from the time of its acquisition in 1995 and until the bankruptcy in November 2010.

1.4 Thesis disposition

This master thesis consists of three main parts: introduction, the main body and conclusion (see Figure 4).

![Figure 4. Thesis disposition](Source: Authors’ own elaboration, 2012.)
The introduction part aims to give the background to the research, explain the problem formulation and research questions, purpose and contribution. Furthermore, the theoretical frame of reference is the first part of the main body of the master thesis, which provides critical evaluation of relevant and up-to-date literature in the field of corporate governance for turnaround processes of distressed firms in a post-acquisition context. The methodology chapter gives an overview of the research purpose, approach, case study design and the method used for the data collection and analysis. The next part deals with the description of the case study context and empirical findings about the company, corporate governance structure, efforts directed at turning the company around and achieving post-acquisition integration. The analysis and discussion chapter shows the results of the comparison of our empirical findings and the established theory and is aimed at answering the research questions. The closing chapter of the main body of the thesis presents a developed model of corporate governance within the studying context. The last part provides conclusion, research limitations and implications for managers and future research.
2. THEORETICAL FRAME OF REFERENCE

This chapter of the master thesis is a review of the theoretical field of corporate governance within the context of turnaround process following international acquisition of distressed firms. Firstly, we will outline the existing theory of corporate governance, its definition, role and theoretical roots. Moreover, the main theoretical issues of primary corporate participants - shareholders, the board of directors and management – are specified. Furthermore, we will give an overview of the development of M&A research and, in particular, acquisitions of distressed firms. The next part of this chapter is dedicated to the turnaround strategy – actions that are essential for the survival of distressed firms. In addition, we specify the concept of integration, its role for the successful acquisition process and different areas needed to be harmonized between the firms. Finally, in the last part of this chapter, relevant research of corporate governance issues within the context of managing international acquisitions of distressed firms is provided.

2.1 Corporate governance

2.1.1 Definition and development of corporate governance

Interest in the topic of corporate governance has been rapidly growing during the last two decades indicating recognition of its importance both within and outside research academia. The research in this area was truly interdisciplinary, involving scholars from economics, management, law, accounting, finance, ethics and politics. Taking into consideration the purpose of this thesis, it is worth mentioning that we explore the issues of corporate governance in the light of management theory.

Indeed, the term “corporate governance”, which appeared in the mid-1980s, is present in the titles and abstracts in total of 14643 articles and 806 times only for the last 2011 year in the Business Source Premier database (University Library, 2012). In addition, Google books (2010) show a steady growth, illustrated on Figure 5, of the books published on the topic of corporate governance since 1990s. The raise of research and debates in this field are also based on the recent cases from the business world of poor corporate governance among top ranked corporations. The most notable examples of corporate crimes, frauds and self-dealing are presented in Appendix 1. These outrageous facts have been drawing attention of scholars, business community, regulating authorities and society.
By exploring the existing research data we found that the definition of the term corporate governance varies between research disciplines and even between the scholars within the same discipline. One of the prevailing definitions refers to corporate governance as “the system by which companies are directed and controlled” (Cadbury, 1992). It was developed by the Cadbury Committee, the first of several bodies entrusted with improving corporate governance in the U.K. However, two distinctive interpretations of this notion were identified in the previous academic research and are presented in Figure 6 below.

**Corporate governance – Extended view**

- Value creation and its “fair” transferring among various internal as well as external corporate stakeholders;
- Their interaction in determining direction and performance of a firm

**Corporate governance – Basic view**

- Defense of shareholders’ interests
- Assure returns on shareholders’ investments
- Moderate the conflict between shareholders and executive managers

Most of the academic works define corporate governance in terms of mechanisms that assist in solving agency-principal problem: conflict of interests between shareholders (suppliers of capital) and executive managers (suppliers of managerial skills). They see the corporation as a nexus of contracts among self-interested and potentially opportunistic parties (Jensen and Meckling, 1976). Thus,
according to Baysinger and Butler (1985, p. 105), corporate governance is “the set of institutional arrangements that tend to align the interests of management and residual risk bearing shareholders and serve to economize on the transaction costs that accompany the specialization of organizational functions”. Similarly, Shleifer and Vishny (1997, p. 737) remark that corporate governance deals with “the ways in which suppliers of finance to corporations assure themselves of getting return on their investments” and the use of governance devices has the main aim at defence of shareholders’ interests (Brunninge et al., 2007).

Recently, the second group of researchers started to claim that a wider view on corporate governance is more appropriate. These scholars look beyond the relations between the shareholders, managers and board of corporations and include other participants, such as employees, customers, suppliers, creditors and the community, in determining direction and performance of the companies (Monks and Minow, 2001; Gabrielsson, 2003; Merchant and Van der Stede, 2007). In a similar manner, Sundaram (2004, p. 195) defines corporate governance as “the top management process that managers and mediates value creation for, and value transferring among, various corporate claimants (including society-at-large) in a context that simultaneously ensures accountability towards these claimants”. Therefore, corporate governance implies some form of “fair” and “equitable” value distribution among various stakeholders, which have implicit or explicit relationships with the firm.

Based on the previous research and extended view on the corporate governance, we developed the definition of the term, which we will refer within this thesis: Corporate governance is the interaction among various corporate claimants (internal as well as external to the firm) in determining the direction, control and performance of a company.

2.1.2 Role of corporate governance

To mitigate the risk of conflict of interests among corporate stakeholders, different corporate governance rules, guidelines and codes of best practice have been introduced, which have a purpose to complement legislative standards and regulations in many countries. The breakthrough for the development of corporate governance in Europe became the release of the Cadbury report in the United Kingdom in 1992 (Cadbury, 1992), which was a response to many corporate scandals in the late 1980s and provided a standard that was used for designing corporate governance codes in many countries. Furthermore, a number of international organizations, such as the OECD (Organization for Economic Co-operation and Development) and the European Commission have also published their guidelines and codes concerning different aspects of corporate governance. In Sweden, for example, the regulatory framework for corporate governance is based on legal requirements, mainly
Companies Act, as well as self-regulation in a form of Stock Exchange’s rules and the Swedish Corporate Governance Code (Lekvall, 2009).

However, corporate governance should be seen as more than just a compliance with the law. It plays various roles for the individuals, companies and business community. First of all, many authors agree that corporate governance ensures that long-term strategic objectives are established, proper monitoring and control over their implementation are set up and there exists effective mechanisms for selection and evaluation of the leadership of a company (Baysinger and Butler, 1985; Monks and Minow, 2001; Steger, 2004; OECD, 2004; Sundaram, 2004). Moreover, according to OECD principles (2004), corporate governance should provide incentives for the management team and board to pursue strategic objectives that are in favour of the company and its shareholders. Therefore, good corporate governance is a key element in promoting accountability, improving economic efficiency and facilitating the firm’s growth.

Another argument in favour of managing interactions among corporate claimants rationally is the view that companies with good corporate governance mechanisms have higher share prices because investors find these firms more reliable, and they are confident in a way a company is controlled (OECD, 2004; Unger, 2006). Therefore, corporate governance enhances investor confidence and facilitates external financing.

Taking a wider view, Tricker (1984, p. 6) highlights that “the governance role is not concerned with the running of the business of the company, per se, but with giving overall direction to the enterprise, with overseeing the executive actions of management and with satisfying legitimate expectations of accountability and interests beyond the corporate boundaries”. Monks and Minow (2001) support Tricker’s view and claim that effective corporate governance assists in maintaining the firm’s integrity, reputation and accountability to its relevant constituencies apart from shareholders. Likewise, it is recognized that aligning the right of corporate claimants maximize the social, economic and environmental well-being of communities (Rocca, 2011).

In a broad sense of the notion, corporate governance is a matter of paramount importance to the economy. Indeed, it is “crucial for society’s ability to mobilize domestic and international savings and channel them to productive ends at the lowest possible cost” (Söderström et al., 2003). A great amount of capital and a large part of a nation’s collective wealth have been entrusted to firms’ management and the board, therefore it is crucial to encourage the firms to use resources more efficiently.

Summing up, corporate governance mechanisms play a significant role in a contemporary business environment. For this reason, OECD in its Principles of corporate governance (2004, p. 11) recognize
that “the presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy.”

### 2.1.3 Theoretical roots of corporate governance

The concept of corporate governance is rooted in many different theories of organizational studies, management, sociology and psychology. In order to get a better understanding of the foundations of corporate governance, we reviewed the main research domains that establish a theoretical framework for this academic field. Furthermore, our findings are summarized in the Table 1 below.

**Table 1. Overview of major corporate governance theoretical foundations**

<table>
<thead>
<tr>
<th>Theory</th>
<th>Core idea</th>
<th>Selected authors</th>
</tr>
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<tbody>
<tr>
<td>Agency theory</td>
<td>Minimization of agency costs in principal-agent relationships to ensure maximization of owner’s returns</td>
<td>Jensen and Meckling (1976); Eisenhardt (1989); Hill and Jones (1992); Nyberg et al. (2010); Yu and To (2011)</td>
</tr>
<tr>
<td>Stewardship theory</td>
<td>Managers are stewards of the principle and they tend to act in the best interest of a firm rather than being opportunistic and self-interested</td>
<td>Donaldson and Davis (1991); Davis et al. (1997); Wheelen and Hunger (2006)</td>
</tr>
<tr>
<td>Shareholder value theory</td>
<td>Emphasis on economic profitability for advancing owners’ wealth</td>
<td>Friedman (1962); Freeman and Reed (1983); Freeman (1984); Hill and Jones (1992); Monks and Minow (2001); Adams et al. (2011); Heracleous and Lan (2011); Weston et al. (2003)</td>
</tr>
<tr>
<td>Stakeholder theory</td>
<td>Highlight social responsibility over economic profitability and sees it vital for a long-term business success to consider a wide range of stakeholders</td>
<td></td>
</tr>
<tr>
<td>Contingency theory</td>
<td>There is no universally best way to lead a company and make decisions because the optimal actions are contingent upon specific situational factors which originate in internal as well as in the external environment of a firm</td>
<td>Fiedler, 1964; Merchant and Van der Stede, 2007; Steger and Amann, 2008</td>
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*Source: Authors’ own elaboration, 2012.*

**Agency theory** has been primarily exploring the relationship between managers and stockholders and it suggests that there is a potential for “managerial mischief” (Nyberg et al., 2010, p. 1029). Eisenhardt (1989, p. 57) in his often-cited article draws an interesting analogy of the agency problem with the following tale:

“One day Deng Xiaoping decided to take his grandson to visit Mao. “Call me granduncle”, Mao offered warmly. “Oh, I certainly couldn’t do that, Chairman Mao”, the awe-stuck child replied. “Why don’t you give him an apple?” suggested Deng. No sooner had Mao
done so than the boy happily chirped, “Oh thank you, Granduncle”. “You see”, said Deng, “what incentives can achieve.”

Fundamentally, the theory is concerned with two types of players: principal (shareholder) and agent (manager), and deals with the situation when “one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision making authority to the agent” (Jensen and Meckling, 1976). The agency theory is built on several assumptions: first of all, the goals between the principal and agent are likely to diverge; second, the agent is better informed about the situation than the principle, that makes it difficult for the principle to control agent’s actions; and lastly, these players have a different risk preferences that might bring different outcomes (Yu and To, 2011). The agency theory literature focuses mainly on the normative aspects of described relationship, such as agent’s equity ownership and their compensation, to ensure appropriate incentives for the agent to act in the best interest of the principle; and the role of the board of directors in controlling managerial behaviour (Jensen and Meckling, 1976; Hill and Jones, 1992; Gabrielsson, 2003).

Stewardship theory, however, questions many of the assumptions stated in agency theory. The main difference between them is that stewardship theory does not consider managers as self-serving individuals, but rather stewards who want appreciation for their efforts and whose goals are growth, achievement and self-actualization (Davis et al., 1997). Stewardship theory advocates challenge the basic assumption of agency theory (conflict of interests) and sees managers as trustworthy collectivists that tend to act in the best interests of the organization (Wheelan and Hunger, 2006). Specifically, Donaldson and Davis (1991, p. 52) suggest that the corporate structures should assist the CEO in attaining superior performance in a way that “the CEO exercises complete authority over the corporation and that their role is unambiguous and unchallenged”.

Stockholder/stakeholder value theory. It have been an on-going business debate on whether companies should operate exclusively in the interests of their owners (shareholders) or should also emphasize the goals of other stakeholders affected by company’s actions (Monks and Minow, 2001). Therefore, we can see a basic conflict of interests in public corporations, which goes back to the basic economics theory of a company and ethical issues (Grant, 2010).

On the one hand, the shareholder value theory emphasizes economic profitability over social responsibility and sees the purpose of a company in advancing owners’ wealth (Adams et al., 2011; Heracleous and Lan, 2011), “so long as it stays within the rules of the game” (Friedman, 1962, p. 133). Moreover, the two basic assumptions in economics affirm that “rational people should act to maximize their own self-interest and that the primary purpose of employees in for-profit organizations is to maximize shareholder value” (Merchant and Van der Stede, 2007, p. 685).
On the other hand, the **stakeholder theory** emphasizes social responsibility over economic profitability and highlights that for a long-term viability the business should take into consideration a wide range of stakeholders, such as shareholders, employees, creditors, customers, suppliers and local communities (Freeman, 1984; Hill and Jones, 1992; Weston et al., 2003). The board of directors, therefore, gets a broader responsibility: rather than just protecting stockholders’ interests, it should be involved in balancing various and often conflicting interests of stakeholders in and around a company (Freeman and Reed, 1983). The words of Henry Ford (Nevins and Hill, 1957, p. 97) can serve as a good illustration for this theory:

“I don’t believe we should make such an awful profit on our cars. A reasonable profit is right, but not too much. I hold that it is better to sell a large number of cars at a reasonable small profit... I hold this because it enables a larger number of people to buy and enjoy the use of a car and because it gives a larger number of men employment at good wages. Those are the aims I have in life.”

**Contingency theory** advocates that there is no universally best way to lead a company and make decisions because the optimal actions are contingent upon specific situational factors (Fiedler, 1964). These factors originate in internal as well as in external environment of a firm and should be considered by managers in decision-making process. The examples of contingent factors include differences in national and corporate culture, ownership aspects, organizational structure, size, stability, growth, technology, competition and regulation of the industry (Merchant and Van der Stede, 2007). Concerning the issues of corporate governance, contingency theory manifests, in line with the purpose of our study, that there is no single model of good corporate governance that could fit every organization (OECD, 2004). That is why managers should take into account a great number of contingent factors, when designing corporate governance structures.

### 2.1.4 Corporate governance structure

Corporate governance structure can be broadly broken up into two groups - internal monitors and external monitors - on the base of managerial ability to determine or influence corporate mechanisms (Sudarsanam, 2000; Sundaram, 2004). The external monitors include the managerial labour market, the stock market and the market for corporate control, whereas shareholders ownership, the board of directors and management team led by the CEO form internal monitors of corporate governance (see Figure 7).

Monks and Minow (2001, p. 1) refer these primary participants in corporate governance (internal monitors) - shareholders, the board of directors and the management (led by the CEO) - to corporate “tripod”, a Greek three-legged piece of religious furniture (see Figure 8).
As we are intended to explore the issues regarding corporate governance mechanisms needed for managing post-acquisition turnaround and integration in terms of shareholders, the board of directors and the CEO, there is a need to clarify the main aspects of each “leg” framing corporate “tripod”.

### 2.1.5 Shareholders

Shareholders are often referred as the owners or stockholders of a firm. They could be individuals or institutions, which legally own any part of stock or shares in public or private company (Steger and Amann, 2008). An eminent US Supreme Court Justice Louis D. Brandeis more than hundred years ago questioned the moral aspects of share ownership (Monks and Minow, 2001, p. 57):

“To my mind there is no such thing as an innocent purchaser of stocks. It is entirely contrary, not only to our laws but to what ought to be our whole attitude towards investments, that the person who has a chance of profit by going into an enterprise, or the chance of getting a larger return than he could get on a perfectly safe mortgage or bond – that he should have a chance of gain without responsibility. The idea of such persons being innocent in the sense of not letting them take consequences of their acts is, to my mind, highly immoral and it bound to work out, if pursued, in very evil results to the community.”

There has been a number of studies that favour concentrated over dispersed ownership in a form of large block of shareholding rather than a big number of transient owners (Jensen and Meckling, 1976; Shleifer and Vishny, 1986; Sudarsanam, 2000). The scholars argue that concentrated
ownership increases monitoring effectiveness (Sudarsanam, 2000) and diminish the free-rider problem, occurring when a firm is owned by numerous small shareholders, leading to a more active involvement of owners in companies (Bebchuk and Weisbach, 2010).

Recently, there has been a movement towards shareholder activism, which is defined as “the use of ownership position to actively influence company policy and practice” (Sjöström, 2008, p. 142). Writing letters, dialogue with corporate management and the board, and filling formal shareholder proposals are some of the ways to pursue shareholder activism. Scholars, who advocate shareholder participation in corporate governance, claim that it can be a useful tool for mitigating the agency problem, existing between managers and owners (Bebchuk, 2005; Harris and Raviv, 2010). In contrast, the main arguments against shareholder proposals are that “the sponsoring shareholders are likely to pursue their own self-serving agendas or be simply too uninformed to make effective governance decisions” (Cziraki et al., 2010, p. 741). Apart from this, shareholder activism can disrupt the boards’ authority unnecessarily and bring instability to a company (Bainbridge, 2006). Ultimately, shareholders can perform their monitoring of the company directly, by participating in the board of the investee firm, or indirectly, by delegating this responsibility to the elected directors (Sudarsanam, 2000).

### 2.1.6 Board of directors

It is generally accepted that the board of directors play a crucial role in corporate governance. The board links the shareholders, providers of capital, and the managers, people who use that capital to generate value (Monks and Minow, 2001). Moreover, the board “serves to resolve conflict of interests among decision makers and residual risk beaters” (Baysinger and Butler, 1985, p. 101) by monitoring the performance of managers and safeguarding the assets of a company on behalf of shareholders (Sudarsanam, 2000).

The responsibilities of the board of directors vary from country to country and are usually defined by regulations and legislation. However, scholars generally agree on the following five responsibilities of a director:

1. “Setting corporate strategy, overall direction, mission or vision;
2. Hiring and firing the CEO and top management;
3. Controlling, monitoring, or supervising top management;
4. Reviewing and approving the use of resources;
5. Caring for shareholder interests” (Wheelen and Hunger, 2006, p. 36).
The board of directors fulfils these responsibilities by conducting three typical tasks:

- **Monitoring and supervising** – baseline of any board work; the directors should watch over developments inside and outside a firm and bring management’s attention to them, ensure compliance with legislation, standards and policies.

- **Evaluate and influence** – task for more active boards; the directors are in charge of the senior officers and CEO succession planning, giving feedback and advice to management’s decisions, actions and proposals.

- **Initiate and determine** – work for the most active boards; by drawing corporate mission, organizational structure and developing strategic options to the management team the directors can make a substantial contribution in the corporate evolution (Wheelen and Hunger, 2006; Steger and Amann, 2008).

Depending on the extent the board members perform the three basic tasks outlined above, involvement of the board in strategic management can differ considerably. Below, in Figure 9, the board of directors’ continuum can be found, which shows involvement of directors from low to high degree (Wheelen and Hunger, 2006). Therefore, the board could vary from being phantom with no real involvement to being catalyst taking a leading role in corporate improvement.

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**Figure 9. Board of directors’ continuum**

Less active boards, for example phantom or rubber stamp boards, typically never determine or initiate strategy unless extreme cases occur. Monks and Minow (2001, p. 189), therefore, state that “too often, it has seemed that they [the board] only pay attention when there is a crisis. There seems to be little concern with what a director is supposed to do, if anything, to prevent a corporate crisis”. Furthermore, some board members cannot devote sufficient time to oversee management because they are serving in too many boards (Merchant and Van der Stede, 2007).

The boards’ performance to oversee the full cycle of management activities depends crucially upon its structure and composition, where the proportion of outside / inside directors is one of the most important criteria (Sudarsanam, 2000). Many firms are monitored by the boards, which are composed of inside as well as outside members. Inside directors are usually managers employed by the company, whereas outside directors are not officers of the board’s company and do not have any direct business relationship with the firm (Weston et al., 2003). Outsiders are usually presented by retired CEOs or officers of the other firms, consultants, academicians, financiers, trade union representatives, private investors or former government officials (Baysinger and Butler, p. 1985).

Researchers, investors and owners have begun to emphasize the importance of independent directors. They claim that outsiders are better able to protect the interests of stockholders, because they “have an incentive to monitor management actions since they have staked their reputation as professional corporate referees” (Sudarsanam, 2000, p. 123). Moreover, having more independent less biased board members can intensify control, enhance monitoring and increase the possibility to evaluate management’s decisions objectively than inside directors (Wheelen and Hunger, 2006; Goranova et al., 2010). In addition, outsiders can be a valuable source of expertise and serve as a link to external business communities (Baysinger and Butler, p. 1985).

Other authors put forward arguments in favour of a higher number of inside directors in the board. Wheelen and Hunger (2006), basing their arguments on stewardship theory (see above), claim that inside managers are more interested in ensuring firm’s success and guaranteeing its continued life. Outsiders might lack necessary competency, interest or time that is needed to evaluate strategic decisions (Sudarsanam, 2000). Lastly, Monks and Minow (2001, p. 209) remark that “directors do
not become independent just because they have no economic ties to the company beyond their job as a director. Disinterested outsiders can mean uninterested outsiders. The key is not “independence,” but whether a director’s interests are aligned with those of the shareholders”.

Nevertheless, trends in corporate governance show that the role of the board is continuously increasing and directors are getting more involved in shaping corporate strategy rather than just reviewing internal initiatives and monitoring management’s decisions (Wheelen and Hunger, 2006).

2.1.7 Management

The board of directors takes proactive stance and is not involved in the daily business decision-making. It is the job of executives, who are responsible for day-to-day operations (Steger, 2004) but the directors should provide the company with the best management talent available. Monks and Minow (2001, p. 164), referring to the principal-agent conflict of interests, dispute good intention of executives: “Being the managers of other people's money rather than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partnership frequently watch over their own.”

The job of top management is “multidimensional and is oriented toward the welfare of the total organization” (Wheelen and Hunger, 2006, p. 48). The CEO, with the support of other executives, should assume responsibility for:

1. *Providing executive leadership and a strategic vision.* Executive leadership, which is defined as “directing of activities towards the accomplishment of corporate objectives” (Wheelen and Hunger, 2006, p. 49), is extremely important because the CEO should set an example for other executives and employees in terms of personal values and attitude. Moreover, by enthusiastically communicating the company’s mission, objectives and strategic plans, the CEO can set high performance standards, show confidence and facilitate change and movement in an organization (Monks and Minow, 2001).

2. *Managing the strategic planning process.* Top management should initiate and manage the strategic planning process. In particular, “top-down strategic planning may be most appropriate for firms operating in turbulent environments” (Wheelen and Hunger, 2006, p. 50). Top executives should evaluate and give feedback to unit plans and ensure that the plans of all functional units fit together.

The members of the board are likely to know less about the company’s operations than the CEO and top management because the directors are dependent on accuracy and timeliness of information prepared by management, who has necessary infrastructure, expertise and time to run the company (Bebchuk and Weisbach, 2010). Researchers state that these crucial parties of corporate governance
should avoid conflicts and find a proper and comfortable balance of power between them in monitoring and governing a company (Steger, 2004).

Following the purpose of this master thesis, the next section will introduce the context for studying corporate governance mechanisms – mergers and acquisitions and, in particular, international acquisitions of distressed firms.

2.2 Mergers and acquisitions

2.2.1 Definitions and development of international mergers and acquisitions

Mergers and acquisitions (M&A) have played a significant role in the world economy for the last two decades. This strategy has been used by the companies to achieve synergy by combining two or more business units in order to enhance competitive advantage (Calipha et al., 2010). The firms are, therefore, willing to assure cost savings, enter new market segments, broaden product portfolio, consolidate an industry or acquire valuable resources (Weston et al., 2003).

From a legal point of view, merger is defined as the “combination of assets of two previously separate firms into a single new legal entity” (Ghauri and Buckley, 2003, p. 207), whereas Evans et al. (2011, p. 527) take acquisitions to mean the case when “one company acquires sufficient shares to gain control of the other organization”. In particular, UNCTAD (2000, p. 99) in their World Investment Report note that the number of cross-border acquisitions, described as a situation, when “the control of assets and operations is transferred from a local to a foreign company, and the former becoming an affiliate of the latter”, is growing worldwide. In fact, there are very few real “mergers of equals”, because in most deals one partner is still dominating another, and therefore scholars focus mainly on acquisitions, which embody the large majority of international M&A (UNCTAD, 2000).

Since 1990s there has been a dramatic growth worldwide of the M&A’s volumes (see Figure 10). Despite the fact that M&A activity subsided when the global economy cooled off – in 2000 and during the global financial crisis in 2008-2009 – it is expected that the number of deals will continue to grow in the future (Evans et al., 2011). Calipha et al. (2010), reviewing the contemporary research in the field of mergers and acquisitions, highlight that “the growth in M&A activity, the volume of capital involved, and the pervasiveness of M&A stand in sharp contrast to their high rate of failure”. Indeed, academic researchers report that only a minority of deals, less than 50%, succeed in achieving anticipated benefits, cost savings, and other synergetic outcomes (Shrivastava, 1986; Ghauri and Buckley, 2003; Pablo and Javidan, 2004; Calipha et al., 2010; Evans et al., 2011).
The increase in M&A business activity during the last decades has been coinciding with the growth of attention from academic researchers. Indeed, the term “mergers and acquisitions” is present in the titles and abstracts in total of 34524 articles and 1476 times only for the last 2011 year in the Business Source Premier database (University Library, 2012). Moreover, Google books (2010) show a steady growth, illustrated on Figure 11, of the books published on the topic of mergers and acquisitions since 1980s.

Various topics within M&A field have been studied by researchers from several disciplines. Birkinshaw et al. (2000) mark out four different schools of thought and the main aspects of them are presented in Figure 12 below. Financial stream focuses on the wealth creation at a societal level, whereas organizational behaviour school explores behavioural implications and “human side of mergers and acquisitions” (Buono and Bowditch, 1989).

The last two streams are especially important for our research because strategic management is concerned with the value creation by achieving various synergies for the merged firms and the process perspective takes into consideration the actions and decisions taken by management to develop post-acquisition integration process (Birkinshaw et al., 2000). In addition, in the limited
scope we will consider the organizational behaviour aspects, as socio-cultural part is also an important side of post-acquisition integration (see in detail further).

**Objective function**

- Financial economics: Wealth creation for shareholders; for economy as a whole
- Organizational behavior: Impact of acquisition on individuals and organizational culture
- Strategic management: Performance of acquiring/acquired firms
- Process perspective: Creation of value after acquisition

**Central proposition**

- Acquisition enhance the efficiency of the market for corporate control and, thus, result in net wealth creation for shareholders
- The congruence between the cultures of the two merged organizations will facilitate employee satisfaction and effective integration
- Synergies (as a result of economies of scale, scope, market power etc.) will have a positive impact on acquirer performance
- The actions of management, and the process of integration, determines the extent to which the potential benefits of the acquisition realized

*Figure 12. Summary of streams of research on M&A*

*Source: authors’ own elaboration, 2012, based on Birkinshaw et al., 2000, p. 397.*

### 2.2.2 Acquisitions of distressed firms

Acquisitions of distressed firms represent a particular area within M&A research. Distressed firms are characterized by the situation when “it confronts the possibility of financial disaster” (Weber, 1994, p. 54), is threatened by impending bankruptcy (Pandit, 2000) or forecasts future decline in performance and results (DiPrimio, 1988). There could be many causes for this existence-threatening performance rooted in external environment as well as internal management. Market maturity, new technologies, declining demand, new powerful competitors and poor management are just few examples (Weber, 1994).

A financially distressed company could eventually file for bankruptcy, make internal restructuring or sell out to another firm (Weber, 1994). In fact, acquisition is the most common alternative for the companies, which efforts to make internal improvements have failed (Bruton et al., 1994). In this case a distressed firm can get essential access to the resources of the parent company (Castrogiovanni and Bruton, 2000). Apart from this, some distressed companies found themselves in a difficult situation not because they lack resources but rather because of mismanagement and inadequate use of existing resources. Therefore, the parent company after the acquisition can change top executives in the troubled firm to improve its management (Bruton et al., 1994).
There are several reasons why distressed firms might be an attractive target for acquisitions. First of all, as Porter (1991) describes, companies with problems could be bought by another firm in order to turn them around and then sell at a profit. Another reason has a more long-term and collaborative character: an acquiring company might be intended to buy a distressed business “with the hope of first turning it around and then gaining various synergies between that business and others in its portfolio” (Castrogiovanni and Bruton, 2000, p. 27). This is the case we focus in our thesis. The benefits of such deals could be rooted in the advantages of cost reduction, risk reduction, the expanding of market power and improvement of management of distressed business (Bruton et al, 1994). As a result, “if properly evaluated, carefully selected distressed M&A opportunities could become a valuable corporate strategy alternative, especially during troubled economic times” (Calandro, 2009).

In order to reanimate a distressed firm, corporate governance actors should take prompt steps to turn the company around using various strategies described in the section below.

### 2.3 Turnaround management

#### 2.3.1 The concept of turnaround

Nowadays many firms experience periods of deteriorating financial performance as a result of global competition, technological turbulence and maladaptive decisions of the management team (Hambrick and Schecter, 1983; Rasheed, 2005). Hofer (1980, p. 19) states that “no matter what the state of the economy [is], no company is immune from internal hard times – stagnation or declining performance”. However, whether the reasons of decline are rooted in external and/or internal environment, managers can prevent the business failure by selecting the proper strategies for restoring the firm’s advantageous competitive position (Rasheed, 2005). Therefore, turnaround techniques are gaining general acceptance among scholars as well as among practitioners.

Indeed, turnaround management has received considerable academic attention during the last three decades (Boyne and Meier, 2009). The term “turnaround management” or “turnaround theory” appeared in the titles and abstracts of 38591 articles, and 255 times for the last 2011 year on the Business Source Premier database (University Library, 2012). Moreover, Google books (2010) show a significant growth, illustrated in Figure 13, of the books published on the topic of turnaround management since 1970s. Though, the academic research on turnaround theory is not as rich as on corporate governance and M&A, it is recognized as a highly important field of management (Hofer, 1980; Pearce and Robbins, 1993; Chowdhury, 2002; Rasheed, 2005).
Most scholars define turnaround as the recovery of a company’s performance following a period of organizational failure or existence-threatening decline by moving away from crippling deterioration to sustainable success or eventual death (Pandit, 2000; Chowdhury, 2002; Boyne, 2006; Boyne and Meier, 2009, Schmitt and Raisch, 2010). This is the definition that we will use in this master thesis. Within this context, Pandit (2000, p. 37) describes turnaround candidates as “firms whose very existence is threatened unless radical action is taken”. Though several factors may reflect an organizational crisis situation, a considerable decline in financial performance is usually viewed as a key determinant in initiating turnaround activity (O’Kane, 2006). Furthermore, Pandit (2000) remarks that the decline could occur over several years or it could be observed over a shorter period of time caused by any extraordinary event.

The turnaround process can conventionally be illustrated as a sequence of several stages (Figure 14) – decline, response initiation, transition and outcome (Chowdhury, 2002).
In the decline stage, once-successful firm reaches a nadir of its performance (the deepest point). As Boyne (2006, p. 373) notes “this is more than a blip or a short-term dip in commercial success; [a firm] faces a stark choice between strategic change that may lead to recovery and strategic persistence that is likely to result in outright failure”.

If the response and transition period are managed properly, the turnaround efforts could be crowned with success and the companies “overcome their troubles and return to match or exceed their most prosperous periods of pre-downturn performance” (Pearce and Robbins, 1993, p. 634). Many scholars refer successful turnarounds to the case when a firm reverses a survival-threatening decline, returns back to its normal operation and achieves sustained profitability (Barker and Duhaime, 1997; Pandit, 2000; Lohrke et al., 2004; O’Kane, 2006). The failure of turnaround efforts involve the “demise of the firm” (Boyne, 2006, p. 373) in the form of takeover by another company or bankruptcy.

### 2.3.2 Strategies for turnaround

The current research distinguishes between three major strategies for turnaround – retrenchment, repositioning and reorganization and replacement (Figure 15). They could also be implied complementary and in parallel (Walshe et al., 2004)

![Turnaround strategies](image)

**Retrenchment** is the strategy that involves “a wide range of largely short-term actions taken to stabilize the organization, to stem its losses and deal with the immediate problems which have precipitated its crisis” (Walshe et al., 2004, p. 204). The core changes are usually associated with the reduction of the size and scope of a business (Boyne, 2006). Therefore, classic retrenchment activities consist of cost cutting and asset reducing activities – downsizing, outsourcing, product elimination, head count cuts, improvement of operational efficiency and production processes and selling assets (Robbins and Pearce, 1992; Boyne and Meier, 2009).
As Boyne (2006) notes, the special emphasis should be on those parts of the business that are unprofitable and unproductive. A distressed firm can involve immediate steps to cut inventory, reduce overheads, quit difficult markets, eliminate unprofitable product lines or services, start outsourcing or sell the assets (Walshe et al., 2004; Boyne and Meier, 2009). When severity of the financial situation is relatively low, stability could be achieved just by the means of cost reduction. However, in the most extreme cases, especially when a firm is very close to bankruptcy, an asset reduction strategy might be the only viable action (Hofer, 1980; Pearce and Robbins, 1993).

Many firms, however, start their turnaround activities with labour lay-offs. In many business areas there exists the possibility of head count cuts and consequent improvement of productivity. But managers should be very cautious in implementing this strategy because “if the reductions are too harsh there can be a real threat to the quality of both the product and the overall service offered to customers” (Thompson, 2001, p. 647). Apart from this, improvement of operational efficiency and production processes is also a part of retrenchment (Robbins and Pearce, 1992). The most typical means include increasing throughput, restructuring work and planning processes or reducing waiting and idle times (Walshe et al., 2004).

Retrenchment strategies have a short-term horizon and are employed in order to yield immediate results (Thompson, 2001; Chowdhury, 2002). Turnaround managers strive for achieving a positive cash flow (revenue generation) and stabilization of financial condition (Robbins and Pearce, 1992; Boyne and Meier, 2009). Boyne (2006, p. 378) states that “these procedures are used to generate resources, with the intention to utilize these for more productive activities”, which are likely to deliver higher performance. Therefore, some researchers call the retrenchment strategy as efficiency turnaround or operating turnaround (Hofer, 1980; Chowdhury, 2002; Boyne and Meier, 2009). Given a high value that retrenchment actions can bring for a distressed company, Robbins and Pearce (1992, p. 290) even claim that “it is rarely possible to achieve turnaround without an initial period of planned retrenchment”.

In contrast, other scholars consider retrenchment as “a false economy that saps the strengths of a company” (Boyne and Meier, 2009, p. 843). Barker and Mone (1994), for example, argue that retrenchment activities are not a cause of turnaround performance but a consequence of dramatic performance decline. In their study they show that this strategy alone does not bring a higher absolute level of performance and may even be harmful for the company. Schmitt and Raisch (2010, p. 2) add that “while some attention to recovery activities may be beneficial, too much attention to such activities may have adverse effects on the firm's ability to successfully manage the turnaround process.”
Repositioning strategy involves manipulating strategy components through adjustments or change of the business field the firm is currently operating in (Chowdhury, 2002). Some scholars also use the term “strategic turnaround” or “entrepreneurial turnaround” instead of repositioning (Hambrick and Schecter, 1983; Hofer, 1980; Boyne, 2006). As Pearce and Robbins (1993, p. 628) state “entrepreneurial turnaround strategies involved doing things differently whereas efficiency turnaround [retrenchment] strategies entailed doing the same things on a smaller or more efficient scale.” The main objective of implementing repositioning strategy is seeking and generating revenue from new sources (Boyne and Meier, 2009).

First of all, repositioning actions could be directed towards improvement of the company’s position on the current market to become more dominant: for example, through product reintroduction, lowering prices, increased advertising and selling efforts (Hambrick and Schecter, 1983; Pearce and Robbins, 1993; Boyne, 2006). Moreover, Thompson (2001, p. 649) describes the rationalization of the product line as a mean of repositioning strategy: “variety reduction can similarly be useful for concentrating efforts on the stronger market segments and opportunities, particularly where the industry overall is losing attractiveness.”

The second direction of entrepreneurial turnaround strategies involves diversifying into new markets and products, developing new products, principal technologies, distinctive competencies and changing the mission and image of the firm (Hofer, 1980; Robbins and Pearce, 1992; Boyne, 2006). The company can expand by developing or acquiring new businesses, which turnaround managers consider attractive for corporate profitability and growth (Chowdhury, 2002). Furthermore, this response to failure can also include long-term renewal strategy of re-establishing the strategic vision, direction and overall purpose of the firm (Walshe et al., 2004; Boyne, 2006).

Reorganization is the strategy, which involves changes in the internal management structure of an organization (Boyne, 2006). It can take a form of redesigning organizational structure, changing the extent of decentralization, corporate culture and leadership (Pearce and Robbins, 1993). Therefore, the company can introduce another organizational structure, which executives think can ensure more effective management, optimization of business processes and decision-making, give more control and clear delegation of power (Wheelen and Hunger, 2006). By increasing the extent of decentralization, “authority for making decisions is pushed down to lower levels in the organization” (Merchant and Van der Stede, 2007, p. 445).

The most frequently cited form of reorganization is the replacement of the CEO and other senior executives. Many scholars argue that replacement of top management team is an essential element of all successful turnarounds (Hofer, 1980; Castrogiovanni et al., 1992; Chen and Hambrick, 2012). Walshe et al. (2004, p. 204) define replacement as “removal of key members of the leadership and
management of the organization, and their replacement either with others from within the organization or with others drawn externally.” In fact, the change can affect just the CEO and some senior executives or involve complete substitution of the board of directors and management team.

In general, there are three benefits associated with replacement strategy that are most frequently cited in academic research papers. First of all, new management team can bring a fresh perspective to the turnaround process (Castrogiovanni et al., 1992). Hofer (1980) notes that incumbent CEO has a strong set of beliefs about the firm and its environment, thus might fail to see the need for change and fix the problems with risky solutions. Following Hofer, Castrogiovanni et al. (1992, p. 26) remark that “current CEOs (especially those who have had extended periods of success) are often locked into a particular perspective yielding specific recipes for running the business”. Hence, it has been found that incumbent managers display “threat rigidity” (Boyne, 2006, p. 380) behaviour, when “an imminent crisis leads to their clinging even more tightly to the existing strategy”. Therefore, new CEOs and other top executives, having a different mind map, background and experience, can bring new ideas and understanding for turning the company around (Barker and Duhaime, 1997). They lack personal commitment to firm’s policies and practices and have “no baggage and no hidden agendas” (O’Kane, 2006, p. 128).

Secondly, incumbent managers might not have the necessary skills and competences to deal with the crisis situation (Castrogiovanni et al., 1992; Chen and Hambrick, 2012). Poor performance is per se an indicator of executive inadequacy. According to Slatter (1984, p. 74), “the existing management is rarely capable of taking the drastic action needed to effect a turnaround”.

Thirdly, replacement strategy can have symbolic aspects to signal all concerned stakeholders of coming dramatic changes (Boyne and Meier, 2009). It might be implemented in order to attract new resources, to impress the market, encourage external agents to give time needed for performance improvement, reassure and motivate personnel (Chen and Hambrick, 2012).

However, several researchers warn against replacement strategy (Barker et al., 2001; O’Kane, 2006). Chen and Hambrick (2012, p. 225), for example, highlight that “CEO turnover often causes trauma and imprudent changes that more than offset any positive consequences”. Moreover, talented employees essential for turnaround process can leave voluntarily because they might feel fatigue and uncertain about their perspectives in the company (Semadeni et al. 2008). Apart from this, Zhang (2008) points out that the board of a distressed firm is usually under pressure and directors make prompt changes of the CEO without deliberateness and care. Nonetheless, when the crisis and decline in performance become severe, it is generally accepted that costs and disadvantages of replacement actions decrease and, hence, “it may well prove the most effective means of portraying a commitment to change” (O’Kane, 2006, p. 121).
Apart from the need to turn a distressed firm around, the parent company should make necessary steps for a post-acquisition integration between the companies. The literature review of the concept of post-acquisition integration, its types and levels is presented in the next sections.

### 2.4 Post-acquisition integration

An important part of thinking within the field of research into mergers and acquisitions deals with the post-acquisition integration process. These scholars build their theories on the premise that “all the value creation takes place after the acquisition” (Haspeslagh and Jemison, 1991, p. 129). Shrivastava (1986) points out also that lack of integration between the merged firms is the major cause of low performance of one third of all mergers and acquisitions. In addition, global M&A survey of 2006 (Calipha et al., 2010) shows that orchestrating and executing the integration process (stated by 47% of respondents) is the critical element of successful cross-border M&A. However, most large corporations have difficulties in integrating their various activities even without acquisitions: functional departments performing a narrow part of specialized tasks, such as finance, marketing, production, accounting, R&D, procurement, need to be properly combined within the large formal organizations (Shrivastava, 1986).

In the case of M&A, “integration is the engine of organizational change and development in acquisition-based growth and plays a critical role in overall corporate renewal strategy” (Chakrabarti and Mitchell, 2005, p. 3). The importance of post-acquisition integration is clearly highlighted in the following statement made by acknowledged researchers in the field of M&A, Haspeslagh and Jemison (1991, p. 11):

> “Many acquisitions look great on paper. Yet, no matter how attractive the opportunity, value is not created until after the acquisition when capabilities are transferred and people from both organizations collaborate to create the expected benefits or to discover others”.

#### 2.4.1 The concept of post-acquisition integration

The existing body of M&A literature does not provide a big variety of definitions of the term post-acquisition integration. However, most scholars agree that integration implies some form of combination processes of the assets and people of acquiring and target firms into one cohesive, single entity (Schweiger and Goulet, 2000; Pablo and Javidan, 2004; Knilans, 2009; Tarba et al., 2012). Mtar (2010, p. 1104) defines integration as “the acquirer’s approach to harmonizing its management practices in the target firm”. In addition, Chakrabarti and Mitchell (2005) note that post-acquisition
integration process involves standardization of firm’s routines and synchronization of their activities across various business units.

The art of combining companies after acquisition deal penetrates though several levels, such as production lines, technologies, human resources, cultures, marketing, information systems, accounting systems and others (Vancea, 2011). However, Shrivastava (1986) highlights that “not all the types of integration are always achieved or even necessarily for merging organizations to function”; the right degree of integration is defined by a variety of contingences.

In the present study, post-acquisition integration refers to the comprehensive definition offered by Chakrabarti and Mitchell (2005, p. 3):

“Post-acquisition integration is the interactive and gradual process of strategic and administrative combination of acquiring and target firms, in which individuals from the two organizations learn to work together and cooperate in the transfer of strategic capabilities.”

2.4.2 Types of post-acquisition integration

As it has been noted above, post-acquisition integration process is multidimensional and involves numerous “changes in the functional activity arrangements, organizational structures and systems, and cultures of combining organizations” (Pablo, 1994, p. 806). One of the first classifications of integration, which we will take as a basis, was given by Paul Shrivastava in 1986 and it identifies three types of post-acquisition integration: (1) procedural integration, (2) physical integration, and (3) managerial and socio-cultural integration (Shrivastava, 1986).

Procedural integration involves “combining systems and procedures of the merged companies at the operating, management control, and strategic planning levels” (Shrivastava, 1986, p. 68). This is done in order to homogenize and standardize work procedures that facilitate communication between two companies, reduce the costs of processing information and increase productivity (Shrivastava, 1986). The first step of procedural integration usually involves legal issues of ownership transfer and combining the companies’ accounting systems, however, the integration of financial systems could be problematic. Reporting forms and instructions usually vary significantly between the firms, where acquirer’s corporate chart of accounts is more complex than the target company has worked with (Chakrabarti and Mitchell, 2005).

Followed by accounting system, other management control procedures within functional areas, for example sales analysis, costing, inventory control, production scheduling, order processing, can be harmonized between the companies (Shrivastava, 1986). These changes should be implemented after a thorough analysis as meaningless replacement of firm’s systems could be disruptive provoking drop
in performance and opposition of the personnel. Indeed, Chakrabarti and Mitchell (2005, p. 7) highlight that mismanagement of employee relations policies, performance evaluation structures, benefits plans, salary structures and profit sharing plans “can lead to a clash of priorities, create ambiguities that cause resistance to change, and therefore increase the probability of failure of the acquisition.”

**Physical integration** implies complex and time-consuming process of “consolidation of product lines, production technologies, R&D projects, plant and equipment, and real estate assets” (Shrivastava, 1986, p. 69). M&A usually happen between firms that have some resources and asset continuity, therefore, according to Chakrabarti and Mitchell (2005) during the integration phase, business reconfiguration requires redeployment (reassignment) and disposal of resources and assets (retrenchment and sale of businesses and organizational assets). This process can provide “more efficient use of existing resources, as well as expand the scope of the firm’s activities” (Chakrabarti and Mitchell, 2005, p. 4).

Furthermore, physical integration implies *product line integration*, which involves “the assessment of whether the products of the acquired business fit with the strategy of the acquirer” (Shrivastava, 1986, p. 69). Therefore, some products, which become redundant after an acquisition, may be eliminated from the common product line, or, if the product line or the whole division do not fit the acquiring company’s corporate strategy, they might be divested. Moreover, integration of *production technologies* (transferring production systems across firm boundaries) and integrating *plant and equipment* are important parts of physical integration. Movement of plant and equipment “may be necessary to reduce production costs, inventory holding costs, and the cost of transporting goods to markets” (Shrivastava, 1986, p. 70), but accurate market valuation of real estate assets is necessary before taking decisions about asset reconfiguration.

Procedural and physical integration can together be related to task integration addressed by Birkinshaw et al. (2000). It is defined as “the identification and realization of operational synergies” (Birkinshaw et al., 2000, p. 400) and is achieved through resource sharing and transfers of capabilities.

**Managerial and socio-cultural integration** is seen by scholars as the most difficult to master. Shrivastava (1986, p. 70) refers managerial and socio-cultural integration to “a complex combination of issues related to the selection or transfer of managers, the changes in organizational structure, the development of consistent corporate culture, and the frame of reference to guide strategic decision-making, the gaining of commitment and motivation of personnel, and the establishment of new leadership.” Birkinshaw et al. (2000) see the goal of human integration in generating positive attitude,
satisfaction, cultural convergence, mutual respect and a shared identity among employees from both firms.

First of all, managerial integration involves transferring top management from the acquiring firm to the acquired firm to ensure control (Shrivastava, 1986). It could take a form of appointing a new CEO or new board directors, which will represent an acquired company. It is usually observed that new top management personnel “bring a team of trusted managers to ensure continued smooth operations and to facilitate the transfer of systems and procedures to the new business” (Shrivastava, 1986, p. 71). The transfer of middle management and staff personnel may also assist in “cross-fertilizing” (Shrivastava, 1986, p. 71) the two companies, however, the movement of employees should be supported by the processes of socialization and cultural adjustment.

Socio-cultural integration takes long time to achieve but is especially important in international acquisitions. Because an acquiring firm might not have sufficient experience in the country or geographical area, where the acquired firm is located, early planning of necessary actions guiding the company through unfamiliar territory is essential (Evans et al., 2011). Indeed, Lakshman (2011, p. 614) remarks that “many beliefs and behaviour of individuals in organizations (or countries) are a result of their culture or collective programming of their minds; they are also a function of the broader social and economic systems in place”. The differences and incompatibility of national or corporate cultures between the merged firms can create organizational challenges in managing the integration process (Calipha et al., 2010; Vancea, 2011). However, researchers have also noted that national and organizational cultural differences can bring positive effects for post-acquisition integration through the opportunities of mutual learning, but these mechanisms have not been fully explored (Evans et al., 2011; Tarba et al., 2012).

Corporate culture, which is defined as “the assembly of attributes and values shared by the employees and which dictate the latter’s professional and moral attributes” (Vancea, 2011, p. 174), implies differences in opinions, capabilities and attitude of top management working on post-acquisition integration, the nature and style of decision-making in implementing changes and designing business strategy (Tarba et al., 2012). Managers in merging firms usually have different frame of reference – “assumptions, information and mental maps that managers use in decision-making” (Shrivastava, 1986, p. 72). By working on socio-cultural integration and promoting communication, managers should develop consistent assumptions and mental maps, which will help them in avoiding conflicts between the employees.

Gaining commitment and motivating personnel is another component of managerial and socio-cultural integration. Evans et al. (2011, p. 547) claim that personnel of the acquired business experiences “merger syndrome”, which is characterized by people’s stress, absenteeism, disbelief,
resentment, hostility, denial, shock, overreaction and anger. Post-acquisition changes usually include employee layoffs and structural redesign to cut costs and decrease redundancy (Chakrabarti and Mitchell, 2005). Therefore, workers feel uncertain about their jobs and future career prospects, afraid to lose their identity, status and affiliation (Shrivastava, 1986). “Merger syndrome” reduces job satisfaction, motivation, commitment, intention to stay in the firm, and provoke perceptions about company’s trustworthiness (Chakrabarti and Mitchell, 2005).

These feelings are usually unavoidable, because they express a natural process of employees’ adaptation (Buono and Bowditch, 1989; Evans et al., 2011). However, proper mechanisms should be developed in order to elude “lowered commitment and productivity, increased dissatisfaction and disloyalty, high turnover among key managers, leadership and power strugglers” (Buono and Bowditch, 1989, p. 20). The integration process should be directed towards maintaining morale and gaining the commitment of employees to newly developed corporate objectives (Shrivastava, 1986). Therefore, such mechanisms as incentives and compensation schemes, opportunities for career development play an important role in the process of building commitment and motivation (Lakshman, 2011).

Finally, managerial and socio-cultural integration deals with *establishing new strategic leadership*. The post-acquisition process usually starts with the appointment of new leadership: CEO and/or other top managers. New leaders might not be widely accepted by their new colleagues and subordinates, they do not have established reputation and trusting relationships, do not have necessary information and are usually unfamiliar with the work style and corporate culture of the acquired company (Shrivastava, 1986). Therefore, it is crucial to re-establish new strategic leadership, which is basically referred to “the creation of a set of conditions in the organization that gives it direction, purpose and guides integrated strategy formulation and implementation” (Shrivastava, 1986, p. 73). In addition, leaders should mitigate possible conflicts in the organization and motivate employees to take active part in the integration process (Lakshman, 2011). Visibility and continuity of the individuals responsible for integration is perceived by Birklinshaw et al. (2000) as one of the main dimensions of human integration. All in all, in the process of socialization and readjustment, “strong and committed leadership is the foundation for the successful execution of integration initiatives” (Evans et al., 2011, p. 550).

**2.4.3 Determinants of the need for post-acquisition integration**

Three different types of post-acquisition integration described in the previous section are not required in all the situations. Indeed, “nonintegration of the acquired business can be satisfactory in some situations, overintegration can be expensive, and underintegration can be unproductive” (Shrivastava,
Pablo and Javidan (2004, p. 114) argue that each acquisition has its own specific characteristics and managers should not rely on “one-size-fits-all solution”. Therefore, in this section we embrace the issues of acquisition’s types and characteristics of the acquiring and acquired businesses as the determinants of optimal level of integration.

Pablo (1994, p. 806) defines the level of integration as “the degree of post-acquisition change in an organization's technical, administrative, and cultural configuration”, and he distinguishes between three levels of integration. A low level of integration involves limited technical and administrative changes while developing standardized basic management systems and processes. At a moderate level physical and knowledge-based resources are exchanged or shared and alterations in the value chain are increased. The higher level of integration refers to extensive sharing of all types of resources, adopting the acquiring firm’s systems and procedures and deep structural and cultural absorption of the target firm (Pablo, 1994).

The need for particular level of integration is primarily based on the motives of acquisition. Acquisitions are often classified into three groups (UNCTAD, 2000; Ghauri and Buckley, 2003):

1. Horizontal acquisitions, which occur between the companies producing similar or related products in the same industry and these products might not compete directly with each other;
2. Vertical acquisitions, which are observed between organizations in client-supplier, buyer-seller or other value chain relationships;
3. Unrelated (conglomerate) acquisitions, which happen between companies in unrelated businesses.

Horizontal and vertical acquisitions are considered as related acquisitions (Salter and Weinhold, 1981). The strategic purposes underlying them is achieving economies of scale by merging the resource base of two companies or economies of scope by performing product or market extensions (Ghauri and Buckley, 2003). The companies might also seek to get access to new technology or managerial expertise, reduce or eliminate competition, consolidate the industry, grow rapidly or exert more control over firm’s operations (UNCTAD, 2000; Ghauri and Buckley, 2003; McCarthy, 2011). While unrelated acquisitions can help the company to spread risks or open up possibilities of entering a new attractive industry, usually they do not have the intention of sharing resources (Shrivastava, 1986).

The value, which is expected to be created through acquisitions, is usually based on cost cutting or increased scope (Ghauri and Buckley, 2003). In the case of related acquisitions and expected cost synergies extensive integration is suggested, whereas acquisitions that are aimed at growth synergies through unrelated acquisitions are the subject to partial or non-integration (Shrivastava, 1986; Oliver Wyman, 2008).
**Size of the firm** is the second determinant of the need for post-acquisition integration. It could be measured by the number of employees or amount of sales and assets. It is generally accepted in the literature that “the larger the organization, the greater the need for integration, because larger organizations possess a greater number of units or elements that need to be coordinated” (Shrivastava, 1986, p. 68). It is especially difficult to manage megamergers or acquisitions between two large organizations, because each actor has its own problems of combining various functional areas or divisions that are usually given autonomy to take decisions about their internal affairs. In the large companies individual managers experience problems even to assess all the areas needed to be integrated as larger firms are much more difficult to manage, integrate and oversee (Buono and Bowditch, 1989). A considerable difference in size can bring serious misunderstandings during the integration process because of “the lack of knowledge of the large acquiring company about the competencies needed for managing a small company, and vice versa” (Calipha et al., 2010, p. 15). Apart from this, large acquiring organizations might intensify beliefs about their superiority and inferiority over the acquired firm and, as a result, managers of the acquired firm are moved from the strategic core of organization and their relative significance is reduced, which reflects in the loss of status, power and impact compared to the managers of the acquiring firm (Pablo, 1994).

Other authors (e.g. Haspeslagh and Jamison, 1991; Pablo and Javidan, 2004) suggest the following factors for understanding the level of post-acquisition integration. Firstly, they take into consideration **autonomy need** as an important aspect. In some cases it is possible to keep the acquired business autonomously with no intention to combine operations of two firms (Pablo and Javidan, 2004). The acquiring firm can introduce a preservation approach by operating autonomously, limiting intrusions and remaining strategic resources, capabilities, operations, culture and other organizational parameters of the acquired firm intact and independent (Haspeslagh and Jamison, 1991). Therefore, it has been observed that “greater autonomy results in limited plans to combine operations of the two firms” (Pablo and Javidan, 2004, p. 116).

Secondly, **interdependence need** can also influence the decisions about the need for inter-firm integration. Pablo and Javidan (2004) claim that “greater strategic interdependence [creates] the need for more integration of the firms’ operations in order to achieve the intended goals of the deal”. That is why, significant changes in one or both firms can follow the deal, and integration managers apply absorption or symbiotic approach (Haspeslagh and Jamison, 1991). In particular, absorption approach refers to a full consolidation of the firms’ activities by assimilating the acquired firm into the acquiring firm’s business, whereas symbiotic approach involves changes in both firms’ processes and design in order to create a combined organization (Vancea, 2011).
2.5 Corporate governance in managing international acquisitions of distressed firms

The current state of research does not give comprehensive information about the role of corporate governance mechanisms (shareholders, the board of directors and top management team) in managing turnaround and post-acquisition integration following the takeover of a distressed firm by a foreign company. The purpose of this master thesis is to provide a better understanding in this field by conducting a case study of the Estonian textile manufacturer. In line with the stated aim, this section gives an overview of studies which are relevant to our investigation.

Fich and Slezak (2008) explore several cases of bankrupt companies and highlight that governance structure, which fit well in one situation, could be ineffective in other set of conditions. They analyse “how different corporate governance characteristics affect the probability and the predictability of a distressed firm ending up in bankruptcy court” (Fich and Slezak, 2008, p. 226). The authors explore the variation in the structure and composition of the board of directors and board ownership. The main results of the study show that boards of a smaller size, with higher ratio of outside directors and larger ownership shares of inside directors perform more effective at preventing organizational failure of distressed firms (Fich and Slezak, 2008). In spite of valuable contribution to the corporate governance field, the authors focus generally on the level of a single firm and one actor of internal corporate monitors (the board of directors).

Another research has been conducted by Castrogiovanni and Bruton (2000) in the field of turnaround processes following acquisitions of the firms in financial straits. The scholars test the necessity of retrenchment actions in post-acquisition context and state that it cannot be a universally applied stage in the business turnaround management. The main implication therefore refers to the conclusion that “desirability of particular turnaround actions or processes may vary from one context to another” (Castrogiovanni and Bruton, 2000, p. 26).

A further set of research has been carried out about the role of top management team (CEOs and other senior executives) in the turnaround process. Raina et al. (2003) state that managing turnaround situations is difficult but achievable. That is why, the leadership aspect becomes a crucial element in achieving sustainable performance recovery (Hofer, 1980; Lohrke, 2004; O’Kane, 2006). The attributes, experience and mind-set of senior management need to be scrutinized in order to choose the best possible candidates, because, “in a majority of cases, sickness of a company can directly be attributed to the failure of the management” (Raina et al., 2003, p. 90). Indeed, the turnaround process requires considerable managerial attention, effort and resources to bring the company “out of the woods” (Hofer, 1980, p. 30). Within this context, O’Kane (2006, p. 121) highlights that top
management team should be “strong enough to survive the complex change processes”. All in all, these researchers assert that appropriate top management team is required to manage multi-phase process of preventing a firm from organizational failure (Lohrke et al., 2004). Despite its valuable contribution, this stream of research investigates the role of just top management team in the cases of individual firms.

Finally, a small part of researchers have looked into the issues of the board of directors, the CEOs and other top managers, which affect post-acquisition integration between the companies. Thus, Goodstein and Boeker (1991, p. 306) assert that “turbulence at the top” has negative consequences for post-acquisition performance and integration process between the firms. Furthermore, DePamphilis (2001, p. 242) giving the credit to the importance of director’s role to the success of acquisitions, points out that “maintaining continuity of board membership is often important in meeting the long-term objectives of the combined forces.” The changes of director’s involvement in strategic issues, for example from nominal to active participation or catalyst level (see section “Board of directors” above), can have significant role during crucial periods of the firm’s development (Goodstein and Boeker, 1991). Talking about the role of senior executives in post-acquisition period, McCann and Gilkey (1988 cited in Angwin, 2004, p. 58) argue that “comprehensive changes in top management are often crucial for acquisition success”. Moreover, Slatter (1984 cited in Angwin, 2004) emphasizes that inadequate top executives are the most important determinant of corporate stagnation and decline; therefore, initial CEO’s change can facilitate turnaround governance. Angwin (2004) in turn states that new managers brought from a different industry make greater changes in the target company because they are not constrained by existing social ties and have a broader perspective.

From the problem statement outlined in the first chapter of this master thesis and presented literature review, it became clear that researchers have been mostly focused on the studies of corporate governance without any specific context (Fich and Slezak, 2008). Furthermore, the research on turnaround management has been oriented mainly on the content of change and individual firms in financial straits. Therefore, this master thesis asserts that more contextual awareness is needed and explores the role of corporate governance mechanisms in managing turnaround process after the acquisition of distressed firms by foreign companies and the impact of post-acquisition integration for turnaround success.
3. METHODOLOGY

A well-considered methodology is the foundation for any business research, this chapter provides information about the main aspects on how current research was conducted. Firstly, we outline the purpose of study, followed by the explanation of the chosen approach and design. Further, we present information about the data collection methods, data analysis and criteria for assessing the quality of the study. Finally, research delimitations and limitations are reviewed.

3.1 Research purpose

The choice of research design, according to Ghauri et al. (1995, p. 26) is “the overall strategic choice made with the purpose of coming up with an approach that allows for answering the research problem”. Hence, research can be classified in terms of their purpose into (1) descriptive, (2), exploratory (3) causal (Hair et al., 2007). Descriptive research is conducted in order to obtain information of the phenomena, ascertain and describe the characteristics of the study object (Collis and Hussey, 2009). Causal research, which is called explanatory research by some scholars, measures and interprets causal relationship between the variables (Sauders et al., 2003).

In order to address the research problem formulated in the first chapter of this master thesis in the best way, exploratory research has been chosen in order to “assess phenomena in a new light” (Robson, 2002, p. 59), bring new ideas and patterns. This type of research is used to develop a better understanding of a business problem (Hair et al., 2007; Sauders et al., 2003), because it “goes beyond description and attempts to explain the reasons for the phenomenon” (Cooper and Schindler, 2008, p. 20). The research presented in this master thesis gives a more contextual understanding of corporate governance mechanisms, rather than “one-size-fit-all” approach. It provides a better conception of the role of corporate governance mechanisms in managing turnaround process of a distressed firm after its acquisition by foreign firms, and necessity for corporate executives in initiating post-acquisition integration between these merged companies. Exploration of the relationship between turnaround process and post-acquisition integration brings also the elements of causal research to this thesis.

3.2 Research approach

Business research is usually conducted by applying qualitative or quantitative approach. In some cases, however, they could be combined in order to enrich the investigation and mitigate limitations associated with this approaches (Bryman and Bell, 2011).
Scholars argue that the main difference between qualitative and quantitative approaches is the kind of information used to study a phenomenon and procedure (Ghauri et al., 1995; Blumberg et al., 2005). Indeed, quantitative approach bases their accounts on quantitative information, i.e. numbers and figures, analysed by statistical methods (Blumberg et al., 2005), or on qualitative information that can be quantified (Collis and Hussey, 2009). Moreover, quantitative approach views the relationship between theory and research as deductive (the emphasis is on testing and verification) and has an objectivist conception of social reality (Bryman and Bell, 2011).

In contrast, qualitative research relies on qualitative information, i.e. words, sentences and narratives, in order “to understand the different meanings that people place on their experiences [and] delve more deeply into people’s hidden interpretations, understanding, and motivations” (Cooper and Schindler, 2008, p. 162). This approach is thought to be ideal in cases where feelings, emotions, perceptions and self-described behaviour are important for exploring a particular research problem (Cooper and Schindler, 2008). Furthermore, qualitative approach usually employs a limited number of observations and analyses several aspects of the research area (Ghauri and Gronhaug, 2005). The low number is explained by the fact that it allows the researcher to do in-depth studies into a phenomenon or give a “thick” description, which is not possible in the case of numerous observations used in quantitative research.

The choice of the particular approach is based on the research problem and the purpose of study (Blumberg et al., 2005; Ghauri and Gronhaug, 2005). The reason for using a particular research approach in this thesis can be found in its purpose. Our exploratory research aims at providing a better understanding of the role of corporate governance mechanisms in a particular context. Hence, in our view, purely quantitative method was unlikely to elicit the rich data necessary to address the proposed research problem. Therefore, qualitative approach as the most advantageous for this thesis was used. By studying corporate governance role after the acquisition of a distressed firm, we intend to achieve an in-depth conception of a turnaround and post-acquisition process, reasons for particular motives of human behaviour and develop a contextual understanding. Moreover, many academics emphasize that qualitative methods are the most useful for inductive (generation rather than testing of theories) and exploratory research, which are used in this master thesis. (Ghauri and Gronhaug, 2005; Bryman and Bell, 2011). Apart from this, we used quantitative information from statistical sources about Estonia and Narva, the Annual reports and financial information of the companies - in order to get a better understanding of the ownership structure and performance. However, this data was not analysed by the use of statistical methods for theory testing or verification (Ghauri et al., 1995), and, therefore, is a part of our qualitative research.
In addition, it has been noticed that there is a lack of empirical studies in the exploring field, especially the ones applying qualitative approach. In fact, out of 30 main academic articles chosen for the literature review on the topic of corporate governance, 21 of them conducted empirical studies, but just 2 out of 21 applied a qualitative approach (Angwin, 2004, Niece and Trompeter, 2004). In the 25 main academic articles about turnaround theory, only four authors (Hofer, 1980; Ruiz-Navarro, 1998; O’Kane, 2006; Chowdhury, 2002) used qualitative studies, and 10 – quantitative. The research on post-acquisition integration shows a similar pattern: out of 25 main articles, 10 of them contained empirical studies, however, there are just three qualitative research papers (Salter and Weinhold, 1981; Birkinshaw et al., 2000; Tarba et al., 2012). By conducting qualitative research this master thesis brings a fresh insight into the research problem outlined above.

Scholars differentiate also between inductive and deductive research. The researcher when applying a deductive approach “on the basis of what is known about a particular domain and of theoretical considerations in relation to that domain, deduces a hypothesis that must then be subjected to empirical scrutiny” (Bryman and Bell, 2011, 11). Therefore, deductive approach aims at theory testing and moves from the general to the particular (Sauders et al., 2003; Collis and Hussey, 2009). An alternative inductive approach, which is applied in this master thesis, refers to the research where “theory is developed form the observation of empirical study; thus, general inferences are introduced from particular instances” (Collis and Hussey, 2009, p. 8), see Figure 16 below.

![Figure 16. Inductive and deductive research](Source: Ghauri et al., 1995.)

This master thesis had its starting point at the case of Krenholm, Estonian textile company, which recently became a bankrupt. The case is briefly outlined in the background of the first chapter. By conducting inductive study, this research aims at collecting and analysing primary and secondary data in order to provide fresh insight and extend the existing theory of corporate governance in specific contexts.
3.3 Research design

The research design provides a framework for the collection and analysis of data, which allows exploring the problem under investigation in the best possible way (Emory, 1985; Bryman and Bell, 2011). Within the framework of a qualitative approach, our investigation was most suited for a case study. As a form of research design, case study is “a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple source of evidence” (Robson, 2002, p. 178). According to Stake (1995), case study is associated with the complexity and specific nature of the case under investigation. This type of research design is very popular and widespread in business and management research (Bryman and Bell, 2011).

The main distinction of a case study design is “the focus on a bounded situation or system, an entity with a purpose and functioning parts” (Bryman and Bell, 2011, p. 60). Therefore, intensive case examination of settings can focus on a single organization, department, group, individual, location, event or situation to get a rich understanding of the context of the research (Ghauri et al., 1995). It is important to mention, that selection of cases should be based on the opportunity to learn from the investigation (Stake, 1995). By conducting a comprehensive case study of the Krenholm company, we expect that learning will be greatest and make it possible to answer the research questions stated in the first chapter. We provided the results of examination of complex events through extensive description and contextual analysis.

Moreover, case study design was chosen for this thesis in order to provide a full contextual analysis of corporate governance mechanisms needed for managing turnaround processes after the acquisition of distressed firms by foreign firms and necessity of post-acquisition integration between the companies. To further support our arguments, another aspect of our case study is worth mentioning - “an emphasis on detail [which] provides insight for problem solving, evaluation and strategy” (Cooper and Schindler, 2008, p. 144). The above mentioned inclination and the flexibility of the case study allowed us for a richness of understanding, which is labelled by scholars as a “thick description” (Cooper and Schindler, 2008, p. 185). We did not only collect simple facts from the secondary data, but went beyond and obtained important information of real-life situations that took place in the company of study in the period from 1995 to 2010. By analysing the Estonian firm over a 15 years period in a retrospective way and comparing our findings across time to identify patterns and trends, brings longitudinal elements of our case study (Hair et al., 2007), which are “concerned with how a situation changes over time” (Bryman and Bell, 2011, p. 62).
Apart from this, case study researchers often utilize qualitative methods (used in this thesis), such as unstructured or semi-structured interviews and participant observation, because of the intensive, detailed examination of a problem they can provide (Bryman and Bell, 2011). Moreover, many qualitative case studies as well as ours tend to take inductive approach focusing on the theory building rather than on theory testing (Hair et al., 2007).

3.4 Data collection

Research method, which is an essential component in conducting business research, basically corresponds to a technique for collecting data (Bryman and Bell, 2011). Hair et al. (2007) state that there are several means for primary data collection: interviews, observations and surveys/questionnaires. However, only personal/group interviews and observation of human behaviour/events are suitable for qualitative research (Saunders et al., 2003; Cooper and Schindler, 2008). Due to the fact that our case company went to bankruptcy at the end of 2010, doing any kind of observations was unfeasible. In order to collect necessary data for our empirical investigation, primary data in the form of semi-structured interviews and secondary data in the form of company’s and personal documents and mass media outputs were used.

Semi-structured interviews were selected as a major source for data collection in this thesis. According to Hair et al. (2007, p. 197), semi-structured interviews allow a lot of flexibility because “researchers are free to exercise their own initiative in following up an interviewee’s answers to a question”. Therefore, the order or amount questions prepared in an interview guide could be adjusted depending on the direction of the interview (Kajornboon, 2005). The interview method was felt to be of the most use in our study because it has a potential to “result in unexpected and insightful information coming to light, thus enhancing the findings” (Hair et al., 2007, p. 197). We have started to explore the case from the outset and preliminary interviews facilitated the refinement of research questions and theoretical focus. Moreover, the advantages of semi-structured interviews are that they help to gather information about complex and sensitive issues, get rich, detailed, more accurate and clear picture of an interviewee’s position (compared to structured interviews), allow prompting and probing deeper into the case (Ghauri et al., 1995; Hair et al, 2007; Kajornboon, 2005; Bryman and Bell, 2011). Despite certain strengths, there are some limitations associated with interviewing, which we will state in the last section of this chapter.

Sample selection. In order to gain a deep understanding of corporate governance issues we chose a purposive sampling, which is widely used in case studies (Bloomberg and Volpe, 2008). This method enables to use researcher’s judgement to select participants that will best enable to answer research questions and meet research objectives (Saunders et al., 2003; Hair et al., 2007).
The interviewees in our study were chosen on the basis of the following criteria: the amount, importance and ability of information they can provide, availability, willingness to participate, and diversity of their positions in the case company in order to get various opinions and increase reliability of the answers. Moreover, we tried to cover the whole period from 1995 to 2010, thus we contacted persons that can enable us to fulfil that objective. Limited timeframe did not allow us to get access to more respondents; however, we think that the number of valuable participants and a long duration of interviews gave us sufficient information for the data analysis. The requests for an interview, which included the purpose of the study, suggested date and time, were sent about 3 weeks in advance, and we got a positive reply from all the selected participants.

The research sample included 10 individuals (see Appendix 2) from 2 different countries – Sweden (Stockholm and Borås) and Estonia (Tallinn, Narva and Tartu). The main participants - Meelis Virkebau, Oleg Klushin, Nina Zaitseva, Peter Poskin, Konstantin Gorlov and Lars Mauritson - occupied top positions in Krenholm (case company) and Borås Wäfveri (its owner from 1995 to 2010) for at least 8 years and have a broad hands-on experience of managing textile business. In addition, we performed interviews with 4 supplementary participants in order to get extra information about the case company, economic and business situation in Estonia and Narva, and receive a feedback on our research topic.

**Interview process.** In accordance with the semi-structured method of interviewing, to direct the interview process, before each meeting we prepared an interview guideline with the questions and areas to be covered (Bryman and Bell, 2011). The guide included general questions about the company, its product line, organizational structure as well as more specific questions about corporate governance issues, turnaround efforts and post-acquisition integration process in regards to our research topic. In accordance with Bryman and Bell (2011), we tried to use language that is relevant and comprehensive to the interviewees. At the beginning of each interview, we explained general information about the research project and the purpose of the study, agreed on the length of the interview and asked permission for audio recording.

The interviews were conducted in the period February-April (see Table 2). There have been 6 private interviews and 2 group interviews. In total we conducted 8 interviews, which lasted in average for 2 hours. We did two trips to Estonia for about 3 days. The interviews in Tallinn, Tartu, Stockholm and Borås were carried out in English, in Narva – in English and Russian. Therefore, during the first group interview we used an interpreter, who translated questions from English to Russian and answers from Russian to English, when there was a need for that. During the second group interview one of the authors of this thesis played the role of interpreter as Russian language is her mother tongue, which also helped to communicate with participants from Narva.
Table 2. List of conducted interviews

<table>
<thead>
<tr>
<th>Stage of data collection</th>
<th>Person</th>
<th>Place</th>
<th>Date</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Pre understanding</td>
<td>Björn Eriksson</td>
<td>Stockholm, Sweden</td>
<td>February 04, 2012</td>
<td>1:29 h</td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Meelis Virkebau</td>
<td>Tallinn, Estonia</td>
<td>February 15, 2012</td>
<td>1:57 h</td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Alexander Brook</td>
<td>Narva, Estonia</td>
<td>February 15, 2012</td>
<td>1:30 h</td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Oleg Klushin</td>
<td>Narva, Estonia</td>
<td>February 16, 2012</td>
<td>3:11 h</td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Nina Zaitseva</td>
<td>Narva, Estonia</td>
<td>February 16, 2012</td>
<td></td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Peter Poskin</td>
<td>Narva, Estonia</td>
<td>February 16, 2012</td>
<td></td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Konstantin Gorlov</td>
<td>Narva, Estonia</td>
<td>February 16, 2012</td>
<td></td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Irina Shabas</td>
<td>Narva, Estonia</td>
<td>February 16, 2012</td>
<td></td>
</tr>
<tr>
<td>2. Trip No. 1</td>
<td>Maaja Vadi</td>
<td>Tartu, Estonia</td>
<td>February 17, 2012</td>
<td>1:12 h</td>
</tr>
<tr>
<td>3. Personal interview</td>
<td>Lars Mautitzon</td>
<td>Borås, Sweden</td>
<td>March 26, 2012</td>
<td>3:00 h</td>
</tr>
<tr>
<td>4. Trip No. 2</td>
<td>Oleg Klushin</td>
<td>Narva, Estonia</td>
<td>April 17, 2012</td>
<td>3:51 h</td>
</tr>
<tr>
<td>4. Trip No. 2</td>
<td>Nina Zaitseva</td>
<td>Narva, Estonia</td>
<td>April 17, 2012</td>
<td></td>
</tr>
<tr>
<td>4. Trip No. 2</td>
<td>Peter Poskin</td>
<td>Narva, Estonia</td>
<td>April 17, 2012</td>
<td></td>
</tr>
<tr>
<td>4. Trip No. 2</td>
<td>Meelis Virkebau</td>
<td>Tallinn, Estonia</td>
<td>April 18, 2012</td>
<td>1:02 h</td>
</tr>
</tbody>
</table>

During the first visit to Estonia more general questions were asked about the time before and after the acquisition, changes in products and markets, cultural aspects, organizational structure and main problems. The aim of these questions was to get a better understanding of the situation at Krenholm and further define the research questions. Therefore, during the second trip we re-interviewed several participants to get a deeper knowledge. We asked more specific questions about the corporate governance structure, turnaround efforts and post-acquisition integration between Krenholm and Borås Wäfveri. The reason that group interviews of 3-5 participants, rather than personal interviews, were conducted in Narva is based on the time and financial resources constrains. Moreover, during group interviews were intended to initiate a discussion between the participants in order to bring new insights, test and develop ideas for the research problem.

After each interview we made notes about how an interview went, where it took place, length of the meeting, corrections to the research questions and main ideas for data analysis.

Recording and transcribing interviews. All the interviews were recorded in their entirety with the use of GarageBand software for Apple computers (Apple, 2011). This program allowed us to record long conversations without interruptions and get good quality of the speakers’ voices. In addition, individual notes were taken during the interviews in order to avoid possible problems with the recorder. Later on, the interviews were transcribed verbatim. As Bryman and Bell (2011, p. 483) state, transcribing interviews is a very time-consuming process: “It is best to allow around five to six hours for transcription for every hour of speech.” Because the authors of this master thesis are not professional transcribers, it took us one week and a half to transcribe all the interviews recorded.
In addition to the primary data, we collected **secondary data** in the form of Krenholm’s and Borås Wäfveri’s internal documents (Annual reports, financial information, bankruptcy report, other type of reports), public official documents (statistical information about Estonia, Narva and textile industry in Estonia and Europe), mass media outputs (Expert magazine, official Narva’s newspaper and others), personal documents (letters, history of Krenholm written by one of the interviewees). Before using secondary materials in this master thesis, all the sources were evaluated for their credibility and authority, therefore only official sources of public and media information, internal organizational materials were chosen. According to Ghauri et al. (1995, p. 55), secondary data “not only helps the researcher to formulate and understand the research problem better, but also broadens the base for which scientific conclusions can be drawn.” These documents provided us with the valuable background information about the companies, insight into past managerial decisions and actions, impact of Krenholm’s bankruptcy on the social situation in the city, current situation in Estonia, Narva and textile industry.

### 3.5 Data analysis

Data analysis, which has an objective “to identify, examine, compare and interpret patterns and themes” (Hair et al., 2007, p. 291), is an important part of business research. Information that was collected, organized and analysed allows writing up and presenting findings. It is worth mentioning that in qualitative research data collection and data analysis are very much interrelated processes: analysis helps to identify further direction for data collection, especially when research is based on inductive approach (Saunders et al., 2003; Hair et al., 2007). In this master thesis, data collected from initial semi-structured interviews and secondary sources was analysed in order to find patterns and important themes needed to be explored by collecting additional information on the later stages of research process.

One of the distinctive features of qualitative research, observed by Bryman and Bell (2011, p. 571), is that “it very rapidly generates a large, cumbersome database because of its reliance on prose in the form of such media as field notes, interview transcripts, or documents.” Indeed, interview transcripts, for example, gave us a vast amount of paper, which needed to be analysed. In addition, processing of the Annual reports and other organizational information required significant amount of time and efforts. Therefore, a proper plan should be developed in order to manage the large amount of collected primary and secondary data (Bloomberg and Volpe, 2008).

According to Saunders et al. (2009), the following processes could be used for the qualitative data analysis: summarizing, grouping and structuring of meanings. After each interview we made a short summary of the key points that could be important for our investigation and further data collection.
The next step of data analysis involved grouping of data. As Saunders et al. (2003, p. 378) note “complex nature of the data that you have collected will probably need to be classified into categories before they can be meaningfully analysed”. In this master thesis secondary data was grouped according to the main object in focus: Krenholm, Borås Wäfveri, Estonia, Narva or textile industry. Primary data gained from semi-structured interviews was grouped by marking parts of the quotes with different colours. The grouping was based on the several sub-topics of our research: corporate governance, turnaround management, post-acquisition integration and complementary data. Information that appeared to be irrelevant for the research purpose was reduced. Further, all information within each marked group was arranged in chronological order where possible. The final step of data analysis included structuring of meanings. Within this process we made a structure of the empirical part and analysed how to present collected information in the best way. After that, in the analysis and discussion part, we showed significant patterns and constructed a model of corporate governance. This process helped us to achieve the research purpose and answer the research questions.

3.6 Credibility, dependability and transferability

Reliability and validity are “important criteria in establishing and assessing the quality of research” (Bryman and Bell, 2011, p. 394). However, these terms are usually used to assess quantitative research. Many authors highlight that criteria for evaluating qualitative research differ from those used in quantitative research (e.g. Hair et al., 2007; Bloomberg and Volpe, 2008; Bryman and Bell, 2011). For instance, Bloomberg and Volpe (2008, p. 77) state that in evaluating qualitative research “the focus is on how well the researcher has provided evidence that her or his descriptions and analysis represent the reality of the situations and persons studied.” These scholars use the criteria of credibility, dependability and transferability in order to evaluate qualitative research.

Credibility refers to the degree of how research participants’ perceptions match with the way researchers portray them (Bloomberg and Volpe, 2008). In our master thesis we paid particular attention to present the opinions of interviewees accurately. This was done by sending transcribed interviews to participants in order to get respondent validation (Bryman and Bell, 2011). Moreover, we used multiple methods of data collection: semi-structured interviews were complemented by findings from secondary sources. This method correlates with the Bloomberg’s and Volpe’s (2008) suggestion that “information provided by these different sources should be compared through triangulation to corroborate the researcher’s conclusions.” Apart from this, external peer review (Hair
et al., 2007), done by our colleagues and supervisor in the form of discussions and reviews, helped us to verify our interpretations and assumptions.

Dependability refers to “whether one can track the processes and procedures used to collect and interpret the data” (Bloomberg and Volpe, 2008, p. 78). In the methodology chapter of this master thesis, we explained in detail how we collected the data for our investigation; in addition, all the materials and steps of data analysis are available for external “auditing” upon request (Bryman and Bell, 2011, p. 398). During this spring semester we had several seminar sessions where our progress and research procedures were tracked by two colleagues and supervisor.

Transferability is not whether the research includes a representative sample but “it is about how well the study has made it possible for the reader to decide whether similar processes will be at work in their own settings” (Bloomberg and Volpe, 2008, p. 78). Because qualitative research usually studies small group or individuals or one company (applies case study design), it has its contextual uniqueness and importance of external environment that surrounds the study object (Bryman and Bell, 2011). As the scholars (Geertz, 1973 cited in Bryman and Bell, 2011; Bloomberg and Volpe, 2008) encourage, we provided description of the case study context in the chapter for Empirical findings. But the limited scope of this master thesis does not allow us to give an even broader explanation however, we believe that the given information will allow the reader to understand the context of study and judge about the possibility to generalize the lessons.

3.7 Delimitations and limitations

It is important to explain the reader our delimitations - boundaries of study. In a theoretical field, the scope of our study is narrowed down to corporate governance aspects in the light of management theory and related acquisitions made in order to have long-term relations rather than to get profit out of selling a recovered acquired company. Within the empirical study, we focus on a specific period of Krenholm’s history – from the point of its acquisition in 1995 and until the bankruptcy in November 2010. This company worked in such labour-intensive field as textile industry in former-Soviet country – Estonia. This facts show delimitations of time and location for this master thesis.

Limitations, or potential weaknesses, of our study are connected to the choice of research approach, design and data collection methods. Qualitative approach, in particular, is widely criticized by scholars for its subjectivity because within data analysis researchers decide by themselves what is important and significant (Bryman and Bell, 2011). The choice of research participants may also limit our study because other persons could have given us different answers. Whereas, opinions of interviewees are very subjective, and, because they had to reflect upon past events, participants might
have a critical attitude and tried to “protect” themselves by blaming other actors, therefore, it is always hard to get the “real” truth.

Apart from this, semi-structured interviews “demand greater skills from the interviewer than the fully structured interviews” (Ghauri et al., 1995, p. 65). The authors of this thesis do not have professional experience in interviewing; however, both were previously connected to journalism. Therefore, before each interview a considerable amount of time were spent for the preparation of an interview guide and all the necessary settings. As we indicated above, we conducted also several group interviews. Group interviews are more difficult to control and there is a possibility of group thinking effects (Bryman and Bell, 2011). In order to avoid that, within these group interviews we tried to encourage all the participants to give us their personal opinions and not just to follow a common point of view. Bryman and Bell (2011, p. 482) also note that “the use of a tape recorder may disconcert respondents, who become self-conscious or alarmed at the prospect of their words being preserved.” In our case all the respondents were agreed to make audio recording and, in fact, were really opened and inspired to share their sore concerns about the company with us.

The language aspect could also limit out research. Interviews in Narva were conducted in both English and Russian (native language for the participants). Therefore, it would be advantageous if both thesis authors could speak Russian to be able to freely communicate with interviewees. However, one of the thesis authors is a native Russian speaker, which facilitated the interaction process and made it possible to analyse additional organizational and media information written in Russian.
4. EMPIRICAL FINDINGS

This chapter presents empirical findings collected through primary sources (semi-structured interviews) and secondary sources (organizational internal documents, mass media output, public official documents and personal documents). Empirical data serves as the basis for further analysis and discussion in the next chapter.

4.1 Case study context

Given a great importance to the environment context surrounding the case company – Krenholm – in this chapter we outline the most relevant information in regards to the background and current situation in Estonia and Narva city, where Krenholm was located. Other factors such as the country’s culture, history and political system might also be important; however due to the limited scope of the thesis they will not be presented in this chapter.

4.1.1 Estonia

Estonia is located in the Baltic region and its capital is Tallinn. The state of Estonia became a member of the European Union on the 1st of May 2004 (Estonia.eu, n.d.c). As of the first of January 2010, Estonia’s population was 1,340 million people (Estonia.eu, n.d.d). The biggest cities in the country are Tallinn, Tartu and Narva (Estonia.eu, n.d.c). The largest ethnic groups in Estonia are Estonians with 68.8% of the population, Russians with 25.5%, Ukrainians with 2.1% and Belarusians with 1.2% (see Figure 1 in Appendix 3). The official language in the country is Estonian, however, 15.3% of the citizens speak Russian and 1% speak other languages (Estonia.eu, n.d.d).

Estonia was under the Soviet Union occupation from 1944 until the 20th of August 1991, when it gained full independence (Estonia.eu, 2011). The mass deportations of Estonian residents by the Soviet Union in middle of the 20th century, aimed to “russify Estonia” (Estonia.eu, n.d.a), became one of the most painful moments in Estonian history.
4.1.2 Narva

Narva is the third largest city in Estonia and by the middle of the 19th century Narva became an important industrial center, mainly due to the establishment of Krenholm Manufacturing Company. After the Second World War, almost 98% of the city was in ruins after Soviet and German bombings. The city was rebuilt under the Soviet regime until it became once more a border city after Estonia’s independence in 1991.

By the 1st of January 2011, the registered inhabitants in the city were 64,667 (Table 1 Appendix 4). Approximately 82.02% of the population are Russian nationals while 3.86% are Estonian nationals (Table 3 Appendix 4). Traditional industries for Narva are textile and clothing, metalworking and furniture industry.

4.2 Overview of Krenholm

<table>
<thead>
<tr>
<th>Full name</th>
<th>Krenholm Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Narva (Estonia)</td>
</tr>
<tr>
<td>Founded</td>
<td>1857</td>
</tr>
<tr>
<td>Sector</td>
<td>Production of cotton based products</td>
</tr>
<tr>
<td></td>
<td>(mainly household textiles)</td>
</tr>
<tr>
<td>No. employees</td>
<td>late 1980s:12 000</td>
</tr>
<tr>
<td></td>
<td>1995: 5 500</td>
</tr>
<tr>
<td></td>
<td>2010: 570</td>
</tr>
<tr>
<td>Owner</td>
<td>1995 - 2010: Borås Wäfveri AB</td>
</tr>
</tbody>
</table>


4.2.1 Historical background

The Krenholm Group (“Krenholm”), which was established in 1857, was a vertically integrated producer of cotton based products with a long experience in textile industry (International Financial Corporation, 1999). The company operated a number of textile mills on an 80 hectare site in the city of Narva on Estonian’s eastern border with Russia.

One of the most important contexts for the company was during the Soviet time when Krehnolm was nationalized and remained state-owned until 1995 (Edström et al., 2003). In the late 1980s the company employed more than 10 000 workers and produced approximately 32 000 tons of yarn and 220 millions of running meters of textiles per year, being the largest enterprise in the Soviet Union (Huhtamaa et al., 1995). The production facilities were geared for low-quality mass production and
Krenholm’s mills were working under a central planning regime, headquartered in Moscow, where quantity, rather than quality, predominated (International Financial Corporation, 1999). The sizes of an order were huge, article specifications were largely undemanding, product development was non-existent and quality was low.

![Krenholm and Joala Kanal](https://wikimania.n.d.)

**Figure 18. The picture of Krenholm and Joala Kanal**


After the dissolution of the Soviet Union in 1991, Krenholm was in a very difficult situation without previous customers, suppliers of raw material and with slender financial resources. In 1995, the company, being previously Estonian state-owned, was privatized and the majority ownership was acquired by Borås Wäfveri AB, a long-established Swedish textile company (Shabas, 2008). When the main owner of Borås Wäfveri saw Krenholm factories for the first time in 1993, he was impressed by their large size:

“Marvellous company, absolutely marvellous! More than 2000 looms and 120 buildings, it was very big. It is something that you can see there is a potential, you could do something of this, and it did not cost much money.”

The new owners made a good progress of transforming the company from planned to market economy in terms of managerial training, introduction of information system, increasing capacity utilization, establishing various products and accessing new markets (International Financial Corporation, 1999). In addition, the International Financial Corporation (a member of the World Bank Group) provided a loan of 25.8 million Euros to Krenholm in the year 1999. Apart from the renewal of production equipment, a new sewing plant was built in 2001, which allowed Krenholm to significantly expand the assortment range and production volumes (Shabas, 2008).

However, during the next several years, the financial performance of Krenholm was continuously decreasing that made the board and management of Krenholm and Borås Wäfveri to look for possible cost reduction solutions. Thus, in 2005 all the production units of Boras Wäfveri in Sweden were moved to Narva, where Krenholm took over its mother company’s production functions (Shabas,
At the same time, marketing and sales functions were transferred to Sweden making Krenholm just a production unit for its mother company. Moreover, at the end of 2007 it was decided that Krenholm would stop production of yarns, grey fabrics and terry and start to outsource them (Narvskaya Gazeta, 2008a; Shabas, 2008). Furthermore, by the end of May 2008, because of the critical financial situation, spinning and weaving production were closed down and about 1400 employees dismissed (Borås Wäfveri, 2007; Narvskaya Gazeta, 2008a). Nevertheless, in 2007 “annual turnover dropped down to 773 million EEK and annual operational loss reached 60.9 million EEK” (Shabas, 2008, p. 10).

It is important to note, that after the acquisition of Krenholm by Borås Wäfveri in 1995, the Estonian company saw the change of 7 CEOs in a 15 years period, 6 of whom came to the company during the last 8 years. Moreover, instability of leadership was also present in Borås Wäfveri. Indeed, in 2002 there was a major change in ownership in Borås Wäfveri - two venture capitalists became the main owners and got a majority of the votes during the board meetings. This change brought a new corporate strategy for the company. Apart from this, the top position at Borås Wäfveri was occupied by 7 CEOs from 1995 and up to the bankruptcy, 6 of whom managed the company during the last 10 years.

Eventually, at the beginning of November 2010, Borås Wäfveri decided to apply for its bankruptcy and, later on, for the bankruptcy of its Estonian subsidiary - Krenholm (Ivanov, 2010). Ivanov (2010, p. 9) in his article “How the dinosaurs become extinct” wrote:

> “Have stood still – and now, probably, forever – looms and production lines of previously famous textile manufacturer Krenholm, proudly called as a flagship of socialist industry in Estonia as well as in the whole Soviet Union.”

### 4.2.2 Main products and markets

Krenholm manufactured a broad range of products ranging from yarn to readymade items. The main raw material was cotton. The main products included: yarn, finished fabrics, bed linen, towels, curtains, garments, upholstery fabrics (jacquard), grey fabrics, diapers and table-linen (International Financial Corporation, 1999).

The main markets for Krenholm’s products during the last years 15 years were the Baltic States, Sweden, Norway and Finland, Germany and BeNeLux. A big part of the products were exported to the US (mainly diapers) until 2006, however, due to the tough competition with Asian producers, the market was almost completely lost (Shabas, 2008).
4.3 Overview of Borås Wäfveri

<table>
<thead>
<tr>
<th>Full name</th>
<th>Borås Wäfveri AB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Göteborg, Borås (Sweden)</td>
</tr>
<tr>
<td>Founded</td>
<td>1870</td>
</tr>
<tr>
<td>Sector</td>
<td>Production of cotton based products</td>
</tr>
<tr>
<td></td>
<td>(mainly household textiles)</td>
</tr>
<tr>
<td>No. employees</td>
<td>2010: 15 (in the headquarter)</td>
</tr>
</tbody>
</table>

Source: Authors’ own elaboration, 2012 based on Rosengrens Advokatbyrå, 2011; Prohorov, 2010.

Borås Wäfveri AB (“Borås Wäfveri”) was a traditional Swedish textile producer, originally founded in Borås in 1870 and has thus been in business for 140 years (Rosengrens Advokatbyrå, 2011). The company’s stock was traded on the Stockholm Stock Exchange from November 14, 1985 until November 3, 2010 when Borås Wäfveri filed for bankruptcy (Borås Wäfveri, 2006; Prohorov, 2010).

During the beginning of the previous decade production mills were gradually closed and moved from Sweden to Narva, Estonia, in order to reduce costs (Rosengrens Advokatbyrå, 2011). The business area Strömmär Sweden was sold in April 2009. Eventually, Krenholm became the only production unit in the Group. While in 2002 15% of the Group’s staff worked for the Swedish firms (85% - in Krenholm), on November 2010 in Sweden were left only 15 employees, occupying administrative posts in the Group’s headquarter located in Göteborg (Prohorov, 2010). The economic situation deteriorated in 2009, when the loss reached 1.43 million SEK (Rosengrens Advokatbyrå, 2011). Unceasing difficulties made the company to file for bankruptcy on November 3, 2010 (Dagens Industri, 2010).
During the last years of operation, Borås Wäfveri worked mainly in the segment Premium Private Label and Textile Services, where it supplied textile products to the healthcare and hospitality sector (Borås Wäfveri, 2009). Its brand - Borås Cotton - was famous on the Swedish and international market and represented major textile know-how in production associated with Nordic design. The brand has been known for its quality and safety (Rosengrens Advokatbyrå, 2011). The actual range consisted of home textiles such as bed linen, sheets, curtains, towels, fabric for protective and work clothing and upholstery fabrics (Borås Wäfveri, 2009).

### 4.4. Motives for acquisition

In 1995 Krenholm was privatized by Borås Wäfveri. This was a horizontal acquisition – the two companies produced related products in the same textile industry, however for different segments, therefore they did not compete directly with each other. The main objective underlying the acquisition was achieving cost synergies:
“The factory [Krenholm, authors’ note] retains a vast cost advantage in the form of low wages. An average Estonian textile worker earns just $1.5 per hour, less than a tenth of Swedish levels.” (Brown-Humes, 1999, p. 1).

“If we could use our knowledge in marketing in combination with the cost level in these countries.” (The owner of Borås Wäfveri)

“You got big production from almost nothing, very cheap.” (Consultant in Krenholm)

“They understood that they could not keep production in Sweden for a long time. When they look at possibilities in Krenholm, they understood that the company was a raw diamond that could be cleaned.” (The CEO of Krenholm)

4.5. Corporate governance

In this section we present the data that we collected mainly through semi-structured interviews with the top management and one of the main owners of Krenholm and Borås Wäfveri. Moreover, secondary data in the form of organizational documents and mass media output serves the role of supplementary material.

4.5.1 Corporate governance structure of Krenholm

Corporate governance structure of Krenholm was formed by the shareholders (from its parent company), the board of directors (which existed until 2002) and senior executive team led by the CEO.

![Corporate governance structure of Krenholm](image)

Figure 22. Corporate governance structure of Krenholm

Source: Authors’ own elaboration, 2012.
The Board of directors and the CEO’s

Meelis Virkebau, the first CEO of Krenholm after the acquisition by Borås Wäfveri in 1995, expresses the importance for cooperation between the three levels of corporate governance inside a company as crucial for survival and success:

“When there is a trustable cooperation between shareholders, board members and management, when everybody is open, everybody knows what is expected but if there is something wrong, information flow or mistrust, then this goes down.”

Meelis was characterized as a very capable man by his colleagues and he was able to communicate in Russian, Estonian and English. He had an enormous responsibility in front of him to turn Krenholm into a market oriented organization and to bring Krenholm back to profitability.

“We started our strategy to develop Krenholm as a Western oriented textile company but with another cost level than we have in Sweden. That was really hard work.” (The owner of Borås Wäfveri)

“Meelis was on the top and I also managed him to be the honorary consul of Sweden in Tallinn. So we had a president of Krenholm who was chairman of the Employees association and he was Swedish honorary consul.” (The owner of Borås Wäfveri)

The special council in Krenholm acted as the board of directors. This special council was formed by three members from Borås Wäfveri, the CEO of Krenholm and the divisional manager of the spinning mill.

“The special board for Krenholm started in 1995 and lasted until 2003. The members were Lars Mauritzon, Mats Gabrielsson, Madis Üürike from Borås Wäfveri and Oleg Klushin and Meelis Virkebau from Krenholm.” (The owner of Borås Wäfveri)

There was also an unofficial board of directors in Krenholm, in which Meelis Virkebau the CEO of Krenholm met with the divisional managers of all the subsidiaries. The main purpose of this unofficial board of directors was to increase the communication between the CEO and the divisional managers of the subsidiaries.

“I had a meeting every week with all the managers of the daughter companies: spinning, weaving, finishing. This was the board of directors, we called it in Krenholm. It was when I shared all the news that I had, when everybody spoke what was the problem, how to help, about sales. I created it, I was the chairman and there were all the managers of the daughter companies.” (The CEO of Krenholm)

1 He was the major owner of Borås Wäfveri until 2003; the CEO of Borås Wäfveri until 2000; chairman of the board of Borås Wäfveri from 2000 to 2001 and chairman of the board of Krenholm from 1995 until 2002 - for simplification, here and further refers to “the owner of Borås Wäfveri”.
Meelis Virkebau left Krenholm in January of 2003. One of the most relevant reasons for his departure was the disagreement with the board of directors and top management of Borås Wäfveri in regards to the future strategy for the company. After Meelis left, the special council in Krenholm was dissolved.

“Skipping the board for Krenholm, it was a big company, and they had special problems that were not involved in Borås Wäfveri, but the answer was always from Mr. Blom [Chairman of the board in Borås Wäfveri, authors note] that Krenholm has to be discussed in the board of Borås.” (The owner of Borås Wäfveri)

Meelis Virkebau was replaced by Mats Skogman in February of 2003. Mats Skogman was from Sweden and he was not able to communicate in Russian or Estonian. Skogman was the CEO of Borås Wäfveri and Krenholm at the same time. He worked in Sweden but he committed to visit Krenholm every second week.

“Skogman informed the board of Borås that his ambition was to change Meelis Virkebau as the managing director and then he promised that he would take care of Krenholm together with the CFO, that they would be there every second week but they were not. So you have the biggest industry in Estonia without any leadership from February 2003 until November 2003.” (The owner of Borås Wäfveri)

Skogman started the fiscal year of 2003 as the CEO for Krenholm with previous losses from 2002. World crisis and a recession in the textile market were the main causes that led to a negative result for 2002.

“It was in that way: in 2002 we were at the end of a very big investment period together with the World Bank and Peter Dinsdale, and at the same time there was a recession in the textile market for the first quarter of 2002. However Krenholm managed to get orders but they were for delivery in the first quarter of 2003, so we could see that we would have not very good result for 2002.” (The owner of Borås Wäfveri)

However, there was controversy in regards to the real amount of loss for 2002 in Krenholm.

“The auditors did everything that they wanted to have a loss of 14 million EEK at the end of 2002. That was no problem to balance that, but Skogman together with his CFO, wanted to have a very bad result for 2002, to get a very good result for 2003 so that they could get a very good bonus. So they did everything and it ended up in a loss of 44 million EEK.” (The owner of Borås Wäfveri)

Mats Skogman stayed until the middle of November of 2003 in Krenholm. The next CEO became Thomas Widstrand from Sweden, who was also the CEO for Borås Wäfveri and Krenholm at the same time. This situation brought confusion to the divisional managers at Krenholm.

“It is difficult for me to say for example what is the real position of Thomas in connection to Krenholm and Borås Group. It was a complicated mixture of Borås and Krenholm and we never
understood exactly where Krenholm ends and when Borås started. Widstrand visited Krenholm once every 3 months or so. Who was the real top manager in Krenholm between his visits is difficult to say.” (Department Manager of Krenholm)

Under Thomas Widstrand, the marketing department was moved from Krenholm in Narva, to Borås in Sweden. In addition, the full production of Borås Wäfveri was closed down and moved to Krenholm in 2005. Thomas Widstrand as Mats Skogman was not able to communicate in Russian or Estonian. He was the CEO of Krenholm until the end 2006. In the beginning of 2007, Matti Haarajokki from Finland became the next CEO for Krenholm until the middle of 2008. Haarajokki was characterized as a passive CEO.

“Heis distinctive feature was that he had not an own point of view for every situation, he was only a gentlemen whose obligations were to perform exactly how somebody in Sweden was telling him, we never felt any own initiative from him, no own point of view. His key activity was how many persons to dismiss.” (Department Manager of Krenholm)

“The Finn didn’t have language skills or interest in the local government, there were many cultural differences” (Consultant in Krenholm)

Moreover, Haarajokki was in Krenholm during the weekdays and flew back to Finland every weekend. This action was perceived as a lack of interest for the divisional managers and for a planning consultant at Krenholm.

“[The consultant] had a discussion with Matti Haarajokki and told him it is impossible to work in this way, you don’t know how Krenholm personnel lives, you don’t know what the surrounding circumstances are, you do not know anything about the way of thinking of Krenholm, about the previous history of the company. And staying and moving between Finland, Sweden and Narva it is an unacceptable way of working. The consultant understood it very clear and he was totally against it.” (Department Manager of Krenholm)

After Haarajokki, Igor Poleschuk became the CEO of Krenholm for 6 months in 2008. He was the former marketing manager in Narva and he was able to communicate in Russian and English. During his position as the CEO, Krenholm was a production unit for Borås and only the finishing and sewing mills were still operating.

“Poleschuk wanted it seems to me, to create the real distinctive line between Krenholm’s obligation and Borås obligation and define where is the responsibility of Borås and marketing but very soon, Poleschuk was taken away.” (Department Manager of Krenholm)

The last CEO for Krenholm was Carl-Henrik Koit. Just like Mats Skogman and Thomas Widstrand, he was the CEO of Borås Wäfveri and Krenholm at the same time. He was responsible for managing the bankruptcy of Krenholm in 2010.
Figure 23 represents the changes of the CEOs at Krenholm from 1995 until the bankruptcy in 2010. According to the divisional managers of Krenholm, the constant changes in the top management brought serious consequences. The divisional manager of finishing mill expresses a lack of communication at the moment of the acquisition in 1995:

“A big mistake is the change of management because the company was 100% Russian speaking and when the Estonian management team came, communication was not the best.”

In addition, some of the divisional managers at Krenholm felt that there were misunderstandings and lack of cooperation with the top management.

“What happened in these years it was not one action, it was not one act, it was a combination of little actions but one of the most important is the serious internal misunderstanding, the serious absence of common tasks, serious absence of internal cost calculation and other little things that must be dealt by efficient management and can never be solved if managers are sitting in one box and production in another box.” (Department Manager of Krenholm)

“After Meelis left, nobody listened to us. It was very difficult to fight against this mountain. When there were difficult times at the company who helped?” (Divisional manager of Krenholm)

The divisional managers also expressed their concern in regards to the lack of clear leadership at Krenholm.

“We are trying to remember who were the CEO’s and it is a serious sign that there was no real director.” (Department Manager of Krenholm)

“It is difficult to say, because all this top management, they were more and less vanished, flying somewhere. For weeks, months, Krenholm was under management of divisional managers, spinning, weaving, finishing, and so on, because on the production, they understood more and less what should be done, but as for general strategy, as for general management I have to say during months, we did not understand the general picture, we did not understand the architecture of our future, we did not understand what we will do tomorrow, we felt that day by day, step by step... ” (Department Manager of Krenholm)

Finally, the divisional managers denoted a lack of experience and knowledge of the textile industry from some of the appointed CEO’s and how these constant changes brought instability inside the company.

“In the beginning there were very professional people in the textile industry. And then... change and change and change. After Meelis every year, change and change: marketing people, finance people, and everything else. This was very difficult and different mentality from Estonia and Sweden.” (Divisional manager of Krenholm)
Figure 23. Overview of CEO changes in Krenholm from 1995 to November 2010

Source: Authors’ own elaboration, 2012 based on conducted interviews, 2012
“From the very beginning, Mauritzon, Gabrielsson [the owner and the chairman of Borås Wäfveri at that time; authors’ note], and the board members they were really much involved with the situation in each division, they held board meetings, they participated in very important decisions that were taken at that time. But it lasted until the year 2000 approximately. That was very good because these people were specialists and experts, but after the people that came to Krenholm were not very experienced and did not know about textiles and that was not good.” (Divisional Manager of Krenholm)

“All the presidents that came after were absolutely incompetent. They did not like to get involved in anything related to the textile industry.” (The owner of Borås Wäfveri)

“In my opinion, people who were after Meelis like - Skogman, Widstrand and others - they were accidental persons.” (Divisional Manager of Krenholm)

“You should understand that when Krenholm was managed by professionals it was a good controllable model. But Krenholm lost autonomy and the market changed dramatically. China and Pakistan became stronger and we should have thought about that even in 2000. But nobody took this into consideration. The changes they did here did not match with the situation in the world. This was a tragedy for the company.” (Divisional Manager of Krenholm)

“There was a wrong management done by unprofessional persons. All the professionals left with Lars Mauritzon and Meelis Virkebau. It was a team that directed us in the right way. There was a strategic plan. Where did all of this go to? It was impossible for Thomas Widstrand for example, to manage the company in Narva and in Sweden. There was no real director here.” (Divisional Manager of Krenholm)

Finally, one of the CEOs of Krenholm remarks the importance of the alignment of interests between owners and management:

“There needs to be a total understanding between shareholders and management, this is the starting point, they have to think in the same way, and both sides need to be 100% open and honest, also the board. There was not enough cooperation and information between shareholders and managers, starting in 2003.”

4.5.2 Corporate governance structure of Borås Wäfveri

Corporate governance structure of Borås Wäfveri represents a typical structure for Sweden and other Nordic countries. The main participants are shareholders, the Board of directors, the CEO and senior executive team (see Figure 24).
The ownership structure of Borås Wäfveri was always very concentrated and usually dominated by one or few major shareholders (see Figure 27). These owners had a direct influence on the company’s business, not only taking part in the Annual meetings with shareholders, but especially through the active involvement in the Board. Indeed, during the period from 1995 to 2010 all the major shareholders were always present in the board (see Table 3). According to Corporate governance bodies of Nordic countries (2009), this model differs significantly from those in Anglo-Saxon and European Continental structures, where a dispersed ownership prevails.

The highest decision-making body of the company was the Annual meeting of shareholders, which took place usually in March-May (after the end of the financial year) in Borås or Göteborg (Borås Wäfveri, 1998; 2000-2009). These meetings helped shareholders to control and supervise the company, to report about the most important events from the previous year and plans for the next year by the firm’s CEO, approve financial statement, elect or dismiss individual directors of the Board and auditors, and appoint a new CEO if needed.

The concentration of the ownership in Borås Wäfveri was constituted by four major shareholders during the period of 1995 until 2010. However, this concentration of the ownership was divided mostly in two different periods of time. The first period comprises from 1995 until 2002 where the two major shareholders were Lars Mauritzon, former chairman of the Swedish Textile Association and former member of the board for Eurotext and Madis Üürike, who was the Minister of Finance of Estonia. The second period comprises from 2003 until the bankruptcy in 2010, when the two major shareholders were Mats Gabrielsson and Johan Claesson, both having a background as major
investors and risk capitalists with ownership and participation in diverse companies. For detailed information on the amount of ownership per shareholder refer to Figures 25-27 and to Table 3.

Figure 25. Overview of changes in ownership of Borås Wäfveri from 1995 to 2010

Source: Authors’ own elaboration, 2012.

The changes in ownership determined the restructuring of Krenholm and the strategy for the company.

“In summer 2002 there was a big change in shareholders of Borås Wäfveri and then the company Borås changed the strategy for the entire group. The future of Krenholm would be a factory to Borås and Borås takes care of product development and sales except for manufacturing.” (The CEO of Krenholm)

Differences in opinions on the future for Krenholm and Borås Wäfveri, divided the major shareholders and subsequently the board of directors.

“There were different opinions on how to continue from the Swedish side. There was a period in which Borås had very difficult times in production in Sweden and the conflict started from this.” (The CEO of Krenholm)

The board of directors in Borås Wäfveri was composed of 4-6 members elected on the Annual Meeting of shareholders during the period from 1995 to 2010. The regulations dictated Borås Wäfveri to have at least two directors independent from the major owners (Corporate governance bodies of Nordic countries, 2009). During different years, these directors were CEOs of Borås Wäfveri and other firms, and various consultants (Borås Wäfveri, 1998; 2000-2009). The issues discussed on the quarterly meetings included monitoring of business conditions, financial reporting and budgeting, strategic issues, acquisitions and divestures, appointment and dismissal of the CEO (e.g. Borås Wäfveri, 2008).
Figure 26. Overview of changes in ownership of Borås Wäfveri from 2002 to 2009.  
*Source:* Authors’ own elaboration, 2012.

Figure 27. Overview of changes in ownership of Borås Wäfveri from 2002 to 2009 without minor owners.  
*Source:* Authors’ own elaboration, 2012.
Table 3. Ownership structure of Borås Wäfveri from 2002 to 2010

1 - number of shares, 2 – percent of capital and votes (direct and indirect)

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<th>Main owners</th>
<th>2002</th>
<th>2003</th>
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<td>-1- in SEK</td>
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<td>-1- in SEK</td>
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<tr>
<td>Lars Mauritzon</td>
<td>4 062 700</td>
<td>74.1</td>
<td>440 700</td>
<td>10</td>
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<tr>
<td>Mats Gabrielsson</td>
<td>1 328 800</td>
<td>30.2</td>
<td>1 382 800</td>
<td>31.4</td>
</tr>
<tr>
<td>Madis Üürike</td>
<td>1 328 800*</td>
<td>24.2</td>
<td>1 000</td>
<td>0.02</td>
</tr>
<tr>
<td>Johan Claesson</td>
<td>356 328</td>
<td>8.1</td>
<td>356 328</td>
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<tr>
<td>Total capital:</td>
<td>5 483 461</td>
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<td>4 400 000</td>
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<td>33.9</td>
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<td>Mats Gabrielsson</td>
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<tr>
<td>Madis Üürike</td>
<td>596 878</td>
<td>13.3</td>
<td>600 878</td>
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<tr>
<td>Johan Claesson</td>
<td>4 480 000</td>
<td>100</td>
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<td>Total capital:</td>
<td>4 480 000</td>
<td>100</td>
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*mainly through Gabrielsson Invest AB

Source: Authors’ own elaboration based on the Annual reports of Borås Wäfveri, 2001-2009

Note: data for the period before 2002 was not published in the Annual reports
At the time of acquisition in 1995, the board of Borås Wäfveri was comprised by Mats Gabrielsson who served as the Chairman of the board, Lars Mauritzon who was the current CEO for Borås Wäfveri, Madis Üürike - the Minister of Finance of Estonia (and later the Advisor to the Prime Minister of Estonia) and Lage Rosvall, who was a consultant and specialist in strategies. The first change in the board of directors of Borås Wäfveri was the replacement of Mats Gabrielsson as the Chairman of the board by Lars Mauritzon in the year 2000 and the addition of two new members of the board, Johan Claesson and Stig Arne Blom.

The year after, in 2001, the Chairman of the board, Lars Mauritzon, was replaced by Stig Arne Blom who became the third and last Chairman of the board of Borås Wäfveri. At the same time, Arne Blom was also the CEO for another company outside the group and his dedication to be the Chairman of the board of Borås Wäfveri was very limited.

“That was a weakness because Arne Blom he was CEO of another company and he was so busy, he had no time. I spoke to him about changes in the organization, he always said, well I do not want to have problems of that sort in my knee. That was the answer you always got because he was so busy, then the company started to have some problems.” (The owner of Borås Wäfveri)

“You can take for example what happened with the revenues, it is terrible that the Chairman could permit that to happen, why did not he say something is wrong.” (The owner of Borås Wäfveri)

“Whatever Mr. Blom would say he thought still at the end of the day, these Russians they are so production orientated, he did not understand because he was never there.” (The owner of Borås Wäfveri)

“He had problems with the market orientation in that company, he was really a technician, he came to the company as a production manager. He had not the capacity so what can we do now? There is a recession and people are not buying the textile machinery and things like that anymore, he was not the right guy for that company, because he could never understand market orientation.” (The owner of Borås Wäfveri)

During the remaining years, one of the most significant changes in the board of directors in Borås Wäfveri, was the departure of Lage Rosvall in 2003 due to some differences in opinion with the Chairman of the board, Arne Blom.

“He was very important for the board. He was a specialist in strategies.” (The owner of Borås Wäfveri)

The board of Borås Wäfveri was left without an outside member who could contribute in the strategic decision making for the company. Discussions regarding the strategic future for the group became rare.
“They were not interested in anything like that [the members of the board of Borås Wäfveri, authors’ note], they were not interested in anything outside what happened in the board. Nobody discussed anything like that you have to, if you are in a board in a accompany you have to see what is going on in the world.” (The owner of Borås Wäfveri)

“Nobody discussed about strategy. Just - we have to earn money, we have to earn money it was all you could hear all the time and risk capitalists are thinking in that way, industrialists are thinking in that way.” (The owner of Borås Wäfveri)

Lars Mauritzon decided to leave the board of Borås Wäfveri at the end of 2005. For more detailed information on the changes within the structure of the board of directors of Borås Wäfveri refer to Table 4.

**CEO Turnover**

The CEOs of Borås Wäfveri were involved in the day-to-day operations in the company, production activities, planning, evaluating business units and market situation. Lars Mauritzon was the CEO for Borås Wäfveri from 1995 until 2000. During his time as CEO for Borås Wäfveri, he worked closely with Meelis Virkebau the CEO of Krenholm. Lars was also the Chairman for the special council at Krenholm.

“Chairman of the supervisory council Lars Mauritzon, we communicated in English, the cooperation was fantastic, this was the reason for success, for good understanding and for the good cooperation. In the first years I think we spoke every second or third day.” (The CEO of Krenholm)

Lars Mauritzon left his position as CEO in the year 2000 to become the Chairman of the board of Borås Wäfveri. Mark Sigvardsson filled the position of CEO of Borås Wäfveri in 2000. However, as noted by Meelis Virkebau the current CEO of Krenholm at that time, the communication and cooperation decreased between both CEO’s.

“There were not many changes when Sigvardsson was CEO, there were no changes, but with Sigvardsson bad times started, by this I mean he did not know anything about the industry, he did not know anything about textiles, that is why he was very silent. When we started I gave proposals on how to cooperate more, Krenholm and Borås, and Mark accepted it but this process was very slow.” (The CEO of Krenholm)

After some interventions from the top management of Borås Wäfveri with the board requesting a change of CEO, Mark Sigvardsson left in 2002. Mats Skogman was appointed by Stig Arne Blom as the replacement for Mark Sigvardsson despite previous opposition from other members of the board. During his time as CEO of Borås Wäfveri, Krenholm went through some restructuring starting with the replacement of Meelis Virkebau as the CEO of Krenholm in 2003.
Skogman eliminated the special council for Krenholm and he appointed himself as temporary CEO of Krenholm while performing his duties as CEO for Borås Wäfveri at the same time. Mats Skogman remained the CEO both for Borås Wäfveri and Krenholm until 2004. He was replaced by Thomas Widstrand. Thomas Widstrand initiated also important organizational restructuring both at Borås Wäfveri and Krenholm. First, in 2005 all the production from Borås Wäfveri in Sweden was moved to Krenholm, leaving only administrative offices, sales and marketing.

“During my time the full production of Borås was totally moved to Estonia, the machinery was moved and put in the buildings of Krenholm, during 2005-06, so there were no more operations in Borås since 2006.” (Consultant in Krenholm)

Thomas Widstrand decided also to relocate the marketing department that was located in Narva at Krenholm and centralized it in Sweden.

“Widstrand was dangerous he had come from the metal industry, he learned from school that he has to have a big central marketing department, sales department and marketing director for the whole group, it has to be all this.” (The owner of Borås Wäfveri)

Thomas Widstrand left the company in the middle of 2007 and Sven-Olof Kulldorf became the interim CEO for Borås Wäfveri. Sven-Olof Kulldorf held the position of CEO until Kenneth Uddh replaced him in 2008. The last CEO for Borås Wäfveri was Carl-Henrik Koit and he took position in early 2010 until the bankruptcy in November 2010. For detailed information on CEO turnover refer to Figure 28 and the general picture of corporate governance changes - Figure 29.

All these changes in the structure of the three levels of corporate governance in Borås Wäfveri caused uncertainty according to one of the owners of Borås Wäfveri.

“These changes created instability, during 10 years you have 6 presidents for the group, nobody never learned the business, nobody had any context outside the company, nobody never visited any customers, nobody visited cotton suppliers in the US, nobody was interested in the business, they were just sitting in their offices and for me that is terrible.” (The owner of Borås Wäfveri)

In addition, high salaries were paid to the different CEOs of Borås Wäfveri without ensuring the maximization of owner’s returns.

“You hire a guy, you give him a very high salary, I think the last one had an annual salary of 3.2 million SEK and they stay and then you kick them out and then you paid them another couple of millions.” (The owner of Borås Wäfveri)
### Table 4. Overview of changes in the board of directors of Borås Wäfveri from 1995 to 2010

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<td>Lage Rosvall</td>
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<td>Charles van der Mandele</td>
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<td>Hans Johansson</td>
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<td>Ann-Charlotte Lunden</td>
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<td>Kenneth Uddh</td>
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**Source:** Authors’ own elaboration, 2012

Figure 28. Overview of CEO changes in Borås Wäfveri from 1995 to November 2010
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<td>Chairman</td>
<td>Mats Gabrielson</td>
<td>Lars Mauritzon</td>
<td>Lars Mauritzon</td>
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<td>Thomas Widstrand</td>
<td>Kenneth Uddh</td>
<td>Carl Henrik Koit</td>
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<tr>
<td>CEO</td>
<td>Meelis Virkebau</td>
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<td>Thomas Widstrand</td>
<td>Matti Haarjakoki</td>
<td>Lumon / Carl Henrik Koit</td>
<td>Igor Poleschuk</td>
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4.6 Turnaround

After the dissolution of the Soviet Union in 1991 the situation in independent Estonia, in the textile industry and in Krenholm changed dramatically. The company found itself in the situation when the Russian market was highly difficult to access, while during the Soviet time 95% of all its manufacturing output was delivered to the market of Soviet states (Klushin, n.d.). Moreover, supply of raw cotton from the republics of central Asia was stopped and the bank accounts in Moscow, where money for the export of final goods were accumulated, were blocked. As a result, Krenholm was without raw materials, money and customers and had to start from the very beginning. The CEO of Krenholm from 1991 until 1994 explains the situation of the company under the ownership of the Estonian State.

“I can say that I feel that one more year and I would have become crazy. It was extremely difficult, but we were a team. When we discussed every situation, we tried to find out the way. There were difficult times especially in 1992, when we lost 90 % of the market, of course we sold to Europe, Finland, USA but it was only 10% of our capacity. But we tried to find new markets.” (Former CEO of Krenholm²)

By 1995 Borås Wäfveri had acquired Krenholm and the CEO of Borås Wäfveri, Lars Mauritzon, started to develop a strategy to improve the conditions and increase the profitability of Krenholm.

“Like the Swedish king 300 years before him, Lars Mauritzon, Borås Wäfveri’s chief executive and main owner, is hoping that tactics will carry the day as he struggles to transform Krenholm from an inefficient Soviet monolith into a lean and competitive actor on world markets.” (Brown-Humes, 1999, p. 1).

“Then we started our strategy to develop Krenholm as a Western oriented textile company but with another cost level than we have in Sweden. That was really hard work.” (The owner of Borås Wäfveri)

The importance of formulating a good strategy is fundamental for turning around distressed firms. A professor of management at University of Tartu describes how textile companies have survived in Estonia by applying the right strategy.

“Companies have succeeded in Estonia, mass production is for example in Asia but a little bit more complicated production has stayed in Estonia, it’s a matter of strategy.”

Krenholm was on the border of becoming a Western oriented textile company. The efforts made by the employees and the management team apparently started to pay off. From 1995 until 2002,

² He was the CEO of Krenholm until 1995; member of the board in Krenholm and divisional manager of Krenholm Spinning until 2002 - for simplification, here refers to ”former CEO of Krenholm”.

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Krenholm had annual profits and production was increased. However, a drop in the operating profit of the company for several consecutive months in late 2001 and early 2002 started to turn on red lights.

“*My point of view in November 2001 our operating profit fell down to -3%. For me it was a sign that the CEO should have taken something seriously, December, January, February, March we had operating profit of -11% [accumulated operating profit loss, authors’ note]. It means we have some serious problem, the loss was continuing.***” (Department Manager of Krenholm)

The changes of operating profit/loss of Krenholm are indicated in Figure 30. Because Krenholm was state-owned in the past it has been very difficult to get financial information for that period.

![Figure 30. Operating profit/loss of Krenholm from 1992 to 2007](image)

Note: data for 1995 and 2008-2010 is not available.

*Source: Organizational calculations; Shabas, 2008.*

Profits started to decline and the company started to face crisis once more.

“*2002 was the last year Krenholm was profitable.***” (Divisional Manager of Krenholm)

“*Despite of our loans, despite of all our efforts, gross profit began to decline.***” (Department Manager of Krenholm)

The owner of Borås Wäfveri explained some of the reasons for losses in 2002:
“It was in that way in 2002 we were at the end of a very big investment period together with the World Bank and at the same time there was a recession in the textile market for the first quarter of 2002.”

However, by 2003 things did not get any better and Krenholm started to have a reduction in sales.

“2003 sudden drop in sales and nobody knows why.” (Department Manager of Krenholm)

The drop on sales combined with an increasing number of small orders complicated the financial recovery of Krenholm and its efforts to turn back the company to profitability.

“One of the biggest problems was that the meters per order were decreased over the years, so we started as a mass producer and gradually that refers not only to Borås Cotton collection, but it was really a trend that we started to receive smaller and smaller meters per order, and this led to bigger production costs because of the setups costs and Borås Cotton assortment it was very specific and their orders could be very small.” (Divisional Manager of Krenholm)

“Is like if Volkswagen is to produce Rolls Royce.” (Divisional Manager of Krenholm)

In addition, competition with China, Pakistan, India and Bangladesh for low costs exerted more pressure for a turnaround.

“There was also the beginning of a world crisis in the textile industry in 2003. Pakistan, India and China could produce and sell cheaper. The research was needed. Moreover, the prices for electricity, water and other services were growing.” (Divisional Manager of Krenholm)

A need for some action for turning around the company was strongly demanded. For a better understanding, this part of the empirical section will be divided according to the three different strategies for a turnaround.

4.6.1 Retrenchment

The objective of retrenchment is to reduce costs to increase cash flow. Some of the elements of retrenchment used by Borås Wäfveri to attempt a turnaround at Krenholm include outsourcing, downsizing, head count cuts, improvement of operational efficiency and production processes and selling assets.

**Outsourcing**

Increasing costs for valuable production resources and a weak financial situation, made Krenholm to start outsourcing some of its production. By 2008, the spinning and weaving divisions were closed down and the production was outsourced to Asia.
“Continuous growth of energy and human resource costs and decreasing sales volumes made the Board and management of Krenholm and its mother company look for possible production cost reduction solutions. As a result, in the end of November 2007 the Board decided that Krenholm would stop production of yarns, grey fabrics and terry and would start to outsource grey fabrics and terry towels.” (Shabas, 2008 p. 30)

**Downsizing**

Since 2001 the management of Borås Wäfveri and Krenholm tried to reduce the capacity in the spinning and weaving divisions. However, due to the replacement of the CEO of Krenholm in early 2003 the downsizing project in these divisions was never accomplished.

“We have to reduce the capacity in spinning and weaving. We shall keep limited own production in the weaving to have special qualities that we cannot buy because we are going to buy grey-cloths which everybody can buy. Then we buy the grey-cloth and we had two companies in India, we were very close to make contact but it was stopped by the new CEO so nothing happened with that.” (The owner of Borås Wäfveri)

Despite the fact that the production in spinning and weaving was not reduced in 2001, by 2005 Borås Wäfveri decided to close production in Sweden and the equipment and machinery was moved to Krenholm.

“We received the plan from Borås Wäfveri to move the plant to Estonia, three sheets, the target, the aim, nothing was explained for what this movement will be done. In January 2005 they started to close in Sweden, but why, what was the reason? Nobody knew.” (Department Manager of Krenholm)

By 2008, some of the divisions at Krenholm were closed as well.

“Krenholm only had finishing and sewing, all the spinning, weaving and terry facilities were closed.” (Department Manager of Krenholm)

**Head count cuts**

In 1989 Krenholm had more than 10,000 employees. At the moment of the acquisition of Krenholm by Borås Wäfveri in 1995 the number of employees was reduced to 5,700. Reduction of personnel continued through the years until 2010 when the last 500 employees were laid off.

“In January 1995 there were 5,700 employees but I had to fire 1000 people, in three years’ time.” (The CEO of Krenholm)

“Job cuts have been the most sensitive issue. Staff numbers have already fallen from 5600 to 5000 over the last year, and a further 1000 job losses are expected over the next 12 month in a drive to lift
productivity by 20 per cent. Mauritzon says the factory still employs a lot of “service” staff as a hangover from the Soviet days of full employment.” (Brown-Humes, 1999, p. 1).

“When I started in 2004 there were 4,000 people working.” (Consultant in Krenholm)

“12.12.2007 BoråsWäfveri has confirmed information about the closure of spinning and weaving production. 1000 Narva citizens will be dismissed. This lay-offs will reach a record figure not only for Narva, but for the whole Estonia, said the representative from Labour Inspectorate.” (Narvskaya Gazeta, 2007)

“19.11.2008 After the large-scale lay-offs, there are 1100 workers left at Krenholm.” (Narvskaya Gazeta, 2008b)

Personnel dismissal was not well seen by the employees of Krenholm who argued that a reduction in personnel decreased production opportunities.

“Personnel dismissal can only lead to a reduction of production possibilities.” (Department Manager of Krenholm)

“Then the CEO Matti Haarajokki, he just listened to what Borås Wäfveri told him. We needed the personnel for production, however in Borås they told him: reduction of personnel is needed. It should have not been like this. Then we lost many contracts.” (Divisional Manager of Krenholm)

**Improvement of operational efficiency and production processes**

The goal of improving operational efficiency and production processes is to become more efficient and to reduce slack. Borås Wäfveri hired a consultant to improve production planning.

“Borås wants to put a Swede to improve production planning at Krenholm. My role was to change production planning to deliver the highest precision, planning the orders and the amount of delivery time. Worked with the management team. Lots of workshops.” (Consultant in Krenholm)

“My goal was to continue to change processes, the way we handle orders and planning, communication with sales organizations in the different countries, to find outsourcing partners for part of the production that we did not want to do.” (Consultant in Krenholm)

However, by 2005 when the marketing department was moved from Krenholm in Narva to Borås Wäfveri in Sweden in 2005, the communication between marketing and production started to deteriorate. This bad cooperation and communication resulted in the acceptance of small orders from marketing that were not profitable for Krenholm. Some of the divisions were not using full capacity. This led to an increase in slack and inefficiency.

“After marketing was moved to Sweden, in 2004-2005 it was absolutely an independent structure. These guys in sales and marketing never knew anything regarding production. Lack of communication was an absolute weakness at Krenholm.” (Department Manager of Krenholm)
“There were two marketing units at the beginning when we were acquired: in Narva and in Borås. We worked fine and it was right, but when they combined them, all the problems started. We were asked to produce small batches, there were 70% of them and later even more. This production was of course unrealistic, but nobody listened.” (Divisional Manager of Krenholm)

“We made the same mistakes as Borås. They produced small batches, but very expensive. Here at Krenholm, these small batches for such a big factory formed 80% of the whole production and we started to lose money, which damaged the company a lot.” (Divisional Manager of Krenholm)

The setup costs for changing orders in the finishing division increased due to the high amount of small orders being produced.

“You cannot rely on being just close to the market, it is a dead end, the factory was built for huge production, when I was there they were producing 50 000 kilometres of fabric per year but it was built for maybe double, you need large volumes if you want to compete and only get smaller orders all the time the production setup costs are huge when you change from one order to the next order. Then you get the mismatch of the best economy.” (Consultant in Krenholm)

“We have to keep in mind that the setup equipment in finishing company was able to produce huge amount of few articles of fabrics, but marketing change this absolutely in the opposite direction, short contracts and many articles started to be produced in finishing.” (Divisional Manager of Krenholm)

“Because our machines have a big line and require big contracts and maybe 10 or 20% small contracts, this is normal, this is proportional in the normal production. But if you have small contracts, you stop the machines and then you have to do the washing, canalization, chemicals and heating, then cleaning machines, then start up the small contracts, then stop machines and the same. This is a mistake that started in Borås Wäfveri, because they had 90% of small contracts and Borås had a big sort of products, same mistakes.” (Divisional Manager of Krenholm)

Borås Wäfveri had very different assortment than Krenholm and the orders for Borås required different equipment, hence the equipment had to be replaced more often and the setup costs increased.

**Selling assets**

The owners of Krenholm started selling the assets of the company in 2008. They began by selling the trademarks and the premises.

“In 2008 they started to sell everything, they sold the trademarks, the trademark Borås Cotton. And then afterwards, they thought they could sell the company Krenholm to somebody from Pakistan. They are not interested in production, they are interested in sales organizations and trademarks. But they were selling the trademarks to other people, and then they could not sell the machines.” (The owner of Borås Wäfveri)
“They sold everything, of course they needed the money because they had loses that were terrible.” (The owner of Borås Wäfveri)

At the same time the owners tried to sell the company but they were unsuccessful.

“They really tried, but they started with the wrong end, they started with selling the trademarks and sales organizations and they could not sell the production and nobody is interested on buying production of textile, but trademarks, they were very valuable, and they got some money but not enough money.” (The owner of Borås Wäfveri)

The need for cash was so high that the two major owners bought Krenholm’s property from themselves.

“The company was split up and the machinery and the buildings were placed in one company and the production company was another company so they split the company in two, so the main owner of Borås Wäfveri bought the fixed assets, the land, the buildings everything and of course Krenholm could get money from that into the production again, so that they could continue for a couple of years. There were no assets, just the people left, so all the assets were protected from the bankruptcy.” (Consultant in Krenholm)

4.6.2 Repositioning

New markets and development of new products followed the acquisition of Krenholm by Borås Wäfveri in 1995. Changes in the product portfolio of Krenholm and the opportunity to explore new markets generated new sources of revenue for the company.

Moving into new markets

Borås Wäfveri had a major presence in the Scandinavian markets, the United States, Germany and the United Kingdom. The possibility of accessing these new markets became a window of opportunity for Krenholm.

“The shift over the past four years – and particularly since Borås Wäfveri took control in January 1995 – has been dramatic. Management has been immersed in the ways of the market. Productivity has increased. Some 90 per cent of output is now exported, mainly to the US and Nordic markets. Not a single thread goes to Russia because of punitive import duties.” (Brown-Humes, 1999, p. 1).

“Krenholm was bought by another very good company and Swedish company could reinforce Krenholm with money and experience and with some markets that were opened for Krenholm. Before, Krenholm had good customers but after Borås Wäfveri bought Krenholm new customers appeared. Up to the year 2000 we had very good sales and profit.” (Divisional Manager of Krenholm)
“Krenholm started to sell to Kmart, Ikea and to private brands, such as Gerber. Gerber and Krenholm cooperated in product development. Under the name of Gerber, diaper products were sold successfully.” (The CEO of Krenholm)

Moreover, Krenholm started to open sales companies in Scandinavia, Germany and the United Kingdom to increase the contact with the customers in these new markets.

“On the market we had Krenholm Textile, and there were Krenholm Scandinavia, Krenholm Germany and Krenholm UK sales companies that worked close to the customers.” (The owner of Borås Wäfveri)

However, the Chairman of Borås Wäfveri, Stig Arne Blom, decided to close these sales companies when the marketing departments became centralized in Sweden in 2005.

“And then the Chairman also skipped these companies like Krenholm Scandinavia…” (The owner of Borås Wäfveri)

**Developing new products**

Krenholm started to develop new products for the local and new markets after the acquisition from Borås Wäfveri in 1995.

“We started to produce more wide dyed textiles for bed linen. We started to produce film coating. And of course we started to make wider printed fabrics. We also manufactured goods from ecological cotton, for example bed linen.” (Divisional Manager of Krenholm)

“Krenholm sold also quite a lot of fabric to German manufacturers and other type of products, for example, we produced baby diapers to the US, furniture fabric, composted fabric.” (The CEO of Krenholm)

However, a minor percentage of the total of products was sold under the Krenholm brand. The lack of differentiation in Krenholm’s products was seen as a risk given the high international competition for standard production.

“We started to develop Krenholm brand but differently, we did not invest in the Krenholm brand as brand to the product but as a corporate brand.” (The CEO of Krenholm)

“When I was in Krenholm there were a lot of private brands in the company, I mean, not so many or almost nothing of own labels, only private labels. Basically what you are selling is not a readymade product, is factory capacity. The customer can go to any factory and say the same thing and choose the best offer. This is actually the main problem with the whole setup of the management of Krenholm business, that there was no way to earn money. You are selling not your own products.” (Consultant in Krenholm)
“There is no gain on selling capacity if you do not do it very efficiently and in this company it was very difficult to be efficient because the capacity was huge and the orders were small, so there is no efficiency.” (Consultant in Krenholm)

4.6.3 Restructuring and replacement

Changes in the organizational structure

The new owner of Krenholm after the acquisition changed the company structure with the objective to change the mentality of the management from a planned economy to a market economy. As a result, Krenholm was split up in 6 subsidiary companies and the maintenance company governed by Krenholm Holding Ltd. (see Figure 31). Moreover, the big size of the company made it very difficult to trace failures and mistakes, so dividing the company into subsidiaries facilitated the tracking of these failures.

“Mauritzon [the owner of Borås Wäfveri; authors’ note] says changing the mentality of Krenholm management was Borås’s top priority. The first step was to split the group into a mother company and six subsidiaries. “We had to get the cold steel and cold blood from the market as deep as possible into the company,” says Mauritzon.” (Brown-Humes, 1999, p. 1).

![Organizational structure of Krenholm in 1995-2000](chart)

Figure 31. Organizational structure of Krenholm in 1995-2000

“Then we decided to split up the company in small parties, spinning, weaving finishing etc, to get to learn the people the hard way, what it means to be a market oriented company what it means cost, and purchase price and sales prices, marketing.” (The owner of Borås Wäfveri)
“Krenholm was so large that it was quite difficult to understand is something wrong.” (The CEO of Krenholm)

By 2001 the holding structure was transformed into divisional structure, which contained separate divisions based on individual product lines or services (Edström et al., 2003). However, the role of the units remained the same:

- Spinning – production of yarn out of cotton;
- Weaving – production of grey fabrics out of yarn;
- Finishing – bleaching, dyeing, printing and finishing of fabrics;
- Sewing – production of ready-made goods;
- Terry Cloth – production of terry towels, terry fabrics, jacquard fabrics;
- Textile – marketing and selling company;
- Service – maintenance of machinery, power, water and steam supply, internal transport and construction works (International Financial Corporation, 1999; Andren and Öberg, 1996).

However, both the holding structure and the divisional structure were criticized by some of the divisional managers, the IFC and by exterior consultants. The lack of independence between the divisions was the main reason against these types of structures.

“One of the most important mistakes was that the entire company was divided into different pieces, each company had its own rules and structure and systems. When it comes to pricing it was also so that each company tried to make profit for itself not for the entire company, and of course it was difficult.” (Divisional Manager of Krenholm)

“The company structure adopted by Krenholm has had a tremendous positive effect on the way the units are managed. However, the structure is still very much production oriented. Moreover, managers tend to look only for the interests of their own unit forgetting the overall picture. This structure combined with an imperfect costing system results in lack of transparency.” (International Financial Corporation, 1999, p. 4-1)

“They thought that these stock companies would compete with each other. But how can we compete when we were so interdependent? It was a serious mistake.” (Divisional Manager of Krenholm)

“The divisions did not have freedom, not at all. Everything was flowing in one direction. Most of the value chain flow was one way anyhow. They were really dependent on each other. This was the problem of that structure.” (Consultant in Krenholm)

“It could be a good structure only if you have enough external customers that you can leave on, on their own. Otherwise if you are fully dependent on each other is not really a company structure then is better to have a department structure.” (Consultant in Krenholm)
Another major change in the organizational structure happened after 2003 when Krenholm became just a mere production facility for Borås Wäfveri. Krenholm lost the autonomy to control sales, product development and relation with the customers.

“Krenholm was not independent anymore. Krenholm had no chance to control sales, product development, relation with customers, marketing. It was controlled by Borås Wäfveri in Sweden.” (The CEO of Krenholm)

By 2005 Borås Wäfveri moved the whole production from Sweden to Estonia and the marketing department for Krenholm was centralized in Sweden.

“The full production of Borås Wäfveri was totally moved to Estonia.” (Consultant in Krenholm)

“Before, the sales organization was located in Narva. Narva people worked with the customers and agreed on the price and divisions were involved in assortment and development, negotiated prices. But then the sales functions were given to Borås Wäfveri.” (Divisional Manager of Krenholm)

Replacement

When Borås Wäfveri took over Krenholm in 1995, the current CEO was replaced by an Estonian CEO.

“Borås appointed a 38-year-old Estonian national from another textile company as managing director – replacing an ethnic Russian in the post.” (Brown-Humes, 1999, p. 1)

However, the former CEO stayed in Krenholm as the director for the spinning subsidiary and member of the board in the special council for Krenholm.

“Everybody was quite sure that the CEO was going to be fired, and I did the opposite, because I think he was very important for the company he was so well known that I asked him to be a member of the board. All loved him because he had managed to keep the company running until the liberalization, he had really hard work, they had no money, they could buy some cotton sometimes, he managed with that. He was very important.” (The owner of Borås Wäfveri)

This was the first of many changes of CEO’s at Krenholm during the following years. The changes and its consequences were discussed in the section of corporate governance of Krenholm.
4.6.4 Complementary information about turnaround

Investments

Several investments were made by Borås Wäfveri in Krenholm since the moment of acquisition. Such investments were fundamental for the recovery of the company, to improve profitability and for the employees.

(a) Capital injection through loans and investments

Part of the agreement signed by Borås Wäfveri to the Estonian State for the acquisition of Krenholm was about investments. Borås Wäfveri agreed to invest a minimum of 12 million SEK in three years’ time.

“Borås Wäfveri promised in their contract with the Estonian State that 12 million SEK would be invested in three years. This was outdone by far. Up until the year 2000, 190 million Swedish crowns were invested.” (Edström et al., 2003, p. 110)

In the supervisory board meetings, all the investments that were required for Krenholm were discussed.

“In the supervisory board there was an important question: investments.” (The CEO of Krenholm)

In 1999 Krenholm received a loan from the IFC for 25 million Euros. This loan was used to build a new sewing plant and to buy new machinery that would improve production in the different divisions.

“In 2001 the second sewing factory was built, which allowed the company to significantly widen up the assortment range and production volumes.” (Shabas, 2008 p. 9)

“They have a quite new preparation equipment because we got the loan for 25 million. We had a very good finishing mill.” (The owner of Borås Wäfveri)

“For the first time we managed to do investments in Krenholm and increase the quality that is the reason why we started this very big investments together with the World Bank. That was so important because we did not even had the right machinery in Krenholm to produce the quality we needed to be a supplier for IKEA or Marks and Spencer.” (The owner of Borås Wäfveri)

“There were three matters that improved with the acquisition of new machinery: cost saving, energy saving, more efficient products and totally new type of products what we were not able to produce before, and such an investment was very important to our customers, we got more trust again.” (The CEO of Krenholm)

However, some of the investments were not very well implemented according to some divisional managers at Krenholm.
“The mistake was that this investment was not thought through, Krenholm’s directors of production division were given very short time to think about what equipment to invest. They did not have the time to decide where we want to go and what type of products to develop, what strategy to choose.” (Divisional Manager of Krenholm)

“We started to think about these investments from the wrong end, we should have started with the market need and from assortment and only then we should have talked about equipment, we have to think about the competitors, China, Pakistan.” (Divisional Manager of Krenholm)

(b) Trainings

Another type of investment is the training that was given to the personnel at Krenholm. English courses, marketing, management and finance were some of the examples of training that the divisional managers at Krenholm received.

“Managers in Krenholm had trainings in management, leadership, marketing, English language, we invested a lot to train people.” (The CEO of Krenholm)

“Mauritzon [one of the owners of Borås Wäfveri; authors’ note] stresses the high technical quality of Krenholm’s middle management, but says their lack of market orientation has been a significant handicap. To correct this, management training courses have been run by Mercury International, an Estonian group, over the last year, and many managers have had intensive English tuition.” (Brown-Humes, 1999, p. 1).

### 4.7 Post-acquisition integration

The process of post-acquisition integration started in Krenholm after the takeover by Borås Wäfveri in 1995. However, what was more of a challenge during this process was to achieve the proper level of integration between acquiring and acquired company. In the case of the parent company Borås Wäfveri and the daughter company Krenholm, the integration process was seen from different perspectives and lenses. As a starting point, both companies had different economic systems at the time of acquisition: Borås Wäfveri had a market economy background and Krenholm had a planned economy background.

“I asked myself how are we going to do it, to teach the people how to run a western European company? And they did not know anything about costs and income, and investments and I said we had to divide them in small groups, so we had board meetings every quarter also in these subsidiaries. And we worked very close together at that time.” (The owner of Borås Wäfveri)
In addition, Borås Wäfveri had the minimum number of employees whereas Krenholm had more than 5,700. The CEO of Borås Wäfveri in 1995 argues that size differences were not an obstacle for integration and he emphasized the need for cooperation between the two companies.

“It is important for Krenholm, which they are the largest industry in Estonia and of course also in Sweden we have to take the time to work together.” (The owner of Borås Wäfveri)

Post-acquisition integration is divided in three different areas: procedural integration, physical integration and managerial and socio-cultural integration. The empirical evidence found through our interviews and secondary data for post-acquisition integration will be divided according to these categories.

4.7.1 Procedural integration

The objective of combining systems and procedures at the managerial, strategic and operational level is to standardize and homogenize work procedures to facilitate communication and information flow.

Legal and accounting integration

At the time of acquisition, the main goal for Borås Wäfveri was to implement the same accounting systems and to teach the employees at Krenholm how to understand financial statements.

“The main learning process was marketing and financial statements, questions about profitability, took 3 or 4 years to learn [for the top management in Narva, authors’ note]. Managers needed to look and understand income statements.” (The CEO of Krenholm)

“Accounting systems, there is no problem with accounting systems. From the very beginning we had the same systems, then when we took over in 95 already in October, Krenholm could give us the first monthly reports in computer. Then it became better and better.” (The owner of Borås Wäfveri)

Functional integration

The opinion was divided among the divisional managers in regards to the integration of planning and cost systems in the different functional areas.

“It means that finishing factory was supported from Borås Wäfveri more and less, not completely but more and less, from the beginning of 96-97 but this support existed up to 2005 when Borås Wäfveri was closed and internal consultants, these people that cooperated with me were dismiss. But in general, I received some support, but we never had the chance to understand completely the finishing organization in Borås Wäfveri.” (Divisional Manager of Krenholm)

“They provided new systems, income statements, balance sheets and cash flow. But for example, cost accounting? Nothing, no cost accounting system. No planning system. It was necessary for us to
receive reliable planning system in accordance with modern ideas. My opinion is that as for integration between Krenholm and Borås Wäfveri it was not enough.” (Department Manager of Krenholm)

“That our new owners would support us with new approaches, new accounting systems, planning systems all. You know what we used before was from another reality. So we were very interested to accept all that was possible, but my opinion was that they provided us with very little necessary information. We needed to investigate, plan and teach the new conditions by ourselves, there was very little cooperation.” (Department Manager of Krenholm)

“What they did for us was to create income statements for each division, new balance sheets and of course for the financial director some tools for cash flow. But as for planning system, cost accounting, inventory, R&D nothing it was completely somewhere else.” (Department Manager of Krenholm)

4.7.2 Physical integration

Physical integration involves many aspects such as consolidation of product line, production technologies, R&D projects, integration of plants and equipment, real estate assets and product line integration. Our interviewees commented on some of these aspects in relation to the level of physical integration between Borås Wäfveri and Krenholm.

Production line

Borås Wäfveri and Krenholm produced very different products. Borås Wäfveri offered high quality expensive products while Krenholm produced standard quality medium-low cost products. Hence, their customers were different and Borås Wäfveri and Krenholm did not compete in the same market. Nevertheless, after the acquisition of Krenholm by Borås Wäfveri in 1995, some products for Borås Wäfveri were produced in Krenholm’s facilities.

“Krenholm sold to the large retailers as Swedish IKEA, Borås Wäfveri was never able to sell to IKEA, because the difference in price was compared to Borås 3 times. So Borås Wäfveri sold mainly in small boutiques, also they had their own Borås shops in Sweden and in Finland.” (The CEO of Krenholm)

“Before Borås moved all of its production to Narva, we produced some products for Borås, but from the total production this was I believe may be less than 1% and the rest was produced in Sweden.” (The CEO of Krenholm)

“For example, the roll line fabrics, courtier fabrics, that was purely the initiative of Borås, they brought their equipment and the equipment was installed, we were taught how to do this and Borås
specialists came and taught our specialists how to work on these machines.” (Divisional Manager of Krenholm)

By 2005 Borås Wäfveri closed down the production in Sweden and production was moved to Estonia. Given the differences between the products offered by Borås Wäfveri and Krenholm, achieving the desired quality for Borås products at Krenholm became a challenge.

“Borås was selling their own brand Borås Cotton, in stores like Åhlens, NK, high brands but formerly they were produced in Sweden to control quality but at the end it was moved to Krenholm and was produced there but there were many issues to get the quality on the top level.” (Consultant in Krenholm)

**Plant, equipment and real estate assets**

When Krenholm was acquired by Borås Wäfveri in 1995, there was minimum consolidation of plant and equipment given the high degree of autonomy and independence by Borås Wäfveri to Krenholm.

“We had no idea at that time to move production to Krenholm because Krenholm could not do that, and also one other thing, closing production in Sweden is very very expensive […] Krenholm will be a separate company.” (The owner of Borås Wäfveri)

“It was a big difference, big difference in the market and we did not want to mix them” (The owner of Borås Wäfveri)

However, after 2005 when Swedish production was closed, all the machinery and equipment was moved to Krenholm in Narva.

“The full production of Borås was totally moved to Estonia, the machinery was moved and put in the buildings of Krenholm. Krenholm was the only fixed asset left.” (Consultant in Krenholm)

### 4.7.3 Managerial and socio-cultural integration

Achieving managerial and socio-cultural integration is considered as the most difficult to master, especially when the acquiring and the acquired company are so different. The differences in cultural background, language, economic orientation and the way of working made the managerial and socio-cultural integration difficult to achieve between Krenholm and Borås Wäfveri. As Department Manager of Krenholm expresses that the challenge of reaching a common understanding was not an easy task:

“Our new generations, our students must understand what the real gap is between different cultures, it was so different. My experience with the Swedish consultant shows that it was necessary 100 hours of careful discussion before we began to understand each other. But unfortunately when Borås
walked in they never understood that they were taking a deal with this gap, and to overcome this gap is not an easy matter.”

There are different aspects for achieving managerial and socio-cultural integration. Some include transfer of managers, development of a consistent corporate culture, a frame of reference to guide strategic decision-making, commitment and motivation and establishment of new leadership among others.

**Transfer of managers**

At the moment of acquisition there were very limited transfer of managers from Borås Wäfveri to Krenholm and vice-versa.

“The Swedes have taken a relatively hands-off approach, and no Swedish managers have full-time positions in Narva. Partly this reflects the difficulties of getting Westerns to move to Narva, a grim former Soviet military base on the border with Russia. Partly, says Mauritzon [one of the owners of Borås Wäfveri; authors’ note], it was deliberate policy: “The Krenholm managers have to take their own responsibility. We are merely mentors to them.” (Brown-Humes, 1999, p. 1)

“The collaboration with Borås Wäfveri is very limited. There is a very useful programme of experienced Borås staff paying regular visits to the Krenholm facilities to assist in solving the technical problems. Furthermore, Borås top managers are in the board of Krenholm companies.” (International Financial Corporation, 1999, p. 1-5)

“We had one very good guy who was retired. I hired him as a consultant for Krenholm to help the people, he was a finishing guy. He also worked with spinning and weaving. We also had the manager for the finishing mill in Borås, who was regularly visiting the divisional manager in the finishing subsidiary at Krenholm.” (The owner of Borås Wäfveri)

The CEO of Borås Wäfveri from 1995 until 2000 worked closely with the CEO of Krenholm and made regular visits to Narva.

“In the first years I think we spoke every second or third day. In the beginning he came every quarter maybe 2 days, until the end.” (The CEO of Krenholm)

A couple of years before and at the time the production from Sweden was moved to Estonia in 2005, the visits of regular managers from Borås Wäfveri to Krenholm increased. These managers evaluated, coordinated and helped to install the production machinery in Narva.

“The Swedish management team visited Krenholm the first 7 years maybe once a year, but later in 2002 very often, maybe every second month somebody was in Krenholm to understand how Krenholm was operating. Just regular managers, no members of the board or the CEO. The managers from
Narva went also to visit Borås, all the managers had the chance to see everything in Borås.” (The CEO of Krenholm)

“There were a lot of guys in the Swedish management team in Sweden, some higher managers in that team that were coming to Estonia many times during this period.” (Consultant in Krenholm)

However, to the eyes of some divisional managers and the Swedish consultant at Krenholm, the overall amount of visits from the Swedish management team was not enough.

“The Swedish management team just came to Krenholm once per month or once every second month, for me it was not enough, there was a lot of issues to discuss and to resolve but they just handed them to us - the ones that were in place, that was not so professional because I think that if they knew or cared about the huge cultural differences and the local huge company they actually run, I think it would be worth to be there more in Krenholm. Also the Finn that went home every weekend I consider it was a lack of interest.” (Consultant in Krenholm)

“If we will talk about integration in a broader point of view, where one culture began to understand another culture, when one production approach began to understand the other and so on, if we speak about this type of integration, of course it did not exist on my point of view. But several fragments of integration like income statements, like work meetings, like short visits, yes all this existed but it was fragments.” (Department Manager of Krenholm)

**Socio-cultural integration**

The development of socio-cultural integration includes the differences and incompatibilities of national and corporate cultures.

The differences between Borås Wäfveri and Krenholm could not be bigger. Krenholm came from a planned economy orientation and under the regime of the Soviet Union for decades. Borås Wäfveri had a market economy orientation and had a different mentality than Krenholm. In addition, the differences in language and culture were very high.

“It is necessary to understand because Borås Wäfveri belongs to the western world, and they based on one type of experience and one approach and us we were not the opposite but there was no correlation between our approaches so this fragmented integration was not really a successful integration, that is my opinion.” (Department Manager of Krenholm)

In the case of the style of decision making in designing business strategies, one common and very important topic was the purchase of cotton. The CEO of Krenholm talks about the process of decision making for the purchase of cotton.

“Raw material was so important that we took the decision together, in Krenholm we called it Troika [group of three, authors’ note], we had the raw material manager, who was the spinning manager
and me, we all took a decision together what is the right price for the next three months. We also consulted Lars’s [one of the owners of Borås Wäfveri, authors’ note] opinion as well.” (The CEO of Krenholm)

The divisional managers perceived the differences in opinion as a lack of understanding and communication from the top management of Krenholm and Borås Wäfveri.

“They could not see us as colleagues, because their thinking was different. There was obviously a mismatch of culture and values. The misunderstanding was between Russians and Swedish, but Estonian management was in the middle of this miscommunication. Swedish guys did not perceive us seriously, they thought we were practicing and they should have taken into consideration our knowledge.” (Department Manager of Krenholm)

This bad communication and misunderstanding was not limited to the top management but also to different departments.

“Must be aware and well understood that we never had the chance to discuss, to achieve a common agreement in regards on what we can and can’t do, what is expensive, what is unacceptable. I had been several times at the sales meetings, nobody from the sales department has been to finishing and understand, we could never discuss. Bad communication.” (Department Manager of Krenholm)

“There was an internal conflict within the group, in the production level nobody understood what we should do, and in the marketing department they did not understand us, there was miscommunication, there was a cloud of internal conflict that began to grow and this was the beginning of our tragedy.” (Department Manager of Krenholm)

There was a negative permanent feeling from the divisional managers of Krenholm towards the top management.

“First of all, maybe is not only my personal feeling, but there is a Russian sentence –Ya nachal’nik, ti durak – [I am the boss you are a fool, authors’ note] so all of us felt that they treated us as fools.” (Divisional Manager of Krenholm)

“Our feeling was that top management of the company looked at us like people from the bottom, inexperienced people, who do not understand real things. It was a permanent feeling since the very beginning of the privatization of Krenholm. I can say no one offered to do something to do it better, it was never understood or accepted.” (Divisional Manager of Krenholm)

According to the divisional managers at Krenholm, there was no clear frame of reference on how to follow a strategy. The process of strategic decision-making requires good communication, understanding of a clear plan and specific goals.

“Another mistake is that we did not feel there was any clear plan on how to develop the company, it was not put on paper and it was not clear for employees.” (Divisional Manager of Krenholm)
“Main marketing policies, main marketing decisions, was a guy in Sweden and in accordance with the rules, targets and ideas all these decisions were done. They were more interested in just making sales and increase sales than how it might affect the production of the company.” (Department Manager of Krenholm)

“It was very difficult to understand the strategy of the company up till the end.” (Divisional Manager of Krenholm)

**Commitment and motivation of personnel**

At the time of the acquisition of Krenholm by Borås Wäfveri, there were more than 5,700 employees working full time in Narva. It is common that the trust and motivation of the employees towards the new owners is relatively low after an acquisition. One example in our case is when Krenholm was acquired the Estonian State set the requirement to keep employment at a minimum of 2,000 employees. This requirement caused panic within the 5,700 employees of the company.

“There was no trust in the beginning from all the workers and managers because of these two figures: keep employment at a minimum 2,000 employees, and investments for 20 million EEK in three years, this was the reason why there was no trust, when I started working there were 5,700 people and everybody thought about 2,000. It was so hard to convince people that this was not true.” (The CEO of Krenholm)

Motivation was not improved after the acquisition of Krenholm, and the employment security, which the workers had during the Soviet times, was gone.

“Mauritzon does not claim the western takeover has boosted living standards for Krenholm’s workers nor improved their morale. The managers who are closest to this fell more and more motivated. But for the workers it is different. Many of these people feel it was better in the old times. They felt safe. Today they don’t feel as safe anymore”. (Brown-Humes, 1999, p. 1).

The cooperation and trust to the CEO from the divisional managers started to grow after the second year after the acquisition.

“I am sure that other managers accepted me very fast but probably started to trust, I hope in the second or third year. But I believe after the third year we had a very good cooperation with every manager.” (The CEO of Krenholm)

However, after the departure of this CEO of Krenholm, the constant changes in CEO’s, the change of Krenholm into just a production facility for Borås Wäfveri, the dissolution of the special council for Krenholm, the lack of communication and the constant decrease in the work force reduced the level of commitment and motivation of the personnel at Krenholm. One of the divisional managers of Krenholm talked about the board meetings and the monthly reports:
“We already did not have the board meetings. We were preparing the materials, but nobody asked for them, but we still sent them to the CEO. We were still doing the reports so that personnel knew about the situation, to motivate them to achieve results. We did not step aside from the system that the owners once created. It was normal, but in 2009 nobody was interested in these reports.”

**Establishment of new leadership**

It is difficult to talk about establishing leadership in a company that has had six different CEO’s, two of them being CEO’s of Borås Wäfveri at the same time, in less than 15 years. The efforts by the first CEO of Krenholm to establish a new leadership paid off at the beginning right after the acquisition and this is reflected in the profits the company had the first 7 years. He tried to communicate with the employees through newsletters.

“Krenholm was a company that had an own newsletter, every week we gave maximum information for our people, what is going on in the company, what are we planning, what type of investments, how are the sales results. Everybody read these newsletters.” (The CEO of Krenholm)

But during the time of other CEO’s in the company, the efforts were not very substantial.

“When Skogman was the CEO, they did not speak with people in Krenholm, there was no communication, not even local managers did not know what will happen the next month. This was a huge mistake.” (The CEO of Krenholm)

“The Finnish CEO did not speak Russian, which was a major problem. It is another major issue, they communicated in English. You never get communication going if you cannot talk the same language. The language difference is very difficult and the cultural difference. He never put any time into understanding that Krenholm was a big player locally and obviously you need cooperation with the local government.” (Consultant in Krenholm)

One of the divisional managers of Krenholm clearly expresses her feelings in regards to the constant changes of CEO’s in the company and the consequences of the instability that this created.

“Such a big company…. A clear plan was needed to show the way we were going so that everybody could understand. But when people are changing and nothing is clear, and nobody listens to you… There should have been a team that everybody follows. And step by step advance. But when one people come, another leaves, one director has one strategy, another a different strategy, another person is from a different field and does not understand what was going on in the company. We should have been guided by specialists. But the outsider people that were coming they did not know anything about production. When you have at least some stability we can work and move on. But then it changed and brought to an end. It could have given a good result. But when you jump like this: something here, something there…. ” (Divisional Manager of Krenholm)
5. ANALYSIS AND DISCUSSION

In this chapter of the master thesis the empirical findings will be analysed using theoretical frame of reference presented in the second chapter. The aim is to give the answers for two research questions outlined in the Introduction chapter by discussing the findings of corporate governance in international acquisitions of distressed firms. Having analysed the case of Krenholm, Estonian textile manufacturer, from the time of privatization in 1995 until its bankruptcy in 2010, we have identified two periods with a need for a turnaround: (1): 1995 – 2001, (2): 2002 – 2010. Therefore, analysis and discussion in this chapter will follow this time division.

5.1 First turnaround period

The need for the first turnaround in 1995 was caused by a very difficult financial situation in the company after the collapse of the Soviet Union. Indeed, as the former CEO from those times expressed: “I can say that I feel that one more year and I would have become crazy. It was very difficult [...] especially in 1992, when we lost 90% of the market”. At this time, Krenholm lost almost all of its customers (in former Soviet Union republics), financial resources and suppliers of raw and other materials. Because of the collapse of the bank system in the Soviet Union, 4 million US dollars - half a year’s production, were blocked in one of the Russian banks at the beginning of 1992 (Klushin, n.d). Moreover, the rouble which was used as the Estonian currency until June 1992, depreciated which led to big losses for the company (Andren and Öberg, 1996). Furthermore, the lack of support from the Estonian state and the fears of foreign investors to get involved in the company complicated the situation even more. As a result, operating profit in 1994 before the privatization amounted to 125 670 EEK (~8 032 Euros) and net loss – 2 911 390 EEK (~186 071 Euros).

In the empirical part we refer mainly to operating profit/loss when we present the need for turnaround, because this indicator was used by Krenholm’s divisional managers as the main criteria for analysing current and historical performance. Operating profit/loss shows earnings from the company’s normal core operations, and the declining operating profit impedes the development progress and other actions that the owners want to implement to improve financial situation.

Borås Wäfveri acquired Krenholm in 1995 and the turnaround efforts were directed towards the improvement of the critical financial situation and transforming the company “from an inefficient Soviet monolith into a lean and competitive actor on world markets” (Brown-Humes, 1999, p. 1).
The new owners initiated a reorganization program to turn Krenholm around. One of the first steps was the replacement of the CEO, who managed Krenholm during the Soviet era, by an Estonian national from another textile company. As many researchers think, this is an essential step in the turnaround process (e.g. Hofer, 1980; Chen and Hambrick, 2012). Newly appointed CEOs can bring fresh perspectives and understanding for initiating necessary changes (Castrogiovanni et al., 1992; Barker and Duhaime, 1997). However, it seems reasonable that the main reason of replacement of the previous CEO in Krenholm was not the lack of his ability or incompetence. This senior executive was able to keep Krenholm “alive” even during very dramatic times in Estonia and in the company. Moreover, the reason for poor performance was not an executive inadequacy but rather extraordinary events such as an imposed external political and economic change in the society.

All the research participants gave high praise to his personality and merit: “It was his child [Krenholm; authors’ note], he grew up here and he felt responsibility for it” (Divisional Manager of Krenholm). The main owner of Borås Wäfveri in 1995 added: “All loved him because he had managed to keep the company running until the liberalization, he had really hard work, they had no money [...] he managed with that.” The reason for replacement, therefore, had more a symbolic aspect to signal employees and other executives about the coming large-scale changes, first of all, in the way of thinking (from planned and production oriented to market economy).

The initial changes also involved other reorganization strategies: redesigning organizational structure and changing the extent of decentralization. Thus, in 1995 the new owner introduced the holding structure: previous departments (production mills) were transformed into subsidiary companies. The main reason of this strategy was to get more control (find the sources of problems) and change the relationships between the business units to more market oriented: “Changing the mentality of Krenholm management was Borås’s top priority” (the owner of Borås Wäfveri; cited in Brown-Humes, 1999, p. 1). The new organizational structure intended to increase the level of decentralization because each subsidiary was given a degree of autonomy to buy and sell their raw materials and ready products from outside customers and other subsidiaries within the Holding. However, because of the high degree of interdependence between the units, the subsidiary managers did not “have enough freedom to be a business maker” (expressed the consultant during our interview). Even though, the new structure did not bring the desired results, it was also a symbolic transformation for the company into a more market oriented way of working.

Organizational structure was again redesigned in 2001 when divisional structure replaced holding structure. This was in accordance with the demand from the IFC, which gave a loan to Krenholm, but also because of many drawbacks of the holding structure. However, new structure was also not
efficient: “The divisions did not have freedom. Everything was flowing in one direction” (explained the external consultant).

Apart from reorganization actions, during the first turnaround period Borás Wäfveri implemented a **retrenchment** strategy, which has a short-term focus and is used to get immediate results (Thompson, 2001). At Krenholm this was done mainly in the form of *head count cuts*. “In January 1995 there were 5700 employees but I had to fire 1000 people, in three years’ time”, said the CEO of Krenholm at that time. The managers saw this as a way to improve productivity because the Soviet policy of full employment gave job places to an excessive number of people.

Moreover, **repositioning** was a very important strategy for the first turnaround. The objective of the repositioning strategy is to generate revenue from new sources (Boyne and Meier, 2009). In the mid-1990s Krenholm had to diversify into new markets. However, the first step in that direction was to increase quality of the products: “Krenholm had no quality to go to European market [...] we could increase the quality up to a certain level so we could be a good supplier to IKEA and Mark and Spencer”, said Borás Wäfveri’s owner. As it was mentioned before, during the Soviet times, an overwhelming majority of textiles from Krenholm went to Soviet Union republics. However, after the dissolution of the Soviet Union in 1991 Russia introduced “punitive import duties” (Brown-Humes, 1999, p. 1). Therefore, Krenholm had to find different markets for its products. With the help of its parent company Krenholm started to export to the Nordic countries, Germany, the United Kingdom and the United States.

Another important strategy that is not mentioned in the existing literature on turnaround is the ability of acquiring companies to make **investments** into the acquired companies in order to save the distressed firms from financial disaster. Indeed, our case shows several examples that are connected to this concept. First of all, capital injections through investments from the parent company and loans were done. Borás Wäfveri invested 190 million SEK in Krenholm during the period 1995-2000. Moreover, a big loan of 25 million Euros was taken from the International Financial Corporation, which allowed the company to renew the machineries, increase quality and enlarge the production (a new sewing plant was build).

Secondly, investments into human resources were significant. For Krenholm the transformation from planned into market economy was of a high importance, the firm’s divisional managers got training in marketing, management and English language. “Lack of market orientation has been a significant handicap”, stresses Borás Wäfveri’s owner in the newspaper interview (Brown-Humes, 1999, p. 1). A single distressed firm does not have opportunity for this type of investment programs, even the banks
are usually extremely cautious in giving loans to companies suffering from existence-threatening performance.

As a result, Krenholm recovered after its crisis. In the year 2001 the company showed operational profit of 11.8 million EEK and reached the sales level of 1.24 billion EEK. The divisional managers also called the period from 1998 to 2001 as the “success time” for Krenholm. However, the next organizational crisis that came after this period shows that cooperation between Krenholm and its parent company was not at the level needed for sustainable performance.

Corporate governance mechanisms played an important role in turnaround process during 1995 to 2001. In 1995 Krenholm changed its ownership from being entirely state-owned to mainly private owned by Borås Wäfveri - a foreign company. The parent firm at that time was owned by Lars Mauritzon, who had more than 70% of the shares. In addition, he was also the CEO of Borås Wäfveri until the year 2000. Collaboration between the CEOs of Krenholm and Borås Wäfver played a significant role: “cooperation was fantastic, this was the reason for success, for good understanding” (the CEO of Krenholm).

Another important corporate governance mechanism was the board of directors in Krenholm. Scholars recognize the board of directors as a critical part of the corporate governance, which safeguard the assets of shareholders and monitor the performance of managers (Sudarsanam, 2000; Monks and Minow, 2001). In Krenholm the board of directors was knows as the special council, which was composed by the members from both companies. “There was a very strong influence on Krenholm from the board”, said the owner of Borås Wäfveri. The board facilitated setting the direction for the company, monitoring and control of top management, giving feedback and advising the top management team. Therefore, a special council made a substantial contribution in the corporate evolution. It was very important that the main decisions about Krenholm’s direction were taken on-site and after discussion with the top management team of Krenholm. The board of directors had a leading role in establishing the strategy, policies and objectives of turnaround actions. Therefore, the degree of involvement in strategic management was high, which Wheelen and Hunger (2006, p. 38) call “catalyst” board.

In addition, each subsidiary of Krenholm had its unofficial board of directors. “It was when I shared all the news that I had, when everybody spoke what was the problem, how to help”, noted the CEO of Krenholm. These board meetings were of absolute importance for establishing close cooperation with the subsidiary managers, informing them about the main change processes and monitoring their performance. In such a big company as Krenholm, this type of communication and control was necessary.
The board of directors of Borås Wäfveri, which also played significant role in the turnaround process, was composed by two inside directors (chairman and the CEO) and two outside directors (Minister of Finance in Estonia and consultant and specialist in strategies). Many researchers claim that outsiders have a better position to protect the interests of shareholders, enhance monitoring and control (e.g. Sudarsanam, 2000; Wheelen and Hunger, 2006; Goranova et al., 2010). In the case of Borås Wäfveri two independent directors were also a valuable source of expertise and the link to external business community. Indeed, in the survey of directors of US corporations (see in the section 2.1.6) 67% of respondents said that “special expertise, which is important for the company” is one of the important criteria of a good director.

The board of directors of Borås Wäfveri worked in close cooperation with Krenholm’s CEO and the board: “We had a very close connection between Krenholm and the board of Borås” (the owner of Borås Wäfveri). This cooperation was important for turnaround efforts, with the help of Borås Wäfveri, Krenholm improved its survival-threatening performance and was on its way to become a European company working in the market conditions: “The shift over the past four years – and particularly since Borås Wäfveri took control in January 1995 – has been dramatic. “Management has been immersed in the ways of the market” (Brown-Humes, 1999, p. 1).

Even though the boards of directors at Krenholm and Borås Wäfveri actively monitored the company, day-to-day operations were performed by the CEO of Krenholm. After the privatization, he had a hard task to change the purely production orientation of the company and find new sources of revenue for recovery. The CEO of Krenholm had detailed knowledge of the textile industry: “He was on the top” (the owner of Borås Wäfveri noted). Moreover, subsidiary managers of Krenholm gave high praise to the skills and competence of all the corporate governance actors running the company during the first turnaround. Thus, for example, the divisional manager of the finishing factory said: “In the beginning there were very professional people in the textile industry [...] It was a team that directed us in the right way.”

Taking into consideration the crisis situation at Krenholm after the dissolution of the Soviet Union and enormous efforts needed to bring the company back to profitability, it is worth to highlight the following two aspects. Firstly, close cooperation between the board of directors and the CEOs was established, and Krenholm’s top managers were invited to monitor the progress during the board meeting. Secondly, the main corporate governance actors had a good competence and detailed knowledge about managing textile business. However, intense cooperation and communication was only at the very top management level (between shareholder, the board members and the CEOs),
which brought significant consequences for managerial and socio-cultural integration between the companies. This issue will be further clarified and discussed below.

The main aspects of the first turnaround strategies and the role corporate governance is summarized and presented in Table 5.

Table 5. First turnaround and the role of corporate governance

<table>
<thead>
<tr>
<th>The first turnaround</th>
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<tbody>
<tr>
<td>Reorganization and replacement</td>
<td>1995 – new Estonian CEO instead of ethnic Russian which managed the company during the Soviet era (symbolic aspect); 1995 – Holding structure with 6 subsidiaries 2001 – Divisional structure</td>
</tr>
<tr>
<td>Retrenchment</td>
<td>Head count cuts.</td>
</tr>
<tr>
<td>Repositioning</td>
<td>Market reorientation into Nordic countries and the US; quality improvement;</td>
</tr>
<tr>
<td>Supportive strategies</td>
<td>Capital injection through investments and loans; Investments into human capital (management, marketing and language trainings)</td>
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<table>
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<tr>
<th>Corporate governance</th>
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<tbody>
<tr>
<td>Shareholders</td>
<td>Active involvement and monitoring</td>
</tr>
<tr>
<td>The board of directors</td>
<td>Special council in Krenholm - catalysts board; unofficial boards in every subsidiary Close cooperation with the board of directors of Borås Wäfveri (2 outside directors); professionals in textile business</td>
</tr>
<tr>
<td>Top management team</td>
<td>Close cooperation between the CEOs of Krenholm and its parent company; high competence in textile business</td>
</tr>
</tbody>
</table>

Source: Authors’ own elaboration.

In international acquisitions of distressed firms, apart from the need for turnaround, corporate governance actors should also be involved in interactive and gradual process of inter-firm harmonization (Chakrabarti and Mitchell, 2005; Mtar, 2010). In the M&A literature, this process is called post-acquisition integration. Calipha et al. (2010) note that orchestrating and executing the integration process is a critical element of successful cross-border M&A. Post-acquisition process is multi-dimensional: there are several areas that needed to be combined. Shrivastava (1986) identifies three types of post-acquisition integration: (1) procedural, (2) physical, (3) managerial and socio-cultural. However, each business case gives decision makers various precondition, which can help to find a proper level of integration.

According to Pablo and Javidan (2004), autonomy and interdependence need are the crucial factors for setting the level of post-acquisition integration. Other researchers (e.g. Shrivastava, 1986; Ghauri and Buckley, 2003) cite the motives of acquisition and size of the firm as the determinants for the need of post-acquisition integration. According to the theoretical frame of reference, the level of integration during the first turnaround period should have been low between Krenholm and Borås Wäfveri. Krenholm was kept autonomous at the beginning: “We did not want to mix them” (the owner
of Borås Wäfveri). Therefore, even the big size of Krenholm did not create the need for high level of post-acquisition integration. Moreover, the companies were not that much interdependent on each other. Even though, Krenholm needed investment injections from its parent company, it was not required to build interdependent operations and procedures.

As it was mentioned in the empirical findings, Krenholm was bought in order to achieve cost synergies: “They understood that they could not keep production in Sweden for a long time” (the CEO of Krenholm from). “The factory [Krenholm, authors’ note] retains a vast cost advantage in the form of low wages”, states in one of the newspapers from 1999 (Brown-Humes, 1999, p. 1). However, economies of scale by merging the resource base of two companies were not possible to achieve right after the takeover. One reason for that is the lack of necessary equipment to produce high quality products for Borås Wäfveri. Secondly, the intention to keep high-quality brand and high prices of Borås Wäfveri in the eyes of customers aside from low wage locations. Thirdly, closure of the production mill in Sweden (e.g. compensation for employees) required large amount of financial resources, but Borås Wäfveri’s owners did not have the ability to do that at that time. Therefore, even though the motivation of takeover was the achievement of cost synergies, high autonomy led to the low need for the post-acquisition integration between Krenholm and Borås Wäfveri during the initial period.

It is worth to have a closer look at different types of post-acquisition integration between Krenholm and Borås Wäfveri during the first turnaround period: (1) procedural, (2) physical, (3) managerial and socio-cultural. The role of procedural integration is to standardize work procedures, which can facilitate communication between two companies and more effective processing of information. It has been noticed that integration of accounting systems worked well, and “from the very beginning we had the same systems” (the owner of Borås Wäfveri). It was very important for the managers of Krenholm, because during the Soviet times this kind of financial statements was non-existent. “You know what we used before was from another reality” (Department Manager of Krenholm). But with the help of Borås Wäfveri, Krenholm’s executives mastered accounting and financial reporting systems very fast. However, as many divisional managers expressed, they did not get sufficient support for planning and cost accounting system. “As for planning system, cost accounting, inventory, R&D nothing it was completely somewhere else” (Department Manager of Krenholm). Therefore, the level of procedural integration was low between Krenholm and Borås Wäfveri during the first turnaround period (see Figure 32).

Physical integration is the second type of post-acquisition integration. It is a complex process of combining product lines, technologies, plants, equipment, and real estate assets in order to achieve
operational synergies. During the period from 1995 to 2001 there was very limited physical integration between Krenholm and Borås Wäfveri, because Krenholm was kept autonomous and independent: “We produced some products for Borås, but from the total production this was I believe may be less than 1%” (the CEO of Krenholm). Managers of Borås Wäfveri did not want to consolidate product lines of the two companies because of the big difference in quality and image.

The third type of post-acquisition integration is managerial and socio-cultural integration. The objective of this type of inter-firm combination is to achieve a positive attitude, cultural convergence, shared identity and mutual respect between the employees of two organizations. Transfer of managers was limited, and there were no Swedes working full-time in Narva. Few consultants from Borås Wäfveri helped with different technical problems. “The Krenholm managers have to take their own responsibility”, said the owner of Borås Wäfveri (Brown-Humes, 1999, p. 1). However, top management of the parent company did regular visits (usually for the board meeting once per quarter) to Krenholm in order to monitor the progress. Moreover, during this period, cooperation between the CEOs of the two companies was very intensive: “In the first years I think we spoke every second or third day” (the CEO of Krenholm).

Socio-cultural integration is especially important in international acquisitions. It takes long time to overcome obstructive differences in national and corporate culture between the merged organizations. National culture is defined as the “collective programming of the mind which distinguishes members of one nation from another” (Schoenberg, 2000, p. 49). Differences in national cultures create various assumptions, values and norms. Corporate culture implies differences in opinions, the nature and the style of the decision-making in designing business strategies but what is the most important, the capabilities and the attitudes of top management in implementing changes.

Many research respondents from Krenholm noted substantial differences in national and corporate cultures between Krenholm and Borås Wäfveri. The intense cooperation, mentioned above, between shareholders, the board members and the CEOs was predominantly at the very top level of corporate governance and communication with divisional directors was very limited. Therefore, the mismatch between cultures and values created “we-they” feelings, tensions and feelings of inferiority: “They could not see us as colleagues” (Department Manager of Krenholm).

Gaining commitment and to motivate personnel after the acquisition is not an easy task. It is common to observe employees’ stress, disbelief and resentment in the acquired company (Evans et al., 2011). Many Krenholm’s workers preferred Soviet times and after the acquisition they felt uncertain about their career prospects. The task of the newly appointed CEO at Krenholm was also to establish new leadership. One of the most important issues in the national culture is the language. Krenholm’s
employees were entirely Russian speaking and the fact that the new Estonian CEO could speak Russian had a positive influence on the communication process. Villinger (1986 cited in Ghauri and Buckley, 2003), for example, studied post-acquisition learning of Western firms in Eastern European countries and he noted that “knowledge of partner’s language and cultural awareness is considered the most important issue for post-acquisition integration in Easter Europe” (Ghauri and Buckley, 2003, p. 219)

Post-acquisition integration between Krenholm and its parent company during the period from 1995 until 2001 is illustrated in Figure 32. This representation of post-acquisition integration is schematic and based on authors’ judgement (formed by the theory exploration and interview answers).

![Figure 32. Post-acquisition integration between Krenholm and Borås Wäfveri during the first turnaround period.](image)

From the data analysis we see that the level of post-acquisition integration was close to the level required by the existing theory. The low level of physical and procedural integration was satisfactory because Krenholm was kept autonomous during the first turnaround period. The level of managerial and socio-cultural integration was moderate: the top executives and board members of the two companies communicated closely and built cooperative relationships. However, we argue that it was not enough to reach a proper level of integration. Strong “merger syndrome” (Evans et al., 2001, p. 547), feelings of inferiority and stress, mismatch between national and corporate cultures, insufficient communication at the mid-management level were the main obstacles. Higher level of managerial and socio-cultural integration could have been a necessary accompaniment for a successful turnaround and the restoration of sustainable performance.
5.2 Second turnaround period

The need for a second turnaround in 2002 was caused by different factors. First, the textile industry was facing a recession in the first quarter of 2002 and Krenholm had a reduction in orders for production. Second, there was a problem of cash flow in the company. When Krenholm was acquired by Borås Wäfveri in 1995, initially Borås Wäfveri only paid 12 million EEK, but took over Krenholm’s previous tax obligations with the Estonian State. The total amount of those obligations was 350 million EEK that had to be paid within 6 years’ time. Therefore, it meant that this debt had to be paid from the annual cash flow of the company. In addition, in 1999 Krenholm had signed a loan with the IFC for 25 million Euros. By 2001, Krenholm started to pay back this loan from the company’s cash flow as well. In summary, Krenholm had been paying debts and obligations from its annual cash flow for a number of consecutive years since 1995.

By January 2003 the board of directors and the CEO of Borås Wäfveri decided to take action to turnaround the situation in Krenholm and to try to stop the losses that started in 2002. Krenholm was in need for reorganization and the first action taken by Borås Wäfveri was the replacement of the CEO of Krenholm. The current CEO of Borås Wäfveri became the newly appointed CEO of Krenholm playing a double role as an executive office for both organisations. As mentioned before, the replacement of the CEO of a company is one of the strategies for turnaround and is supported by the argument that “current CEO’s (especially those who have had extended periods of success) are often locked into a particular perspective, yielding specific recipes for running the business” (Castrogiovanni et al., 1992, p. 26). Moreover, researchers argue that “the existing management is rarely capable of taking the drastic action needed to effect a turnaround” (Slatter, 1984, p. 74). In fact, the replacement of the CEO in Krenholm became a recurrent strategy adopted by Borås Wäfveri. Krenholm had five more CEO’s since the departure of the Estonian CEO in 2003 until the bankruptcy in 2010.

The turnaround process that started in 2003 involved other reorganization strategies: the redesigning of the organizational structure. Thus, after 2003 Borås Wäfveri changed the organizational structure of Krenholm. “The future of Krenholm would be a factory to Borås Wäfveri and Borås takes care of product development and sales except for manufacturing” (The CEO of Krenholm). In fact, by 2005 the whole production from Borås Wäfveri in Sweden was closed down and moved to Krenholm in Estonia. According to the top management and the board of directors of Borås Wäfveri, Krenholm was prepared to take the full production from Sweden due to the heavy investments in machinery and equipment that were done in the previous years. In addition, the marketing department that was
located in Narva was centralized in Sweden, concentrating all the marketing activities in one office and under one marketing director for the whole group.

To cope with the need to generate cash flow, Borås Wäfveri applied diverse retrenchment strategies in a different numbers of occasions. The core changes are usually associated with the reduction of the size and scope of a business (Boyne, 2006; Boyne and Meier, 2009). One of the most sensitive strategies was the constant reduction in the workforce of Krenholm. By 2004 the number of employees had been reduced to 4000 and by 2008 the number of employees decreased to 1100. In 2010 before the bankruptcy, Krenholm had approximately 500 workers. In addition to the constant reduction in the work force, Borås Wäfveri hired a Swedish consultant to improve the operational efficiency and production processes. The goal was to improve production planning to deliver high efficiency and the reduction of slack. However, small orders were produced in Krenholm and the company was using approximately 60% of its capacity. “It is like if Volkswagen is to produce Rolls Royce” mentioned one of the divisional managers. In addition, the setups costs for changing orders in finishing division increased considerably. Krenholm was producing small orders with many different types of assortment.

Another strategy employed by Borås Wäfveri was the downsizing of the production facilities. First, as mentioned before, Borås Wäfveri closed down all the production in Sweden in 2005. Moreover, by 2008 the sewing, spinning and terry divisions had been closed. The increase in operational costs in combination with low sales and high international competition were determinants for the decision to close down these divisions. In consequence, Krenholm was in need to outsource some of its steps of production such as grey fabrics and terry towels to other countries particularly in Asia.

The final retrenchment strategy applied by Borås Wäfveri in Krenholm - the selling of assets – was desperate measure to obtain cash flow to continue with the daily operations. This strategy is used specially in the most extreme cases when a firm is very close to bankruptcy. The first assets that were sold by Borås Wäfveri were the trademarks such as Borås Cotton. Furthermore, the major owners of Borås Wäfveri and Krenholm bought the fixed assets from themselves, splitting up the machinery and buildings and placing them in different companies that belonged to these major owners. The price that was paid for these assets was inferior to the real value, however Krenholm was able to get money into the production again to continue operations.

Finally, the bad economic and financial situation of Krenholm and the increase of international competition led to a poor use of the repositioning strategy. On the one hand, the centralization of the marketing department in Sweden caused the closure of the sales companies that were allocated in the different markets where Krenholm sold its products. In other words, the presence of Krenholm in the
current markets was reduced and there was little or none selling efforts in new markets. On the other hand, the small orders with different types of assortment that were produced in Krenholm, contradict what Thompson (2001, p. 649) describes as a rationalization of the product line where “variety reduction can similarly be useful for concentrating efforts on the stronger market segments and opportunities”.

Although we have mentioned before that the existing literature does not cover the investments made by the parent company to the daughter company, we consider investments as an alternative strategy for turnaround acquisitions of distressed firms. Nevertheless, we argue that investments strategy does not always lead to the desired results but are a powerful mean to inject cash flow into the company, training personnel or the ability to buy machinery, raw material etc. through the loans made by the parent company. In the case of Krenholm, we consider that after Borås Wäfveri closed down the production in Sweden and moved it to Estonia in 2005, there was a need for a turnaround but not just for Krenholm but for Borås Wäfveri as well. Therefore, in this case the investments during the last years before the bankruptcy in 2010 were minimal or none due to the lack of capital from the parent firm to invest in Krenholm.

The result for the second turnaround effort was unsuccessful. Both Borås Wäfveri and Krenholm were declared in bankruptcy in 2010 and the facilities were closed down. Many factors contributed for the decline of Krenholm. However, we will focus our analysis to the responsibilities of the corporate governance in the turnaround efforts of Krenholm.

Corporate governance mechanisms played a very important role in the second period for turnaround that lasted from 2002 until 2010. In 2002 there was a major change in the concentration of the ownership of Borås Wäfveri. Lars Mauritzon and Madis Üürike were the former major shareholders of Borås Wäfveri until 2002. Mats Gabrielsson and Johan Claesson became the new major shareholders of Borås Wäfveri from 2002 until 2010. The high concentration of ownership in Borås Wäfveri opened the door for high involvement from the shareholders in the company through shareholder activism, which is defined as “the use of ownership position to actively influence company policy and practice” (Sjöström, 2008, p. 142). In the case of Borås Wäfveri, special emphasis should be put in the background and experience of the major shareholders. On the one hand, from the first period we have Lars Mauritzon, who was the former chairman of the Swedish Textile Association and former member of the board for Eurotext and Madis Üürike, who was the Minister of Finance of Estonia. On the other hand, from the second period of turnaround we have Mats Gabrielsson and Johan Claesson who are well known and recognized risk capitalists with ownership and participation in diverse companies. Some of the disadvantages of shareholders involvement in the
company’s policy and practice are that shareholder activism can disrupt the boards’ authority unnecessarily and bring instability to a company (Bainbridge, 2006). In addition, “shareholders are likely to pursue their own self-serving agendas” (Cziraki et al., 2010, p. 741).

Lars Mauritzon, Madis Üürike, Mats Gabrielsson and Johan Claesson were also members of the board of directors in Borås Wäfveri. Hence, the changes in the ownership of the company also led to changes in the structure of the board of directors. Moreover, one of the most significant changes was the departure of Lage Rosvall due to differences in opinions with the Chairman of the board Stig Arne Blom. Lage Rosvall was an outside member of the board who was a specialist in strategies. His knowledge and capabilities were determinant for the future of Borås Wäfveri and Krenholm. The importance of capable outside members in the board of Borås Wäfveri was a deciding factor for the development of long-term strategies for Krenholm. Researchers argue that having more independent and less biased board members can intensify control, enhance monitoring and increase the possibility to evaluate management’s decisions objectively (Wheelen and Hunger, 2006; Goranova et al., 2010). In addition, outside directors “have an incentive to monitor management actions since they have staked their reputation as professional corporate referees” (Sudarsanam, 2000, p.123).

One of the main responsibilities of a member of the board of directors is to control, monitor and supervise top management (Wheelen and Hunger, 2006). Thus, this responsibility is even greater for the chairman of the board of directors. The chairman of the board of Borås Wäfveri in 2002 was Stig Arne Blom. He remained the chairman of the board until the bankruptcy of Borås Wäfveri. Blom came to Borås Wäfveri with a background as a production manager. During his time as the chairman, he was serving as the CEO for another company. He divided his time and devotion to perform his duties. He rarely visited Krenholm and he was unaware of the needs and changes in the daughter company. In addition, when he was most needed to reinforce the turnaround efforts, he proved to have a lack of interest in Krenholm: “You can take for example what happened with the revenues, it is terrible that the Chairman could permit that to happen” (The owner of Borås Wäfveri). Therefore, there was not a clear corporate strategy or an overall direction from the board of Borås Wäfveri in relation with the personnel at Krenholm.

Moreover, Stig Arne Blom decided to dissolve the special council in Krenholm which acted as the board of directors. In theory, it can be said that the dissolution of the special council was to exercise more control over Krenholm, “the answer was always from Mr. Blom that Krenholm has to be discussed in the board of Borås” (The owner of Borås Wäfveri). However, this decision could be questioned since there was a lack of understanding and a detachment from the members of the board in Borås Wäfveri towards the reality at Krenholm. This decision complicated the turnaround efforts in
Narva. Furthermore, the unofficial board of directors at Krenholm in which the CEO met regularly with the divisional managers from every division was also dissolved. The communication between the divisional managers, the top management of Krenholm and the board of directors was severely damaged. We consider both the special council and the unofficial board of directors necessary to establish a good cooperation and communication between the board in Borås Wäfveri, the CEO of Borås and Krenholm and the divisional managers of Krenholm.

The board of directors is responsible for hiring and firing the CEO and top management (Wheelen and Hunger, 2006). Taking into consideration the situation in the board of Borås Wäfveri, it is worth to highlight the following aspects. First, the chairman of the board of directors of Borås Wäfveri appointed most of the new CEOs for Krenholm and Borås Wäfveri despite the fact that some of the members of the board did not agree with some of the candidates. Second, many of the appointed CEOs did not have the capabilities or knowledge to run Krenholm as a market oriented textile company. It is the responsibility of the directors to provide the organization with the best management talent available for an effective turnaround. In addition, three of the appointed CEOs for Krenholm were also the CEOs for Borås Wäfveri at the same time. This caused an absence of an authority figure in Krenholm whose main responsibility should be to guide the company in the turnaround process: “we are trying to remember who the CEOs were and it is a serious sign that there was no real director” (Department Manager of Krenholm). Moreover, the constant replacements of CEOs in Krenholm caused and environment of instability and uncertainty.

Notwithstanding, replacing a CEO and providing executive leadership and strategic vision go hand in hand. It is the responsibility of the corporate governance through the CEO to establish this leadership and vision. The first CEO of Krenholm was replaced in 2003 in an effort to turnaround the negative financial situation that the company was going through. However, as mentioned earlier, the newly appointed CEO of Krenholm was performing the role of the CEO of Borås Wäfveri at the same time. Even though he made the commitment to visit Krenholm on a regular basis but this did not happen “he promised that he would take care of Krenholm together with the CFO, that they would be there every second week but they were not.” (The owner of Borås Wäfveri). His absence in Krenholm as the CEO left the biggest company in Estonia without any leadership from February until November of 2003. In addition, the next CEO of Krenholm was also the CEO of Borås Wäfveri at the same time. During approximately 3 years Krenholm was operating without any leadership: “he visited Krenholm once every 3 months or so. Who was the real top manager in Krenholm between his visits is difficult to say” (Department Manager of Krenholm). Therefore, we consider setting an executive leadership during the process of turnaround is a decisive element for success.
In addition, another factor that was determinant for the effective turnaround of Krenholm was the role of corporate governance in aligning the interests of shareholders and top management. The agency principal problem focuses on ensuring the appropriate incentives for the agent to act in the best interest of the principle; and the role of the board of directors in controlling managerial behaviour (Jensen and Meckling, 1976; Hill and Jones, 1992; Gabrielsson, 2003). In the case of Krenholm, the initial annual loss for 2002 set by the auditors was of 14 million EEK. However, this initial figure was modified by the CEO and the CFO of Krenholm and the end result for 2002 was a loss of 44 million EEK. There was an agreement in Borås Wäfveri in which the amount of annual bonus would be determined by the amount of increase in the profits for the year. Corporate governance should enforce the proper alignment of interests between the shareholders, board of directors and top management especially during a turnaround process.

As it is true that replacing the CEO and other top executives having a different mind-map, background and experience, can bring new ideas and understanding for turning the company around (Barker and Duhaime, 1997), it can be argued that the top management should possess the necessary capabilities, knowledge and experience to turnaround international acquisitions of distressed firms. In addition, the constant replacement of the CEOs in an organization creates instability and uncertainty. Moreover, in the case of Krenholm, we observed that the CEOs never had the time to know the business, to know about the company. Hence they were confronted with the inability to formulate and manage the strategic planning process and provide executive leadership and strategic vision inside the organization.

The main aspects of the second turnaround strategies and the role of corporate governance is summarized and presented in Table 6.
Table 6. Second turnaround and the role of corporate governance

<table>
<thead>
<tr>
<th>The first turnaround</th>
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| Reorganization and replacement | Constant replacements of CEO’s: 5 different CEO’s from 2003-2010.  
2005 - Production from Borås Wäfveri closed down and transferred to Krenholm in Estonia.  
2005 - Centralization of marketing.  |
| Retrenchment | Continuous head count cuts in Krenholm.  
2004 - Borås Wäfveri hires a consultant to improve production planning.  
Closure of production facilities in Sweden.  
Closure of sewing, spinning and terry divisions. Outsourcing to Asia.  
2008 - Selling of assets (trademarks and premises).  |
| Repositioning | Reduction of presence in different markets.  |
| Supportive strategies | Few investments from 2002-2010.  |

<table>
<thead>
<tr>
<th>Corporate governance</th>
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| The board of directors | Changes in the structure of the board.  
Loss of important competences and capabilities.  
Dissolution of the special council of Krenholm.  |
| Top management team | Constant replacement of CEO’s.  
Physical absence of CEO authority in Krenholm.  
Lack of competence and leadership.  
There was no communication and cooperation with the personnel at Krenholm.  
Managerial opportunism.  |

Following the arguments set by Pablo and Javidan (2004), Shrivastava (1986) and Ghauri and Buckley (2003), the level of integration of Krenholm for the second turnaround period will be analysed according to the factors such as the autonomy, interdependence, motives of acquisition and size of the firm. First, as mentioned before, the motive for the acquisition of Krenholm by Borås Wäfveri was to achieve cost synergies. However, during the first period of turnaround, economies of scale were not possible to achieve right after the takeover due to a need for machinery and equipment renovation. In addition, the western market orientation was still not in the mentality of the employees at Krenholm. Nevertheless, by 2005 Krenholm had invested in renovating its machinery and equipment and the personnel at Krenholm were very close to achieve a full market orientation. To achieve cost synergies, the full production of Borås Wäfveri in Sweden was moved to Krenholm in Estonia. In other words, when the motivation for acquisition is to achieve cost synergies the integration should be high.

The level of autonomy in Krenholm was low due to the decision from Borås Wäfveri to control product development, sales and finances at Krenholm. In addition, the level of interdependence between Borås Wäfveri and Krenholm was high since Krenholm handled production for Borås.
Wäfveri and Borås Wäfveri was in charge of marketing and other functions for Krenholm. Therefore, the suggested level of integration according to the theory should be high. Moreover, the “larger the organization, the greater the need for integration” (Shrivastava, 1986, p.68), hence the need for integration was high. In summary, theory argues that the suggested level of integration for the second period of turnaround should be high between Borås Wäfveri and Krenholm. However, by analysing the different types of post-acquisition integration: (1) procedural, (2) physical and (3) managerial and socio-cultural, we will determine the real level of integration Borås Wäfveri and Krenholm had during the second period for turnaround.

**Procedural integration** at Krenholm was only at the level of legal *issues of ownership transfer and combining companies* during the first years of the second turnaround period. The divisional managers of Krenholm clearly expressed that by 2002 the level of procedural integration was limited to the integration of income statements and balance sheets. There was a lack of procedural integration within functional areas: “*But for example, cost accounting? Nothing, no cost accounting system. No planning systems.*” (*Department Manager of Krenholm*). However, by 2004 Borås Wäfveri hired an external consultant to improve production planning. Even though the consultant worked jointly with the divisional manager at Krenholm until 2007, procedural integration at the planning level was not achieved for different reasons. First, the consultant became aware of the increase in slack due to the absence of efficiency in the production. Second, the consultant reported the causes and possible solutions to reduce the increase in slack but top management at Borås Wäfveri ignored his arguments. Therefore, the real procedural integration between Borås Wäfveri and Krenholm was low to medium.

The **physical integration** between Borås Wäfveri and Krenholm involves many aspects. First, when Borås Wäfveri decided to close production in Sweden and move it to Estonia in 2005, all the *machinery and equipment* was transferred to the facilities of Krenholm. In other words, there was a high integration of plants and equipment after 2005. Second, even though Krenholm and Borås Wäfveri had very different products, the *product line* from Krenholm was also used for the production of Borås Wäfveri. Product line integration was so high that at some degree the divisional managers were unsure to whom the production orders belonged: “*The point is that we never understood if it was for customers of Krenholm or customers of Borås Wäfveri*” (*Department Manager of Krenholm*). Finally, there was physical integration of the marketing functions of Borås Wäfveri and Krenholm. The marketing and sales were centralized in Sweden and the office was under one marketing manager for both companies. In summary, we conclude that the real physical integration between Borås Wäfveri and Krenholm was high during the second period for turnaround.
Finally, the **managerial and socio-cultural integration** was heavily influenced by the different changes and events that were developed during the second period for turnaround. The *transfers of managers* increased when the production from Borås Wäfveri was moved to Krenholm. Regular managers visited Krenholm repeatedly to train the personnel on how to install and operate the new machinery. However, these visits were limited to low level managers, and after all the production was transferred and installed in Krenholm the transfers of managers decreased considerably. Moreover, when Borås Wäfveri closed its production in Sweden most of the managers were laid off. In other words, there were no more managers to transfer. In addition, there were no transfers or visits from the top management in Borås Wäfveri and the members of the board of directors and the CEO’s rarely paid visits to Krenholm.

The gap between the differences in cultures grew bigger after the departure of The Estonian CEO of Krenholm in 2003. The achieved level of managerial and socio-cultural integration during the first period of turnaround was moderate. The reason behind the moderate level of managerial and socio-cultural integration was that the intense cooperation was only achieved at the very top level of corporate governance. Nevertheless, during the second period for turnaround the situation was rather different. For example, the replacement in 2003 of the Estonian CEO by a Swedish CEO who could not communicate in Russian and at the same time was the CEO for Borås Wäfveri. There was no effort in having cooperation between the CEO of Borås Wäfveri and the CEO of Krenholm simply because they were just the same person. Admittedly, it could be argued that this can bring certain advantages, in the case of Krenholm it resulted in a distancing in differences in culture between the employees at Krenholm, the CEO and Borås Wäfveri. The physical absence of the CEO at Krenholm deteriorated the relationship with the divisional managers and the personnel. Two of the CEO’s of Krenholm were the CEO’s of Borås Wäfveri and after the first CEO of Krenholm after the acquisition only one more CEO was able to communicate in Russian. Moreover, it is extremely difficult to *establish a new leadership* when the CEO is absent and there is a high CEO turnover rate.

The differences in opinions between the CEO of Krenholm and the divisional managers were seen as a lack of understanding and communication. In addition, these effects were spread to other divisions and departments. For example, the differences in opinions and the unmanaged differences in culture between production in Krenholm and the marketing department in Sweden were catastrophic. There was never a common understanding between both areas resulting in the acceptance of unprofitable orders from marketing and the sense of inferiority and impotence from production. In summary, the integration of a national and corporate culture was not achieved during the second period for turnaround. Moreover, the *commitment and motivation* from the personnel at Krenholm was very low.
The constant reduction in the workforce, the permanent sensation of feeling ignored and misunderstood caused a low level of commitment and motivation.

In summary, the real level of managerial and socio-cultural integration between Krenholm and Borås Wäfveri was low. The post-acquisition integration between Krenholm and its parent company during the period from 2002 until 2010 is illustrated in Figure 33. This representation of post-acquisition integration is schematic and based on authors’ judgement (formed by the theory and interview answers).

![Figure 33. Post-acquisition integration between Krenholm and Borås Wäfveri during the second turnaround period. Note: 0 – the lowest level, 5 – the highest level. Source: Authors’ own elaboration, 2012.](image)

From the data analysis we can observe that the real level of post-acquisition integration differs from the one suggested by the existing theory. The real procedural integration was low to medium since there was integration at the legal level, but not at the functional level despite the efforts made by the external consultant from Borås Wäfveri. The existing theory suggests a high level of procedural integration and we agree with this suggestion. We consider that after the production from Borås Wäfveri was moved to Krenholm there should be a high integration of systems to harmonize procedures. The real physical integration between Krenholm and Borås Wäfveri was high after the production was moved to Estonia. Machinery and equipment were transferred to Krenholm in Narva. In addition, the centralization of the marketing department in Sweden proves that the physical integration within functional departments was also high. The existing theory suggests high physical integration. However, in the case of Krenholm, we consider the physical integration should be moderate. The reason behind this logic is that even though full production from Borås Wäfveri was
moved to Krenholm, both companies were very different. They had different business models and their products were not within the same category.

Moreover, the products for Borås Wäfveri and Krenholm were produced in the same product line. This caused an increase in the setup costs since Krenholm’s machinery was built for mass production and Borås’s products were defined as high quality and very differentiated. Customers of Borås Wäfveri were demanding lower prices since now all the products for Borås Wäfveri were produced at Krenholm. One more point to add is that the business model of Borås Wäfveri was unintentionally being transferred to Krenholm. In other words, the small orders that usually went to Borås Wäfveri, started to go also for Krenholm. In addition, we argue that the existing high integration within the marketing departments was a big mistake. As mentioned before, both companies had different business models, offered different products and operated in different markets. Communication was broken between marketing and production and decisions were taken that directly affected Krenholm’s operations. Therefore, we suggest that the proper level of physical integration should have been moderate.

Finally, the real socio-cultural integration between Krenholm and Borås Wäfveri was low. The divisional managers in Krenholm were more aware of the operations than the CEO. In addition, there was a big gap in cultural differences and corporate culture. Furthermore, there was no communication and most of the CEO’s of Krenholm were absent. There was never a strategic vision or leadership from the CEO’s and from top management of Borås Wäfveri. The constant changes in the CEO’s created instability and the lack of competence from the top management in Krenholm and the board of directors of Borås Wäfveri damaged the process of managerial and socio-cultural integration. The existing theory suggests a high level of managerial and socio-cultural integration. We agree with the existing theory and we put emphasis on the need to achieve high level of managerial and socio-cultural integration when there is an international acquisition of a distressed firm and the motive for the acquisition is to create cost synergies.

Figure 34 represents a graphic picture of the development of Krenholm since the moment of acquisition until the bankruptcy. The first period for turnaround was characterized by heavy investments made by the parent company to the daughter company. A strong reorganization strategy was applied. The aim of the reorganization strategy was to change the orientation from planned to market economy. New markets were accessed by Krenholm and product development increased. The general post-acquisition process achieved was close to the proper level required. The proper level of managerial and socio-cultural integration was almost reached, however there were some deficiencies
since the integration was mainly at the very top management level. We argue that there was a temporary success in the efforts for turning around Krenholm from 1995 until 2001.

For the second period of turnaround that started in 2002 there were some substantial changes that caused the inability to turnaround the situation at Krenholm. First, there was a change in the ownership of Borås Wäfveri. Due to the high shareholder activism in Borås Wäfveri, the changes in ownership became relevant for the future of both companies. In addition, the main shareholders were also part of the board of directors at Borås Wäfveri. Hence, there were also changes in the board structure. By 2003, important capabilities and competences had been lost in the board of Borås Wäfveri. In addition, the efforts for achieving a high level of managerial and socio-cultural integration were soon decreased. The replacement of the Estonian CEO of Krenholm and the arrival of different CEOs that did not possess the knowledge and experience in the textile industry and lacked language skills were some of the main causes for failure. In addition, after the production from Sweden was moved to Krenholm the need for a turnaround became for both companies. The inability to make investments from the parent company during the second period of turnaround was also an important factor that contributed to decline. In summary, the substantial efforts were not sufficient to turnaround Krenholm for the second time due to a lack of capabilities and competence from the top management at Krenholm and from the board of directors in Borås Wäfveri. In addition, the level of managerial and socio-cultural integration was very low and this affected considerably the turnaround efforts between Krenholm and Borås Wäfveri. The lack of investments was the last factor that contributed to this decline.
Reorganization and replacement; retrenchment; repositioning + investments;
Reorganization and replacement; retrenchment. No repositioning or investments.

Strong corporate governance and link between the corporate governance actors of two companies at the high managerial level;
Weak corporate governance. Loss of important capabilities and competence. Weak link between the corporate governance actors of the two companies.

Closer to the proper level of integration.
Moderate level of managerial and socio-cultural integration
The real level of integration was inappropriate according to the conditions of both companies.
Low level of managerial and socio-cultural integration.

Figure 34. General picture of turnaround periods at Krenholm.

*Source: Authors’ own elaboration, 2012.*
5.3 Role of corporate governance in managing the turnaround process

In this section we will present the answer to the first research question that was formulated in the following way:

RQ1: What is the role of corporate governance mechanisms in managing turnaround processes after an international acquisition of distressed firms?

Distressed firms require a special attention from corporate governance actors because unprofessional management of turnaround process, essentially needed to recover the company, will “sink” the business. In order to achieve planned synergies after cross-border acquisition of distressed firms, the companies should take into consideration several aspects highlighted below.

Corporate governance mechanisms should facilitate communication within the distressed firm and between the merged companies. Because the board members are dependent on the accurate information about operations of the firm, provided them by the CEO and other top executives, close cooperation between the board of directors and top management team led by the CEO is needed. However, successful coalition between the very top corporate governance actors is not sufficient for bringing sustainable performance. Communication process should also penetrate though the lower organizational layers. Mid-managers and other employees should not feel under informed and left behind during the turnaround process. That is why, a two-way communication should be directed towards the mitigation of uncertainty, stress, resistance to change and anxiety of personnel, provision of feedback about turnaround progress and possible drawbacks to the top management.

High turnover at the CEO level is harmful for managing turnaround process at the distressed firms. It creates instability, uncertainty and confusion about the actions needed for restoring the profitability. “Turbulence at the top” (the term is adapted from Goodstein and Boeker, 1991, p. 306) erodes the backbone required to lead the firm through difficult times to the radiant future. Therefore, the role of corporate governance is to provide clear leadership and its continuity in order to unite the firms and achieve cohesion in actions.

It is also very important to stress that all change efforts carried out by corporate governance actors should be implemented only after proper planning which is focused upon the overall vision. The vision defines desired result and condition of the company after the turnaround process: personnel issues, core markets, product line, organizational structure and other parameters. Firms’ executives set direction and give meaning to changes. The vision could be adjusted during the transformation
process, however, goals establish in the very beginning are important to give the purpose and sense for changes.

The choice of corporate governance actors can really affect the turnaround process in international acquisitions. Managerial incompetence and lack of necessary knowledge, skills and experience in the particular industry and turnaround strategies can lead to faulty, inappropriate and ill-defined actions. Therefore, the choice of the “right” board members, the chairman, the CEO and other top executives is of a paramount importance for the successful turnaround outcome.

Finally, the role of corporate governance in managing turnaround processes after international acquisition of distressed firms is to reinforce the post-acquisition integration between two firms. Post-acquisition integration aims at harmonizing various areas in the merged organization, therefore scholars define procedural, physical, managerial and socio-cultural integration types (e.g. Shrivastava, 1986). In the specific context, we are exploring, managerial and social-cultural integration deserve a special attention. The connection between turnaround process and post-acquisition integration is further discussed in the answer to the second research question.

5.4 Relationship between turnaround and post-acquisition integration

Corporate governance within international acquisitions of distressed firms is complicated by the need to integrate the parent company and the acquired business. The synergies intended to achieve by combining two companies could only be created by initiating proper post-acquisition integration process. The second research question refers to the interplay between turnaround and post-acquisition integration processes:

RQ2: What is the relationship between turnaround and post-acquisition integration processes in managing international acquisitions of distressed firms?

Post-acquisition integration facilitates turnaround process and can support achieving sustainable positive performance. First of all, post-acquisition integration works on achieving efficiency between two companies. By working on procedural integration communication is facilitated and, therefore, the costs of processing information could be reduced and productivity could be increased. Physical integration of product lines, plants, equipment and other assets reduces costs and makes the use of existing resources more efficient. Hence, physical and procedural post-acquisition integration correlates with retrenchment, repositioning and reorganization strategies of turnaround.
Consequently, integration of companies, done at the proper level and manner, assists turnaround efforts in acquisitions of distressed firms.

Furthermore, as our case study shows, in international acquisitions managerial and socio-cultural integration should be put in the forefront. Foreign companies might acquire distressed firms in the geographical area where they do not have sufficient experience. The difference in national and corporate cultures can create tensions and opposition. Autonomy removal in the decision making process from the top management team of the acquired organization to “superior” parent company gives rise to the feelings of inferiority and “merger syndrome” (Evans et al., 2001, p. 547): disbelief, absenteeism, resentment and stress. All of these processes complicate turnaround success. Therefore, in cross-border acquisitions corporate governance mechanisms should support transfer of managers between the companies, socio-cultural integration, gaining commitment, motivating personnel and establishing new strategic leadership.

It is very important to note that the appropriate level of post-acquisition integration is particular to each case, and “one-fit-all-size” approach should be avoided. The desired level of integration should be analysed and established by the corporate governance on the basis of theoretical development and characteristics of particular acquisition and merged organizations. If the proper level of post-acquisition integration is achieved according to each case, the turnaround efforts will improve and the chances to succeed will increase. Emphasis in managerial and socio-cultural integration is suggested especially in the cases of international acquisitions of distressed firms.
6. CORPORATE GOVERNANCE MODEL

In accordance with the purpose of this master thesis this chapter presents a developed corporate governance model guiding corporate governance actors in international acquisitions of distressed firms. The model was created based on the empirical findings gained through the case study of Estonian textile manufacturer and conducted analysis.

![Corporate Governance Model](image)

- close communication
- clear leadership and its continuity
- vision
- proper choice of corporate actors (competence, skills and experience)

facilitate

- proper level of integration
- major focus on managerial and socio-cultural integration:
  - transfer of managers
  - socio-cultural integration
  - commitment and motivation
  - establishing new leadership

The model illustrates in a graphical form the role of corporate governance in managing turnaround in international acquisitions of distressed firms and the relationship between turnaround and post-acquisition integration processes. The role of corporate governance in the turnaround process was discussed in the previous chapter. The main aspect of corporate governance mechanisms in this context are close two-side communication penetrating all organizational levels within the acquired company but also between the parent and the target companies, clear leadership and its continuity, vision outlining overall direction of turnaround, “right people” - proper choice of corporate governance actors based on their competence, skills and experience in a particular industry and turnaround process.
Moreover, corporate governance should reinforce post-acquisition integration between the distressed company and the acquirer. The important task is to identify the proper individual level of post-acquisition integration based on the characteristics of the acquisition and merged organizations. The major attention in international acquisitions should get managerial and socio-cultural integration in the form of transferring managers between the firms, integration of corporate and national cultures (socio-cultural integration), gaining commitment and motivation, and establishing new strategic leadership. Done properly, managerial and socio-cultural integration can facilitate turnaround process.

Consequently, the turnaround outcome will be achievement of planned post-acquisition value by gaining synergies from combining two organizations, restoration of distressed firm’s profitability and bringing sustainable performance to the merged organization. This model provides the foundation for developing corporate governance mechanisms within a context of international acquisitions of distressed firms and sets a discussion for further theoretical and empirical research.
7. CONCLUSION

The final chapter of this master thesis gives a general overview of the research and its outcome. Moreover, it explains the limitation of the current research, implications for the managers and academics.

7.1 General conclusion

“There is nothing wrong with change, if it is in the right direction”

Winston Churchill (Forbes, n.d.)

Now, more than ever, the turbulent business environment does not differentiate between big or small, old or young, experienced or inexperienced companies. It influences organizations all over the world crossing virtual borders. The big “Goliaths” of our time are facing great challenges of withstanding constantly changing external conditions, and, unfortunately, some of them are falling down. This is the story of Krenholm, the Estonian “Goliath” in the textile industry that fell into the demise in the autumn of 2010. In 1995 the responsibility of turning the distressed company around was taken by a long-established Swedish firm. Even in 1999 a banker in Tallinn (Brown-Humes, 1999, p. 1) said: “It is very visible. Failure would hurt enormously.” After a thorough analysis we realized that the case of Krenholm could serve as the foundation for discussing the issues of corporate governance within a new context – international acquisitions of distressed firms.

The theoretical field of corporate governance has been rapidly developing within many disciplines since 1990s. Scholars and practitioners have realised the importance of this field and the role of corporate governance mechanisms not just in determining direction and performance of the firms but also for “fair” transferring of value among various internal and external corporate stakeholders. Corporate governance aspects became especially important in the light of widely used strategy for corporate growth – cross-border mergers and acquisitions. The most cited reason for M&A is the gain of various synergies of combining two organizations together. This is also the motive for acquiring distressed firms, which are characterized by existence-threatening decline in financial performance. Acquisitions of distressed companies occur regularly and should not be seen as a rare phenomenon. However, the role of corporate governance within this context is becoming especially important because corporate executives should ensure successful turnaround process for restoring organizational performance and the process of integrating two companies in a united entity. Only in this case the
company can restore the profitability of the distressed firm, bring sustainable performance and consequently acquire the post-acquisition value.

The purpose of this master thesis was to provide a better conception of the role of corporate governance mechanisms in managing turnaround process after the acquisition of a distressed firm by a foreign company. Moreover, we explored the necessity of initiating post-acquisition integration by corporate executives between the target and the acquiring company. After conducting an in-depth case study we designed the model of corporate governance within the context of international acquisitions of distressed firms (Figure 35). According to the model, corporate governance mechanisms should assure close two-side communication going through all the organizational levels within the acquired company but also between the parent and target companies, clear leadership and its continuity, vision determining overall direction of turnaround, proper choice of corporate governance actors based on their competence, skills and experience in a particular industry and turnaround process. Moreover, corporate governance should reinforce post-acquisition integration between the distressed company and the acquirer. It is important to find a proper level of integration according to each particular case. There should not be “one-size-fit-all” solution. Furthermore, the major attention in international acquisitions should be upon managerial and socio-cultural integration. Consequently, proper post-acquisition integration can facilitate the turnaround process and gaining synergies from combining two organizations.

While this model has its certain limitations discussed below, it brings a valuable contribution to the field of corporate governance and acquisitions of distressed firms by illustrating real-life examples. Our conclusions can serve as a starting point for further discussions within two level of academia: on the theoretical and practical levels. The importance of the present research is also emphasized by the significant economic and social role of the textile industry in Estonia and all the Baltic States, the focus on highly sensitive region in Estonia and consequences of the bankruptcy of Krenholm on the situation in Narva city, Estonia and the European textile industry.

7.2 Limitations

The theoretical contribution of this master thesis has its limitations. Our conclusions are based on the case study of one company that might pose the question of generalizability for other companies and contexts. Many scholars note that a case study design has its limitations concerning external validity or generalizability (e.g. Ghauri et al., 1995; Cooper and Schindler, 2008). It is clear that one case cannot represent the whole population, however, exploring the case in depth enables to generate
concepts and models, which could be further tested on a larger sample of organizations (Bryman and Bell, 2011). For example, Mintzberg (1979 cited in Ghauri et al., 1995, p. 91) says: “What, for example, is wrong with a sample size of one? Why should researchers have to apologize for them? Should Piaget apologize for studying his own children, a physicist for splitting only one atom?” Therefore, even studies of a single case could be fruitful for the theory building by giving a ground for new frameworks and hypotheses (Cooper and Schindler, 2008).

In this master thesis, the case was chosen on the basis of potential learning which is possible to gain from the failed corporate governance mechanisms resulted in the bankruptcy of the biggest industrial enterprise in Estonia. Theoretical conclusions derived from the case study contributes to the understanding of the corporate governance role in managing distressed acquisitions and the richness of detail provides multiple applications for managers and researchers.

Because of the initial delimitation set for our study, we did not take into consideration external factors, which might have affected the performance of the case company. First of all, the Estonian economy has been growing fast since its independence in 1991 and expanded after its admission to the European Union in 2004. In the period of 2000-2008 Estonia showed a remarkable growth of 7% per year, placing the country within the three fastest growing countries in the European Union (Estonia.eu, n.d.d). “During that period, Estonia took a big jump in the improvement of average standard of living, increasing its GDP per capita from 45% in 2000 to 67% in 2008, compared to EU27” (Estonia.eu, n.d.d). By the end of 2010, the overall GDP grew to 3.1% bringing economic stability to Estonia after the international crisis in 2008 (Statistics Estonia, 2011). The average monthly wage in Estonia has more than doubled since 2003, which was of 430 Euros (see Figure 4 Appendix 3). According to statistics of Estonia, by December 2011 the average monthly salary was 918 Euros (Statistics Estonia, 2012b). Therefore, the growth of wages and level of living could have influenced on the possibilities for the development of low-cost textile industry in Estonia.

Secondly, the first of January of 2005 witnessed one of the biggest changes ever made in the textile industry since the industrial revolution. The opening of the quota system that restricted textile and apparel importation ended for all the member-countries of the World Trade Organization (Abernathy et al., 2005). This event changed the way on how companies and even countries compete to be able to cope with the demands from the market to produce better, cheaper and faster. The elimination of the quota system was taken step by step over a period of 10 years since the agreement was signed by the members of the WTO in 1995 (Abernathy et al, 2005). This agreement opened the doors for countries like China, India, Pakistan, Indonesia and Bangladesh to compete directly with mass producers in Europe by offering low labour costs. “The European textile industry now faces the challenge of
maintaining and improving its position in the market in the face of increasing international competition and advances in technology” (Keenan et al., 2004, p. 314). The elimination of quotas in the textile industry had had its effect on the viability for the mass production in Europe and decision taken by shareholders at Krenholm.

Apart from the ineffective role of corporate governance mechanisms for turning Krenholm around, the fast growth of the Estonian economy during the last decade and elimination of quotas for textile and apparel within the WTO members might have had a significant influence on the reasons of this low performance and final consequences.

## 7.3 Implications for further research

Corporate governance theory within the context of international acquisitions of distressed firms is an important area for further investigation. First of all, the corporate governance model developed in this master thesis could be tested on other cases to understand the possibilities of its generalizability. Secondly, scholars can study corporate governance issues within the same context but without delimitations for related acquisitions by analysing unrelated (conglomerate) acquisitions of distressed firms. Moreover, in our research we did an investigation on the company that operated within the textile industry. Further research can bring fruitful results by analysing the industry effects in international acquisitions of distressed firms. Furthermore, theory should recognize the existence of an initial turnaround phase called investments as a strategy to initiate the turnaround process in international acquisitions of distressed firms. The benefits of this alternative strategy are unexplored. The existing literature does not cover in full the presence of the investment phase initiated by the parent company as a potential short term strategy for turning around international acquisitions of distressed firms. Finally, by conducting this research we would like to attract attention of scholars, businesses and the local government to the situation in Narva and the future of textile industry in Estonia and Europe.

## 7.4 Implications for managers

Cross-border acquisitions of distressed firms represent a popular strategy for cost reduction, risk reduction and expansion of market power. Therefore, managers should take into consideration a wide range of aspects in order to achieve the intended objectives. In our master thesis we provide recommendations for the corporate governance actors in the form of a corporate governance model.
Practitioners should become aware of the requirements for strong corporate governance, identification of the necessary level of post-acquisition integration, reinforcement of post-acquisition integration in order to achieve sustainable recovery of the acquired distressed company. Our recommendations should serve as guidance (not a rule) for managers engaging in international acquisitions.

“I have to say, our life is finished. We did what we could but you have to remember this, what happened in Krenholm. These are important lessons for you.”

(Department Manager of Krenholm)
REFERENCES


Pandit, N. R., 2000. Some Recommendations For Improved Research on Corporate Turnaround. *M@an@gement, 3*(2), pp. 31-56.


Steger, U. and Amann, W., 2008. Corporate governance: How to Add Value. Chichester: John Wiley & Sons Ltd.


APPENDIX

Appendix 1. Recent corporate governance scandals

Source: Authors’ own elaboration, 2012, based on Steger and Wolfgang, 2008
# Appendix 2. Research participants

<table>
<thead>
<tr>
<th>Person</th>
<th>Place of residence</th>
<th>Position</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Major participants</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meelis Virkebau</td>
<td>Tallinn, Estonia</td>
<td>CEO of Krenholm in 1995-2003, current Chairman of the Board of Estonian Clothing and textile Association</td>
</tr>
<tr>
<td>Oleg Klushin</td>
<td>Narva, Estonia</td>
<td>CEO in Soviet times up to 1995 and Divisional Manager of Krenholm Spinning until July 2002</td>
</tr>
<tr>
<td>Nina Zaitseva</td>
<td>Narva, Estonia</td>
<td>Divisional Manager of Krenholm Finishing until October 2008</td>
</tr>
<tr>
<td>Peter Poskin</td>
<td>Narva, Estonia</td>
<td>Deputy Manager of Service Center at Krenholm in 1997-2000, Manager of Development Department of Service Center at Krenholm in 2000-2008</td>
</tr>
<tr>
<td>Konstantin Gorlov</td>
<td>Narva, Estonia</td>
<td>Divisional Manager of Krenholm Weaving until 2008</td>
</tr>
<tr>
<td>Lars Mauritzon</td>
<td>Borås, Sweden</td>
<td>Main owner until 2003, CEO until 2000 and Chairman from 2000 to 2001 of Borås Wäfveri; Chairman from 1995 to 2001 of Krenholm</td>
</tr>
<tr>
<td><strong>Supplementary participants</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aleksandr Brokk</td>
<td>Narva, Estonia</td>
<td>City Council member, General Director of Nakro Tannery and the owner Technopark</td>
</tr>
<tr>
<td>Irina Shabas</td>
<td>Narva, Estonia</td>
<td>Sales Support Department Management during 2006-2008</td>
</tr>
<tr>
<td>Maaja Vadi</td>
<td>Tartu, Estonia</td>
<td>Dean of the Faculty of Economics and Business Administration, Professor of Management in University of Tartu</td>
</tr>
</tbody>
</table>

*Source: Authors’ own elaboration.*
Appendix 3. Statistical information about Estonia

Figure 1. Population by nationality in Estonia as of January 1, 2010
Source: Authors’ own elaboration, 2012 based on Estonia.eu, n.d.d.

Figure 2. Real growth of GDP in Estonia in 2003-2010 (%)
Source: Authors’ own elaboration, 2012
based on Permanent Mission of Estonia to the UN, 2011.
Figure 3. Unemployment rate in Estonia in 2000-2011 (%)

*Source: Authors’ own elaboration, 2012 based on Statistics Estonia, 2012a.*

Figure 4. Average monthly wage in Estonia in 2003-2011 (EUR)

Figure 5. Inflation rate in Estonia in 2001-2011 (%).

Table 1. Main trade partners of Estonia in 2010, as a % of total trade

<table>
<thead>
<tr>
<th>Country</th>
<th>Exports</th>
<th>Country</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Finland</td>
<td>17.0</td>
<td>1. Finland</td>
<td>14.9</td>
</tr>
<tr>
<td>2. Sweden</td>
<td>15.7</td>
<td>2. Germany</td>
<td>11.3</td>
</tr>
<tr>
<td>3. Russia</td>
<td>9.7</td>
<td>3. Sweden</td>
<td>10.9</td>
</tr>
<tr>
<td>4. Latvia</td>
<td>9.0</td>
<td>4. Latvia</td>
<td>10.8</td>
</tr>
<tr>
<td>5. Germany</td>
<td>5.2</td>
<td>5. Russia</td>
<td>8.2</td>
</tr>
<tr>
<td>7. USA</td>
<td>3.8</td>
<td>7. Poland</td>
<td>6.4</td>
</tr>
<tr>
<td>8. Norway</td>
<td>3.4</td>
<td>8. Netherlands</td>
<td>3.3</td>
</tr>
<tr>
<td>9. Denmark</td>
<td>2.5</td>
<td>9. China</td>
<td>3.0</td>
</tr>
<tr>
<td>10. France</td>
<td>2.5</td>
<td>10. Italy</td>
<td>2.4</td>
</tr>
<tr>
<td>Others</td>
<td>26.3</td>
<td>Others</td>
<td>21.1</td>
</tr>
</tbody>
</table>

*Source: Permanent Mission of Estonia to the UN, 2011.*
Appendix 4. Statistical information about Narva

Table 1. Number of registered inhabitants in Narva

<table>
<thead>
<tr>
<th></th>
<th>01.01.2009</th>
<th>01.01.2010</th>
<th>01.01.2011</th>
<th>Number of registered inhabitants incl.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registreeritud elanike arv sh</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- mehed</td>
<td>65 886</td>
<td>65 506</td>
<td>64 667</td>
<td></td>
</tr>
<tr>
<td>- naised</td>
<td>36 454</td>
<td>36 197</td>
<td>35 681</td>
<td></td>
</tr>
<tr>
<td>Naisi 1000 mehe kohta</td>
<td>1 238</td>
<td>1 235</td>
<td>1 231</td>
<td></td>
</tr>
<tr>
<td>Pindala (km²)</td>
<td>84.54</td>
<td>84.54</td>
<td>84.54</td>
<td></td>
</tr>
<tr>
<td>Asustustihedus (in/ km²)</td>
<td>779</td>
<td>775</td>
<td>766</td>
<td></td>
</tr>
</tbody>
</table>

Source: Narva Department for Development and Economy, 2010

Table 2. Population of Narva by sex and age

<table>
<thead>
<tr>
<th>Vanusegrupp Age group</th>
<th>01.01.2009</th>
<th>01.01.2010</th>
<th>01.01.2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Kokku Total</td>
<td>Mehed Male</td>
<td>Naised Female</td>
</tr>
<tr>
<td>0 - 4</td>
<td>3 018</td>
<td>1 560</td>
<td>1 458</td>
</tr>
<tr>
<td>5 - 9</td>
<td>2 941</td>
<td>1 513</td>
<td>1 428</td>
</tr>
<tr>
<td>10 - 14</td>
<td>2 574</td>
<td>1 359</td>
<td>1 215</td>
</tr>
<tr>
<td>15 - 19</td>
<td>3 672</td>
<td>1 885</td>
<td>1 787</td>
</tr>
<tr>
<td>20 - 24</td>
<td>5 190</td>
<td>2 731</td>
<td>2 459</td>
</tr>
<tr>
<td>25 - 29</td>
<td>4 436</td>
<td>2 297</td>
<td>2 139</td>
</tr>
<tr>
<td>30 - 34</td>
<td>4 282</td>
<td>2 107</td>
<td>2 155</td>
</tr>
<tr>
<td>35 - 39</td>
<td>4 000</td>
<td>2 256</td>
<td>2 344</td>
</tr>
<tr>
<td>40 - 44</td>
<td>4 319</td>
<td>1 997</td>
<td>2 322</td>
</tr>
<tr>
<td>45 - 49</td>
<td>5 228</td>
<td>2 341</td>
<td>2 887</td>
</tr>
<tr>
<td>50 - 54</td>
<td>5 410</td>
<td>2 409</td>
<td>3 001</td>
</tr>
<tr>
<td>55 - 59</td>
<td>5 244</td>
<td>2 155</td>
<td>3 089</td>
</tr>
<tr>
<td>60 - 64</td>
<td>3 526</td>
<td>1 417</td>
<td>2 109</td>
</tr>
<tr>
<td>65 - 69</td>
<td>3 216</td>
<td>1 117</td>
<td>2 099</td>
</tr>
<tr>
<td>70 - 74</td>
<td>3 615</td>
<td>1 147</td>
<td>2 468</td>
</tr>
<tr>
<td>75 - 79</td>
<td>2 632</td>
<td>704</td>
<td>1 928</td>
</tr>
<tr>
<td>80 - 84</td>
<td>1 462</td>
<td>341</td>
<td>1 121</td>
</tr>
<tr>
<td>85 +</td>
<td>541</td>
<td>96</td>
<td>445</td>
</tr>
<tr>
<td>Kokku Total</td>
<td>65 886</td>
<td>29 432</td>
<td>36 454</td>
</tr>
</tbody>
</table>

Source: Narva Department for Development and Economy, 2010
Table 3. Ethnic composition of population in Narva

<table>
<thead>
<tr>
<th>Rahvus</th>
<th>Arv / Number 01.01.2009</th>
<th>Arv / Number 01.01.2010</th>
<th>Arv / Number 01.01.2011</th>
<th>% 01.01.2011</th>
<th>Nationality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eestlased</td>
<td>2 571</td>
<td>2 544</td>
<td>2 498</td>
<td>3.86</td>
<td>Estonians</td>
</tr>
<tr>
<td>Venelased</td>
<td>53 285</td>
<td>53 307</td>
<td>53 039</td>
<td>82.02</td>
<td>Russians</td>
</tr>
<tr>
<td>Ukrainlased</td>
<td>1 729</td>
<td>1 728</td>
<td>1 662</td>
<td>2.55</td>
<td>Ukrainians</td>
</tr>
<tr>
<td>Valgevenelased</td>
<td>1 471</td>
<td>1 452</td>
<td>1 377</td>
<td>2.13</td>
<td>Belorussians</td>
</tr>
<tr>
<td>Soomlased</td>
<td>506</td>
<td>508</td>
<td>477</td>
<td>0.74</td>
<td>Finns</td>
</tr>
<tr>
<td>Tatarlased</td>
<td>340</td>
<td>339</td>
<td>318</td>
<td>0.49</td>
<td>Tatars</td>
</tr>
<tr>
<td>Muud</td>
<td>5 984</td>
<td>5 628</td>
<td>5 306</td>
<td>8.21</td>
<td>Others</td>
</tr>
</tbody>
</table>

_Narva Linnavalitsuse Elanikkonna Registreemise Büroo / City Population Registration Office_

Source: Narva Department for Development and Economy, 2010

Table 4. Citizenship of the population in Narva

<table>
<thead>
<tr>
<th>Kodakondsus</th>
<th>Arv / Number 01.01.2009</th>
<th>Arv / Number 01.01.2010</th>
<th>Arv / Number 01.01.2011</th>
<th>% 01.01.2011</th>
<th>Citizenship</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eesti</td>
<td>29 969</td>
<td>30 152</td>
<td>29 978</td>
<td>46.36</td>
<td>Estonian</td>
</tr>
<tr>
<td>Vene</td>
<td>23 294</td>
<td>23 565</td>
<td>23 462</td>
<td>36.28</td>
<td>Russian</td>
</tr>
<tr>
<td>Ukraina</td>
<td>158</td>
<td>166</td>
<td>166</td>
<td>0.26</td>
<td>Ukrainian</td>
</tr>
<tr>
<td>Valgevene</td>
<td>47</td>
<td>48</td>
<td>50</td>
<td>0.08</td>
<td>Belorussian</td>
</tr>
<tr>
<td>Läti</td>
<td>67</td>
<td>66</td>
<td>74</td>
<td>0.11</td>
<td>Latvian</td>
</tr>
<tr>
<td>Leedu</td>
<td>87</td>
<td>88</td>
<td>95</td>
<td>0.15</td>
<td>Lithuan</td>
</tr>
<tr>
<td>Teised riigid</td>
<td>129</td>
<td>148</td>
<td>280</td>
<td>0.40</td>
<td>Other countries</td>
</tr>
<tr>
<td>Kodakondsus määratlemata</td>
<td>11 941</td>
<td>11 129</td>
<td>10 582</td>
<td>16.36</td>
<td>Citizenship undetermined</td>
</tr>
</tbody>
</table>

_Narva Linnavalitsuse Elanikkonna Registreemise Büroo / City Population Registration Office_

Source: Narva Department for Development and Economy, 2010
Table 5. Registered unemployment in Narva in 2010

<table>
<thead>
<tr>
<th>Month</th>
<th>Registered unemployed at the end of month</th>
<th>Unemployment allowance recipients</th>
<th>Unemployment insurance benefit recipients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jaanuar / January</td>
<td>7351</td>
<td>1266</td>
<td>2018</td>
</tr>
<tr>
<td>Veebruar / February</td>
<td>7525</td>
<td>1205</td>
<td>1974</td>
</tr>
<tr>
<td>Märs / March</td>
<td>7597</td>
<td>1203</td>
<td>1906</td>
</tr>
<tr>
<td>April / April</td>
<td>7480</td>
<td>1196</td>
<td>1787</td>
</tr>
<tr>
<td>Ma / May</td>
<td>7147</td>
<td>1101</td>
<td>1543</td>
</tr>
<tr>
<td>Juuni / June</td>
<td>6797</td>
<td>976</td>
<td>1384</td>
</tr>
<tr>
<td>Juuli / July</td>
<td>6436</td>
<td>837</td>
<td>1277</td>
</tr>
<tr>
<td>August / August</td>
<td>6251</td>
<td>732</td>
<td>1157</td>
</tr>
<tr>
<td>September / September</td>
<td>5903</td>
<td>703</td>
<td>1001</td>
</tr>
<tr>
<td>Oktoober / October</td>
<td>5722</td>
<td>665</td>
<td>845</td>
</tr>
<tr>
<td>November / November</td>
<td>5630</td>
<td>692</td>
<td>661</td>
</tr>
<tr>
<td>Detsember / December</td>
<td>5622</td>
<td>678</td>
<td>680</td>
</tr>
</tbody>
</table>

Source: Narva Department for Development and Economy, 2010

Table 6. Workers average monthly gross wages

<table>
<thead>
<tr>
<th>Year</th>
<th>Narva</th>
<th>Ida-Virumaa</th>
<th>Eesti</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>5 598</td>
<td>5 411</td>
<td>7 222</td>
</tr>
<tr>
<td>2005</td>
<td>5 477</td>
<td>6 057</td>
<td>8 048</td>
</tr>
<tr>
<td>2006</td>
<td>6 200</td>
<td>6 812</td>
<td>9 350</td>
</tr>
<tr>
<td>2007</td>
<td>7 712</td>
<td>8 360</td>
<td>11 260</td>
</tr>
<tr>
<td>2008</td>
<td>9 253</td>
<td>10 265</td>
<td>12 818</td>
</tr>
<tr>
<td>2009</td>
<td>8 792</td>
<td>9 923</td>
<td>12 225</td>
</tr>
<tr>
<td>2010</td>
<td>8 898</td>
<td>10 286</td>
<td>12 236</td>
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Source: Narva Department for Development and Economy, 2010
Table 7. Crimes in Narva

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td><strong>Kuriteod kokku</strong> Total number of criminal offences</td>
<td>2618</td>
<td>2536</td>
<td>2691</td>
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<tr>
<td><strong>I raskusaste</strong> First degree offences</td>
<td>278</td>
<td>230</td>
<td>171</td>
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<td><strong>II raskusaste</strong> Second degree offences</td>
<td>2340</td>
<td>2306</td>
<td>2520</td>
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<tr>
<td>Isikuvastased kuriteod Offences Against the Person</td>
<td>357</td>
<td>330</td>
<td>344</td>
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<tr>
<td>§ 113-114 Tapmised ja mörvad Homicide</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>§ 118 Raske terviskahjustuse tekitamine</td>
<td>16</td>
<td>16</td>
<td>14</td>
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<tr>
<td>§ 120 Ähvardamine</td>
<td>23</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>§ 121 Kehaline väärkohtlemine Physical abuse</td>
<td>283</td>
<td>261</td>
<td>280</td>
</tr>
<tr>
<td>§ 122 Piinamine Torture</td>
<td>15</td>
<td>1</td>
<td>3</td>
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<tr>
<td>§ 141 Vägistamine</td>
<td>5</td>
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<td>4</td>
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<tr>
<td>Kuriteod perekonna ja alaealiste vastu Offences Against Family and Minors</td>
<td>21</td>
<td>14</td>
<td>30</td>
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<tr>
<td>§ 169 Lapse ülalpidamise kohustuse rikkumine Violation of obligation to provide maintenance to child</td>
<td>19</td>
<td>11</td>
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Table 7. Crimes in Narva (continuation)

<table>
<thead>
<tr>
<th>Narkokuriteod</th>
<th>Offences Relating to Narcotics</th>
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<tr>
<td>§ 183 Narkootilise ja psühhotroopse aine väikeses koguses ebaseaduslik käitamine</td>
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<td>§ 184 Narkootilise ja psühhotroopse aine suures koguses ebaseaduslik käitamine</td>
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<td>§ 185 Narkootilise ja psüh. aine edasiandmine nooremale ku 18 a. isikule</td>
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<tr>
<td>Varavastased kuriteod</td>
<td>Offences against Ownership</td>
</tr>
<tr>
<td>§ 199 Vargus</td>
<td>685</td>
</tr>
<tr>
<td>§ 200 Röövimine</td>
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<tr>
<td>§ 201 Omastamine</td>
<td>81</td>
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<tr>
<td>§ 209-213 Kelmused</td>
<td>347</td>
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<tr>
<td>§ 214 Väljalpressimine</td>
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<tr>
<td>Intellektuaalse omandi vastased kuriteod</td>
<td>Offences Against Intellectual Property</td>
</tr>
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<td>Avaliku rahu vastased kuriteod</td>
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<td>§ 263 Avaliku korra raske rikkumine</td>
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<td>§ 266 Omavolilise sissetung</td>
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<tr>
<td>Ametialased kuriteod</td>
<td>Offences Related to Office</td>
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<td>Öigusemõistmisevastased kuriteod</td>
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<tr>
<td>§ 334 Võitstud maksevahendi ja vaartpaberis kasutamine</td>
<td>45</td>
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<tr>
<td>§ 349 Tahtsa isikliku dokumendi kurtarvitamine</td>
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<tr>
<td>Keskkonnavastased kuriteod</td>
<td>Offences Against Environment</td>
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<tr>
<td>§ 391 Majandusalased kuriteod</td>
<td>178</td>
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<tr>
<td>§ 392 Salakaubavedu</td>
<td>88</td>
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<tr>
<td>§ 394 Rahapasu</td>
<td>67</td>
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<tr>
<td>Üldohtlikud kuriteod</td>
<td>Offences Dangerous to Public</td>
</tr>
<tr>
<td>Liikluskuriteod</td>
<td>230</td>
</tr>
<tr>
<td>§ 424 Muutusüüdi juhtimine jaobseisundis</td>
<td>222</td>
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</table>

Source: Narva Department for Development and Economy, 2010