

NATIONAL GOVERNANCE SYSTEMS, STAKEHOLDER POWER, AND POST-ACQUISITION DYNAMICS

LAURENCE CAPRON
INSEAD, Boulevard de Constance
77305 Fontainebleau, France

MAURO GUILLÉN
Wharton, University of Pennsylvania

ABSTRACT

We argued and established empirically that the extent to which stakeholders can pursue their interests within their organizations varies with the nature of national governance systems. We used the post-acquisition target restructuring process as an empirical setting whose outcome reflects the power of the acquirer's shareholders and the target's employees. Using a cross-national dataset of corporate acquisitions and the post-acquisition dynamics, we found support for the predictions that an additional legal protection of shareholder rights increases the acquirer's ability to downsize the target and increase its cost performance, while the protection of the target's employee rights restricts the acquirer's ability to downsize, and transfer resources to, the target, and eventually hurts target performance. We also found that experienced acquirers could partially mitigate the negative effects of labor rights on the post-acquisition restructuring process.

A STAKEHOLDER VIEW ON M&As

The market-for-corporate-control hypothesis contends that the interests of shareholder-principals are best protected by unrestricted competition for the stewardship of corporate assets using a takeover market. Beyond the disciplining merit of disposing of "managerial deadwood" (Samuelson, 1970), economists and strategy scholars attribute a major role to acquisitions in stimulating industry restructuring, achieving efficiency gains, recombining resources and exploring new capability domains (Capron, Mitchell and Swaminathan, 2001).

Following the extant literature, we argue that the acquirer's shareholders have an interest in maximizing the positive impact the acquisition will have on their wealth, i.e. the cash flows that accrue to them, while minimizing the negative consequences. Thus, acquirer shareholders would generally prefer to see management move swiftly to restructure the target. Applying the same simple logic to employees would lead one to assume that they are also predominantly interested in maximizing cash flows, in the form of wages paid to them by the firm. Yet increases in target employees' wages that would come from higher efficiency obtained through target restructuring is likely to be obtained by means of downsizing and changes in work practices. Furthermore, much cross-national research indicates that workers are also interested in

working conditions, intrinsic rewards, and employment stability, which may have the effect of decreasing cash flows to shareholders. Thus, the literature has repeatedly documented that the shareholders of the acquirer and the employees of the target are at odds with each other when it comes to post-acquisition dynamics (Schneper and Guillén 2004).

Acquirer's Shareholders

Under the assumption that shareholders are interested in maximizing their wealth, they will expect management to take action after the acquisition to ensure that the target delivers appropriate cash flows. The literature points out that in settings in which shareholders are in a better position to assert their rights, managers (i.e. their agents) will feel more pressure to make decisions consistent with shareholders' interests. In order to serve the interests of shareholders, it is usual for managers to take actions at the acquired firm that increase the cash flows the target's assets can generate. The M&A literature has outlined two main types of actions acquiring firms take to enhance the performance of the target and ultimately deliver returns to acquirer shareholders: downsizing the target's assets to save costs, and redeploying resources to the target in order to support the restructuring or development of the target.

Restructuring and downsizing are the focus of much economics and strategy research, which sees acquisitions as an opportunity to achieve cost savings through the elimination of redundant activities, organizational problems, and inefficient management practices, notably at the target firm. In contrast, the resource-based view has outlined the role of sharing resources among merging firms, notably when the acquirer transfers its resources to assist the target, as a source of abnormal returns for the acquirer. An acquirer can transfer its expertise to help the target become more cost-efficient and also to help it grow. Enhancing the benefits of acquisitions to shareholders, however, can be problematic. Managers under pressure from powerful shareholders will move quickly to replace the target's management and restructure its assets as well as transfer resources to assist the target, and may thus be able to attain better performance earlier. In contrast, managers who operate under less shareholder pressure might be more inclined to postpone unpopular post-acquisition measures in order to maintain the organizational truce and build their legitimacy. They might keep the target in a preservation mode at the expense of achieving economic benefits in order to maintain consensus. The extent to which the acquirer's managers are under shareholder pressure is shaped by the national institutional regime.

Although the acquirer's shareholders would prefer to restructure the target to maximize their wealth, they pursue their interest against those of other actors. Comparative legal scholarship and more recent economic analyses (La Porta, Lopez-de-Silanes, and Shleifer, 1999) have documented that shareholders' interests receive different degrees of legal protection. If shareholder rights are well protected by legislation, one would expect managers to move swiftly in the wake of an acquisition to extract as much value from the target as possible through reorganization, restructuring, and downsizing. Otherwise, shareholders might take action to remove the managers. It is important to note that if the target's shareholders prior to the acquisition were in a situation in which they could advance their interests based on the legal protection of their rights as owners, the transfer of ownership to a new set of shareholders in itself would not necessarily carry with it much substantial change. If the target's shareholders prior to the acquisition were already powerful, they would have probably put pressure on the target's management to maximize their wealth. In contrast, if the target's shareholders prior to the acquisition were not particularly powerful, it is likely that more opportunities for

restructuring the target and reaping economic benefits will reside within the target after the acquisition has taken place. Therefore, downsizings, resource transfers, and increased financial performance (as defined by the shareholder-oriented view of the firm) are more likely when the new owners have significantly more power than the preceding owners. In the context of cross-border acquisitions, one such situation occurs when the new owners come from a country with better protection of shareholder rights than the target's country.

Hypothesis 1 (H1): The better protected the rights of the acquirer's shareholders, compared to those of the former shareholders of the target, the more the target will witness downsizing (H1a), resource transfers (H1b), and enhanced performance (H1c).

Target's Employees

In the wake of an acquisition, the target's employees can become an important stakeholder whose power may greatly influence post-acquisition dynamics. Although the market for corporate control may serve the interests of shareholders by replacing an inefficient management team (Walsh and Seward, 1990; Jensen, 1993), employees may resist restructuring or reorganization if they feel their interests are undermined. Employees turn out to be crucial actors when it comes to realizing the benefits from most acquisitions. When achieving efficiency benefits, the focus on target employees is not, however, solely on downsizing, as retention and internal mobility issues play a key role as well. M&As also trigger internal reorganization of the workforce. The elimination of jobs typically creates gaps in the division of labor that must be filled by reorganizing the remaining jobs. Furthermore, acquirers do not necessarily lay off a worker whose job is eliminated—they may transfer one worker and lay off another instead. This job bumping produces a cascade of lateral and vertical internal movement in response to the elimination of an organizational position. In sum, achieving efficiency gains through M&As is contingent on the acquirer's ability to make the required adjustments in the target's labor force, division of labor, and employee mobility patterns. Those adjustments can be opposed by target employees who are affected by job cuts, reduced stability, impaired working conditions, or depreciated status.

As in the case of shareholders, there are profound cross-national differences in the extent to which workers can exert power to advance their interests. Countries fall at some point along a continuum defined by two major types: liberal-market economies and coordinated-market economies. Liberal-market economies such as Britain, the US, Australia, Canada, New Zealand, and Ireland, are distinguished by competitive market arrangements, with supply and demand forces having a large impact on organizational outcomes and processes. In liberal-market economies, labor relations are characterized by open market relationships, with firms having the freedom to hire and fire employees almost at will and collective bargaining being uncoordinated and taking place at the firm level. Among liberal-market economies, the United States has the least restrictive employment protection rules.

Given that post-acquisition dynamics may affect the interests of the target's employees, we expect them to resist restructuring to the extent that they have the power to do so. Employees in a highly protective labor regime are more likely to favor voice over exit in response to grievances because they may not easily leave the firm without penalty. Rigid labor markets make hiring a worker somewhat of an irreversible

decision and reduce the mobility of the labor force. In addition, when employee skills are firm-specific because of the length of the typically long periods of employment at the same firm, the employee's greater dependence on the firm makes the option to leave more difficult to pursue.

Hypothesis 2 (H2): The better protected the rights of the target's employees, the less the target will witness downsizing (H2a), resource transfers (H2b), and enhanced performance (H2c).

Acquirer's M&A Experience as a Moderator

Controlling for the likely effect of experience on the acquirer's choice of target firm and country, we argue that acquisition experience offers acquirers insights into the best approaches to negotiate with stakeholders or to address their concerns. With experience, acquirers may be more capable of anticipating the reaction of internal stakeholders and negotiating with them very early in the acquisition process. Frequent acquirers may also be better at designing incentive systems and communicating the benefits of job rotation, new work practices, and work flexibility. Acquisition experience may help acquirers reduce the trauma of target downsizing and help survivors overcome their reaction and recommit to being motivated and productive. With greater experience, an acquirer might become better not only at managing employees' perceptions of justice or fairness concerning the way in which new roles and rewards are allocated to those who are retained by the merged organization, but also at handling employee layoffs. Overall, frequent acquirers may also become better at aligning the pace of integration with the type of post-integration measures they need to take. They may also be more adept at weighing the costs of adjustment versus the benefits to be expected from some post-acquisition actions. Hence, we predict that:

Hypothesis 3 (H3): The greater the acquirer's previous experience with corporate acquisitions, the weaker the negative impact of better protection of the target employees' rights on target downsizing (H3a), resource transfers (H3b), and enhanced performance (H3c).

METHODS AND RESULTS

Data collection is described in Capron (1999). We ran three sets of OLS regressions whose dependent variables were (1) the extent of post-acquisition target downsizing, (2) the extent of post-acquisition redeployment of acquirer resources to target firm, and (3) the post-acquisition target performance. We measured changes in shareholders' rights after the merger by calculating the difference between acquirer country shareholder rights and target country shareholder rights. We used the time-varying country **shareholder rights** index developed by Schnepfer and Guillén (2004). We measured **target labor rights** by using a novel and original measure of violations of the right to free association and collective bargaining (FACB) constructed by Kucera (2002), a senior research officer at the International Labour Organization's (ILO) International Institute for Labour Studies. The measure of FACB violations was based on 37 criteria concerning mainly rights contained in the ILO Conventions No. 87 (Freedom of Association and Protection of the Right to Organize) of 1948 and No. 98 (Collective Bargaining) of

1949 as well as related ILO documents. For more details about FACB measures, see Kucera (2002). We measured the extent to which **the acquirer's experience** could moderate the effects of target labor rights on post-acquisition target restructuring and performance by including in our model an interaction term calculated by multiplying acquirer M&A experience by target country labor rights. Acquisition experience is a self-reported measure of the number of acquisitions made by the acquirer within the five years preceding the acquisition of the specific target.

We found partial support for the predicted effect of the difference in shareholder right protection between the acquirer and the target country. To the extent that the new owner comes from a country with better-protected shareholder rights, the target experiences more downsizing in its R&D, manufacturing, and sales network, controlling for market growth, acquisition motive, and pre-acquisition profitability, among other variables. This confirms hypothesis H1a. In contrast, we found no support for hypothesis H1b on the redeployment of acquirer resources, and some support for hypothesis H1c on post-acquisition performance. In particular, the results indicated an increase in post-acquisition cost efficiency, but not in market share or sales or innovation. Acquirers from an environment with stronger shareholder protection are likely to be subject to greater pressure for the acquisition to deliver results. Cost cutting is often seen as an effective way of delivering rapid results to acquirer shareholders. Furthermore, there might be more opportunities to restructure targets that used to operate under an environment with weaker shareholder pressure, since those targets faced less pressure to reshuffle assets swiftly. For targets that were subject to weaker shareholder pressure before the acquisition, the change in ownership is likely to trigger substantial internal reorganization of the target workforce and asset streamlining. Yet it is worth noting that acquirers with more shareholder orientation do not perform better at increasing revenue-enhancement synergy and innovation at target than acquirers with less aggressive shareholder orientation. We also find that the more the acquirer country is shareholder-oriented compared to the target, the less likely it redeploy its technological resources to the target.

Our results lend systematic support for our second hypothesis, concerning the impact of labor rights in the target country on post-acquisition dynamics. The better protected the rights of the target's employees, the less the target will witness downsizing of either R&D, manufacturing, or sales networks (H2a), and resource transfers of technology, marketing, or management (H2b). Perhaps as a result of these effects, our data showed that the better protected the rights of the employees in the target country, the lower the post-acquisition performance in terms of market share, sales, and product quality (H2c), as judged by the executives interviewed in the survey. It is important to note that, according to these results, target country labor rights not only constrain the acquirer's ability to downsize the target after the acquisition but also its ability (or willingness) to redeploy and transfer its own resources to assist in the development of the target's businesses, and that these two effects coincide with the perception of lower performance.

We found partial support for our third hypothesis, predicting an experience effect as acquirers learn to cope with labor restrictions. While the results did not show that acquirer experience mitigates the effects of labor rights when downsizing the target (H3a), they did indicate that labor influence is mitigated during resource redeployment as acquirer experience grows (H3b). We also find that as experience grows, labor influence is mitigated by acquirer experience in terms of market share, sales and product quality (H3c), although not in terms of cost efficiency. These results suggest that experience helps the acquirer minimize workforce resistance when it pursues growth-oriented objectives (sending resources into the target) and revenue-enhancement synergies, whereas experience does not help the acquirer cope with the power of the labor force when it pursues downsizing or cost-saving synergies.

CONCLUSION

Our empirical results shed light on the role of the institutional environment on firm strategy and in particular on its M&A strategy. While much research on M&As has emphasized firm-level factors of merger success, there is little systematic evidence showing that country-level institutional factors play an important role in the merger value-creation process. Notably, we found that the power of the various stakeholders in the post-acquisition process is embedded in the legal environment of the merging firms. It complements previous insights of the M&A literature documenting the negative effects of target employees' resistance to post-acquisition value creation. The cause of employee negative emotions and attitude has been attributed to cultural misfit, loss of organizational identity, fear of job losses, or lack of fairness on the part of the acquirer. The M&A literature, however, has not yet examined the conditions under which target employees could actually exert their power in the acquisition process and successfully oppose shareholders' interests. Our findings showed that the target employees' power takes its roots in the legal system of the country in which the target firm is located. More generally, the political balance between acquirer shareholders and target employees depends to a certain extent on the institutional characteristics of both acquirer and target countries. We also believe that much progress needs to be made to understand the complexity of the relationship between firm-level governance systems, micro-level processes of value creation, and country-level institutional regimes. Our paper represents just a first step in this direction.

REFERENCES

- Capron, L. 1999. The long-term performance of horizontal acquisitions. **Strategic Management Journal**, 20: 987-1018.
- Capron, L., W. Mitchell, and A. Swaminathan. Asset divestiture following horizontal acquisitions: A dynamic view. **Strategic Management Journal**, 22: 817-844.
- Kucera, D. 2002. Core labour standards and foreign direct investment. **International Labour Review**, 141: 31-69.
- La Porta, R., F. Lopez-de-Silanes, and A. Shleifer. 1999. Corporate ownership around the world. **Journal of Finance**, 54: 471-517.
- Samuelson, P.A. 1970. **Economics**. New York: McGraw-Hill.
- Schneper, W. D., and M. F. Guillén. 2004. Stakeholder rights and corporate governance: A cross-national study of hostile takeovers." **Administrative Science Quarterly**. 49: 263-295.

Copyright of *Academy of Management Proceedings* is the property of *Academy of Management* and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.