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Lessons from the flipside: How do acquirers learn from divestitures to complete acquisitions?

Trang Thu Doan [a, *], Padma Rao Sahib [b], Arjen van Witteloostuijn [c]

[a] Vietnam National University, International School, 144 Xuan Thuy, Cau Giay, Hanoi, Vietnam
[b] Department of Global Economics and Management, Faculty of Economics and Business, University of Groningen, Nettelbosje 2, 9747 AE Groningen, The Netherlands
[c] School of Economics and Business, VU University Amsterdam, De Boelelaan 1105, 1081 HV Amsterdam, The Netherlands

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We examine whether experience from prior divestitures is associated with higher completion likelihood in subsequent acquisitions. We argue that through divestitures, firms could extract meaningful knowledge that is helpful for completing their acquisitions, such as a general understanding of acquisition deal-making stages, and the stories and aims of the target in an M&A transaction. In addition, viewing divestitures as the flipside of acquisitions, we conjecture that the selling firm can observe how the divested component of their business is acquired, and vicariously learn from these observations. We also investigate the relative importance of learning from divestiture vis-à-vis acquisition experience in determining acquisition deal completion. Finally, we contend that the effect of learning from divestitures on acquisition deal completion depends on acquisition experience and deal value. We find evidence supporting our conjectures in a sample of 2164 M&A transactions from the worldwide computer and printing industries between 1991 and 2010.

Introduction

The research stream on factors that influence the decision whether to complete an acquisition deal[1] has experienced considerable growth in the last decade (e.g., Chakrabarti and Mitchell, 2015; Dikova et al., 2010; Kim and Song, 2017; Li et al., 2017; Muehlfeld et al., 2012; Zhou et al., 2016). These studies are conducted in the context of the *M&A pre-integration process* – i.e., the period before the official integration. This process normally starts with the decisions of firms on both the direction (industry) and manner (acquisition *versus* greenfield) of expansion, followed by evaluating potential targets and selecting a suitable partner. Once the target selection process is completed and the intention to acquire is approved by the board of directors, firms publicly announce their commitment to acquire and enter the important stage of due diligence. During this stage, both firms are involved in several negotiations, and administrative and strategic activities to clarify synergies as well as potential risks of the future integration. Other related issues such as premium bids, method of payment and integration of human resources are also taken into account (Chakrabarti and Mitchell, 2015; Muehlfeld et al., 2012; Sherman, 2011). If both

* Corresponding author.
E-mail addresses: trangdt@isvnu.vn (T.T. Doan), P.Rao.Sahib@rug.nl (P. Rao Sahib), a.van.witteloostuijn@vu.nl (A. van Witteloostuijn).

[1] In this paper, the terms 'M&A deals' or 'M&As' are also used to refer to acquisition deals.

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firms agree on all of the terms and conditions, and the future integration receives approval from the regulatory authority, an announcement on the completion of the pre-integration process (i.e., the deal is *completed*) will be made publicly, and the two firms will enter the integration period (Haspeslagh and Jemison, 1991; Jemison and Sitkin, 1986).

Prior research indicates that not all deals reach the integration stage. Depending on the industry and the types of the deals (e.g., domestic *versus* cross-border), M&A abandonment rates vary between 5 and 35 percent. For example, Chakrabarti and Mitchell (2015) find that 17.3 percent of the 1603 M&A domestic acquisitions announced by U.S. chemical manufacturing firms between 1980 and 2004 were abandoned. In another study on cross-border M&A deals "from" and "to" emerging countries between 1995 and 2010, the abandonment rate is 34.3 percent of the 2736 deals in the sample (Zhou et al., 2016).

This variation in rates of M&A abandonment has stimulated research interest in the factors influencing the completion likelihood of M&A deals. The financial losses from failing to complete M&A deals are undeniable. In addition to transaction costs, firms walking away from an M&A deal may have to bear a termination fee, which can go up to billions of dollars in many cases. An example is the $4 billion that AT&T had to pay Deutsche Telekom after terminating the offer in 2011.[2] Furthermore, not only financial costs, but also the reputation and credibility of managers involved in the transaction can be damaged by the abandonment of an acquisition (Jemison and Sitkin, 1986; Officer, 2003). For instance, the failed merger between General Electric and Honeywell in 2001 led not only to the dismissal of CEO Michael Bonsignore of Honeywell (Cabral, 2011), but also severely sullied the reputation of General Electric Chairman Jack Welch before his retirement in the same year (The Economist, 2014). Considering these losses, M&A abandonment is clearly not a welcome end for the parties involved in the deal.

In addition to implications for practitioners, findings from recent studies also suggest that the M&A pre-integration process is a fertile ground for academic research, particularly in strategic management. Although the common assumption is that whether an M&A deal will be completed depends mostly on the bidding prices, prior research has demonstrated a number of non-financial determinants of M&A completion. Examples of such non-financial aspects are the geographic distance between the two firms (Chakrabarti and Mitchell, 2015), distance in country law, regulation and risk (Zhou et al., 2016), capital market development and business group affiliation (Kim and Song, 2017), legitimacy concerns (Li et al., 2017), cultural and institutional differences between acquirers and targets (Dikova et al., 2010), and experience with prior acquisitions (Muehlfeld et al., 2012).

We attempt to contribute to this research stream by investigating whether firms can learn from prior divestitures to complete an M&A deal. Recent studies have confirmed that firms' experience with past acquisitions has a significant impact on the probability that an M&A deal is completed (Muehlfeld et al., 2012). In addition, Brauwer et al. (2014) demonstrate that experience with prior sell-offs can enhance firm performance. Similar to learning from acquisitions, divestiture experience allows firms to better understand issues related to implementing divestitures, and to develop routines for handling these activities (Shimizu and Hitt, 2005). Empirical evidence from Zollo and Reuer (2010) indicates that the accumulation of alliance experience facilitates successful implementation of acquisitions, suggesting the possibility of knowledge spillover across different restructuring activities. Inspired by these notable findings, we explore the role of learning from prior divestitures on M&A completion. With "divestitures", we consider sell-offs, transactions in which "assets sold from one firm to another in exchange for cash and/or securities" (Bergh and Lim, 2008: 595). Hence, by the very nature of the associated transaction, a divestiture can be regarded as the flipside, or the "mirror image", of an acquisition (Villalonga and McGahan, 2005). We propose that this "flipside" context offers the target firms valuable opportunities to enrich their understandings of the procedures associated with the M&A pre-integration period, which can enhance the likelihood of completing a future M&A deal.

Moreover, the special context of the flipside also allows target firms to learn vicariously from their partners – i.e., the acquiring firms – to handle the pre-integration process of their subsequent M&A deal. Whilst knowledge from prior acquisitions may trigger firms to refine their routines regarding acquisitions deal-making, which may limit the diversification of knowledge (Haleblian and Finkelstein, 1999; Sitkin, 1992; Zahra and George, 2002), lessons learnt from prior divestitures stimulate firms to alter their current M&A deal-making routines. This enhances their current understanding of M&A deal-making processes (Schilling et al., 2003). These arguments lead to two propositions: (1) firms can learn how to complete M&A transactions from experience with prior divestitures; and (2) the learning impact of divestiture experience on acquisition completion may well be larger than that of acquisition experience.

Learning in strategic contexts such as M&As, in both the ex ante deal-making and ex post integration phase, appears to be much more complicated than in operational contexts such as manufacturing or distribution due to the complexity and heterogeneity of acquisitions (and divestitures). Hence, similar to learning from acquisition experience, the learning effect of divestiture experience on acquisition completion likelihood may not be constant and stable, but rather is likely to vary across different contingencies. We anticipate that background knowledge on acquisitions can accelerate firms' retrieval, collection and analysis of new knowledge obtained in the flipside context. Hence, firms that already have experienced acquisitions will learn better from divestitures to complete a subsequent M&A deal. In addition, the size of the deal may also moderate the relationship between divestiture experience and M&A completion. We suppose that firms tend to have set routines for small M&A transactions. However, in larger deals, as increased attention, consideration and effort are required, managers will need

[2] This $4 billion includes $3 billion break up fee in cash and $1 billion of wireless spectrum access (Source: https://arstechnica.com/tech-policy/2011/12/att-admits-defeat-on-t-mobile-takeover-will-pay-4-billion-breakup-fee/).