

2-2019

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DOI: <https://doi.org/10.5465/amj.2017.0323>

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Citation

ZHANG, Cyndi Man and GREVE, Henrich R.. Dominant coalitions directing acquisitions: Different decision makers, different decisions. (2019). *Academy of Management Journal*. 62, (1), 44-65. Research Collection Lee Kong Chian School Of Business.

Available at: https://ink.library.smu.edu.sg/lkcsb_research/6207

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**Dominant Coalitions Directing Acquisitions:
Different Decision Makers, Different Decisions**

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We received excellent editorial advice from Pursey Heugens. We are grateful to Guoli Chen, Vinit Desai, Vibha Gaba, Marc-David Seidel, Margrethe Wiersema, seminar participants at Stanford GSB and MS&E, UC Irvine, and University of British Columbia, and the AMJ reviewers for their helpful comments on the paper.

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Abstract

Coalitions are important in organizational decision making, but the question of how coalitions are built and make decisions in response to firm performance is still not sufficiently explored. In this study, we develop and test theory on how potential coalitions are built through shared experience and recruitment of allies. When organizations respond to performance relative to aspiration levels, either as problemistic search following low performance or opportunity exploration following high performance, members form coalitions to influence decisions. We develop theory of coalition formation that builds on upper echelons theory and the theory of dominant coalitions to predict how past experience of decision makers leads to preferred actions by each member and subsequent coalition formation. We use this theory to make new measures of potential coalitions and apply it to acquisitions made by firms in China. We find evidence that the experience of members of the key decision making group—the board of directors—affects the potential coalition building, and hence the type of acquisition target, as predicted.

INTRODUCTION

Two important contributions in “A Behavioral Theory of the Firm” (Cyert & March, 1963) were the theory of dominant coalitions and the theory of problemistic search. Problemistic search predicts when organizations change, while dominant coalitions predict which alternative is chosen. Problemistic search has received more theoretical and empirical attention and follow-up, even though dominant coalitions is the theory that directly examines how decisions are made. In dominant coalition theory, each decision can trigger building of new coalitions supporting each alternative, even if the reason for support could differ across members (Cyert & March, 1963: 29-32). It can also imply continuation of past coalitions. This differs from traditional views of organizations as stable formal hierarchies or informal power structures. The theory also covered interdependence among decisions such as individuals yielding in one decision in order to gain influence in another decision. The flexible view of decision making seen in this theory has struck many as realistic (Gavetti, Greve, Levinthal, & Ocasio, 2012), but also as difficult to turn into specific predictions, as it argues against the stability needed to build a research stream with clear predictions.

Currently a close equivalent to dominant coalition theory is upper echelon theory, which contains research that incorporates coalition building through its focus on how managerial characteristics affect organizational decisions (Carpenter, Geletkanycz, & Sanders, 2004; Hambrick & Mason, 1984). This work uses the theory of dominant coalitions to aggregate from the experience of individual decision makers to a group decision, gaining predictions by adopting a more stable view of decision making through viewing decision-maker backgrounds and positions as giving relatively stable preferences (Bromiley & Rau, 2016). Its research progress has been impressive, and has led to many findings on how the composition of the upper echelon of organizations affect behaviors such as international diversification (Sambharya, 1996; Tihanyi, Ellstrand,

Daily, & Dalton, 2000), competitive aggression (Ferrier, 2001), and firm growth (Kor, 2003).

Although upper echelon theory gained predictions from having fewer contingencies than the original dominant coalition theory, this has led to two shortcomings. The first shortcoming is that the building of coalitions has been viewed as relatively simple, with many studies focusing on average upper echelon characteristics (Carpenter et al., 2004). This implies that a group majority or average dominates, but dominant coalition theory specifies that coalitions could either arise naturally from a pre-existing majority group or be built from a minority group finding allies among the neutral, ambivalent, and undecided. Such political maneuvering has been missing from much of the subsequent work. Upper echelon theory can be extended by incorporating coalition building, and this extension is especially valuable if the decision-making group has significant variation in member preferences.

To address this shortcoming, we draw from two theories. First, dominant coalition theory saw coalitions as being formed by subgroups with shared interests and grown to dominant size through recruitment of neutral, ambivalent, and undecided individuals who could become allies (Cyert & March, 1963: 29-32). This suggests that the modeling of coalition building should take into account both the strength of each contesting group and the potential allies they can recruit. This is an extension of prior research, which has looked at the proportion of decision makers of one specific type, such as outside directors (e.g., Wade, O'Reilly, & Chandratat, 1990). The group strength is determined by the number, commitment, and status of its members. Second, faultline theory predicts that decision-making teams with sharp divisions between subgroups will have more contestation and poorer decision making (Lau & Murnighan, 2005), again suggesting that coalition building has distinctive properties in groups with undecided members. Incorporating dominant coalitions and faultlines into upper echelon theory produces a more realistic and

flexible model of coalition building.

The second shortcoming of upper echelons theory is that it implicitly assumes a steady inflow of similar decision-making opportunities. Contrary to early evidence that upper echelon effects depend on the performance level (Boeker, 1997), upper echelons research focuses more on non-contingent effects than on change induced by the organizational performance (Bromiley & Rau, 2016). To address this shortcoming, we draw on the theory of problemistic search (Cyert & March, 1963: 120-122; Greve, 1998), which posits that organizations search for solutions when performance below an aspiration level indicates a problem. This search is initially near the presumed cause of low performance, but becomes broader if satisfactory solutions cannot be found or do not work. This theory has led to an accumulation of studies showing that many organizational changes are driven by performance below the aspiration level (Gavetti et al., 2012; Greve, 2003b; Shinkle, 2012). These changes are motivated by decision makers seeking to solve a problem of performance below the aspiration level. High performance also affects organizational decision making, because it gives opportunities to invest retained earnings, and it gives executives greater discretion through looser board supervision of their proposed actions (Hambrick & Finkelstein, 1987; Li & Tang, 2010; Tuggle, Sirmon, Reutzel, & Bierman, 2010). The influence on firm actions is particularly high when decision makers can claim a role in contributing to firm performance (Boeker, 1989; Hickson, Hinings, Lee, Schneck, & Pennings, 1971). These theories suggest that decisions are triggered by problem solving or opportunity pursuit, causing the upper echelon effects to be dependent on performance relative to aspiration levels.

We thus have an opportunity to draw on the behavioral theory of the firm with its theory of coalition building and problemistic search to address these gaps in current upper echelons research. We combine two theoretical mechanisms: (1) decisions are triggered by comparison of performance

and the aspiration level; (2) when making decisions, decision-makers with similar experience attempt to build dominant coalitions in order to reach their favored outcome. We elaborate these mechanisms in the theory section with an emphasis on the second. Our main contribution is to enrich theory on coalition building by identifying members seeking to form a dominant coalition and accounting for members who can be recruited as allies. Our second contribution is to develop the concept of potential coalitions as a result of coalition building and construct empirical measures to assess potential coalitions, detect the likely dominant coalition, and predict the alternative chosen. This contribution allows coalition building to move from theory to concrete predictions for empirical research. Our third contribution is to incorporate the performance relative to aspirations as a condition that triggers coalition formation to make decisions on organizational change.

We apply the theory to the decision on the type of acquisition made by the focal firm. This outcome connects well to our contribution because acquisitions are a strategic behavior that is affected both by upper echelon composition and performance relative to the aspiration level (Haleblian, Kim, & Rajagopalan, 2006; Iyer & Miller, 2008; Jensen & Zajac, 2004). Acquisitions are approved by the board of directors. We can identify the experience of each board member, infer their preferred solutions and likely allies, and predict the potential coalition formation and decision (Desai, 2016; Dowell, Shackell, & Stuart, 2011; Ocasio, 1994). We study listed firms in China from 2000-2012, after the 1980s market reforms and the 1990s growth of the stock market. Firms in our study have board members with various degrees of experience with market competition and state control, giving rich variation in the decision making group that will seek to build or retain a dominant coalition to determine acquisition choices. To investigate the effect on another strategic decision, we also examine whether firms choose to borrow from state banks.

THEORY

Upper Echelon Experience Guiding Decision Making

Coalition theory starts with the individual characteristics that affect the decision making. Cyert and March (1963: 122) posited that the training and experience that organizational members obtained in their work biased them towards repeating decisions. This has been overlooked in later theory construction and empirical studies in the behavioral theory of the firm, but has seen significant work in the upper echelon perspective (Carpenter et al., 2004; Hambrick & Mason, 1984). Managers reuse knowledge from their past experience when making current decisions, as seen in specific effects such as international experience driving international diversification (Sambharya, 1996; Tihanyi et al., 2000), and general effects such as higher education level allowing greater innovativeness and diversification (Bantel & Jackson, 1989; Wiersema & Bantel, 1992) and greater heterogeneity in tenure and specialization providing more flexible strategic responses (Cho & Hambrick, 2006).

Extending this argument, we posit that the experience that individual decision makers have obtained outside the organization, such as through education or past work, also influences their decisions. Experience provides ways of thinking that a decision maker can apply when solving problems, and even a store of past solutions that can be matched to current problems. It is particularly important for the board of directors, because they are supposed to bring their outside experience to bear when the organization makes important decisions (Baysinger & Hoskisson, 1990; Westphal & Fredrickson, 2001). There is abundant evidence that experience drawn from other board memberships influence board decision making (e.g., Davis & Greve, 1997; Haunschild, 1993; Tuschke, Sanders, & Hernandez, 2014).

Upper echelons theory contains mechanisms that link experience and organizational outcomes. Prime among them are behavioral propensities to repeat familiar actions, cognitive propensities to

categorize and consider problems in familiar ways, and human capital to assess consequences of familiar actions with greater confidence (Carpenter et al., 2004: 760). There is evidence supporting these mechanisms also outside upper echelons. Repetition of familiar actions has been studied in work on organizational momentum, or the repetition of recent strategic initiatives (Amburgey, Kelly, & Barnett, 1993; Amburgey & Miner, 1992). Cognitive propensities are a source of firm failure to change following technological or regulatory changes (Audia, Locke, & Smith, 2000; Cho & Hambrick, 2006). Human capital effects are seen through the skill transfer in decisions such as acquisition premium determination (Beckman & Haunschild, 2002; Zhu, 2013). Each of these mechanisms is based on decision makers having a greater liking for decisions that match their experience, and imply that decision makers will be affected by their experience.

Coalition Building

Upper echelons theory sees organizational actions as reflecting the top decision makers of the organization (Hambrick & Mason, 1984). The behavioral theory of the firm, however, emphasizes the dominant coalition, which can be a subgroup of these. To integrate the two theories, we develop a theory that starts with individual decision maker experience and ends with coalition building to reach a decision. In past work, a common mechanism is that a majority rule is applied in group decisions, as the views that are most frequent in a decision making group will dominate the discussion, often leading to suppression of alternative views (Bazerman, Giuliano, & Appelman, 1984; Greve & Zhang, 2017; Peterson, Owens, Tetlock, Fan, & Martorana, 1998). Decision makers holding the most prevalent experience will favor decisions that are proximate to their behavioral propensities, and will seek to determine firm actions through consensus, compromise, or contestation (Cyert & March, 1963; Pfeffer & Salancik, 1978).

While members of each subgroup can be counted based on their attachment to each alternative

view, coalition building is more complex than the simple majority rule. The strength of a coalition is jointly determined by the number of members, their commitment, and their status within the board. Commitment to a view can derive from depth of experience, as when a Chinese board member has greater commitment to US business practices when having both education and work experience from the US, as opposed to just one (Chung & Luo, 2013). Status can derive from many characteristics including past success (Reschke, Azoulay, & Stuart, 2017). Higher status gives greater influence on decisions in groups generally (Berger, Rosenholtz, & Zelditch, 1980; Ridgeway, Johnson, & Diekema, 1994) and specifically in boards of directors (e.g., Belliveau, O'Reilly, & Wade, 1996; Zald, 1969).

Equally important, each decision has a distinct set of alternatives, so a stable preference or dominant coalition may not exist across decisions. Instead, each alternative is judged on its costs and benefits, and decision makers seek to build and retain coalitions to influence the decision. The coalition building involves the steps of assembling a subgroup with shared experience and recruiting additional members to build sufficient strength to determine the decision. While the actual coalition in each case is uncertain, potential coalitions can be predicted by examining the size of subgroups with shared experience that are likely to engage in coalition building, as well as the size of subgroups that are not already committed, and hence can be recruited to coalitions.

The complexity of coalition building leaves researchers with two steps to obtain a rigorous prediction on the direction of change. First, the experience of each member can be examined for their likely preferred actions (Bertrand & Schoar, 2003; Jensen & Zajac, 2004). Second, the composition of the decision-making group can be assessed to estimate the strength of the potential coalition that can be formed in favor of each alternative. The second step implies examining the decision-making group to identify subgroups that favor each alternative strongly, as well as individuals who are not

strongly aligned with each subgroup, or who are aligned with both, and to see these neutral and ambivalent individuals as potential allies of the coalition that each subgroup seeks to form (Cyert & March, 1963). The second step has been mostly omitted in previous research, which instead only examines the proportion of decision-makers likely to favor a specific action (e.g., Finkelstein, 1992; Jensen & Zajac, 2004). For example, many studies have used the proportion of inside or outside directors as indicators of opposing views of firm governance (e.g., Joseph, Ocasio, & McDonnell, 2014; Shen & Cannella, 2002; Wade et al., 1990). Coalitions need to be built and retained through recognition of common interest and rallying around it, however, and the dualistic approach of dividing boards into groups assumed to be for or against a specific option is insufficient to handle the distribution of experience across board members.

The recruitment of allies is important because coalition building and retention has the three main components of subgroup cohesion, outgroup cooptation, and full-group confrontation (Eisenhardt & Bourgeois, 1988; Pfeffer & Salancik, 1978). First, each subgroup maintains contact through network ties or in meetings, which is sometimes done covertly. Second, members of each subgroup seek to coopt individuals with undetermined allegiance through direct interaction, often in contest with members of the opposing subgroup. The members most committed to the group view are particularly active in cooptation efforts. Finally, the formal decision-making occasion becomes an arena for persuasion, with the aim of providing an appearance of consensus despite the different views. Often the end result is a consensus with qualifications (Eisenhardt & Bourgeois, 1988), with some members agreeing with a specific decision despite continued disagreement with the underlying principles.

Although the components of this process are well known, it is worth considering how it influences decisions. First, numerically stronger subgroups have an advantage in the final decision. Second, the importance of cooptation is well understood by executives and board members, and will

lead to significant pre-meeting influence attempts that are likely to let undecided individuals assess the power of each subgroup and the costs and benefits of complying with it. Because coalition building and retention is an ongoing activity in organizations, each individual will consider whether opposing a strong subgroup in a specific decision will make it harder to exert influence in future decisions. This gives an advantage to a stronger subgroup in the cooptation stage. The advantage is greater when there are fewer unaligned members, making cooptation efforts easier to focus. The final decision is thus more likely to conform to the strongest subgroup, but this prediction is less certain when the decision-making group has more unaligned members that need to be influenced. Third, groups in which the members have multiple characteristics relevant to a decision and each can have none, one, or more characteristics may be divided cleanly into subgroups with well-defined faultlines, or there could be overlaps among the potential subgroups. This affects the internal group tension and subgroup formation, and has been the subject of significant research on the formation of faultlines and their effects on group conflict and decision making (e.g, Lau & Murnighan, 2005; Li & Hambrick, 2005; Meyer & Glenz, 2013).

This process of building and retaining coalitions means that shared experience helps predict group decisions, as it identifies which subgroups of members are potential coalitions. In addition, member affiliation with each subgroup can have varying commitment, and this can also help predict potential coalitions. Finally, the status of each member can vary, and thus shape the influence when building coalitions. Thus, the theory should identify the commitment to each experience by each member, the cohesion of the subgroups of members holding the same experience, and the member status. Based on these ideas, we develop new measures using factor analysis and a faultline measure that are presented in the methodology section, and we compare the findings of analyses using these measures.

Performance Triggering Decision Tasks

The upper echelons perspective has so far had limited consideration of the different triggers of decision tasks addressed by the decision-making group. This is an important gap because application of decision-maker experience depends on the purpose of the decision. The behavioral theory of the firm, on the other hand, specified that performance below an aspiration level on an organizational goal triggers problemistic search (Cyert & March, 1963), which is oriented toward solving the problem of low performance and continues until decision-makers are satisfied with a proposed solution. This theory of low performance leading to organizational change has been supported for a wide range of outcomes such as product introduction (Gaba & Joseph, 2013), innovations (Greve, 2003a), market expansion (Barreto, 2012), alliance partner choice (Shipilov, Li, & Greve, 2011), mergers and acquisitions (Iyer & Miller, 2008), divestiture (Desai, 2016), and risk taking (Kacperczyk, Beckman, & Moliterno, 2015). These outcomes have in common that a problem identified through low performance is followed by a choice of change action.

While low performance pressures firms to find a new direction, theoretical and empirical work has found that high performance leads to increased managerial discretion (Hambrick & Finkelstein, 1987; Tuggle et al., 2010) and provides the firm with slack resources that can be used to explore new opportunities (Tyler & Caner, 2016; Voss, Sirdeshmukh, & Voss, 2008). Exploration of new opportunities also triggers decision making because it implies choices among alternative actions and allocation of slack resources. Hence, high performance triggers decision making for the purpose of pursuing opportunities, and will be followed by coalition building to influence the choices of alternative actions. Although performance below and above the aspiration level triggers different decision-making occasions, each involves coalition building, either to solve a problem or pursue an opportunity, because decision makers will disagree on what actions are the best responses to each

occasion.

In order to test this model of organizational change as a result of board experience and potential coalitions, we need to specify what kind of experience influences judgments of which actions are proximate to the decision-maker experience, and how the experience of individual decision makers, along with their commitment and status, aggregates up to a potential dominant coalition. This is a question that should be related to the empirical context and concrete differences among decision makers (Meindl, Stubbart, & Porac, 1994). To do so, we introduce our empirical context, the acquisition decisions by firms during the transition to a market economy in China. This context and outcome are appealing because the market transition gave the board responsibility for highly consequential decisions that were contentious because of the coexistence and divergence between market and state experience in boards, which in turn motivated coalition building, making it a sharp test of our theory.

BOARD EXPERIENCE IN CHINA

China instituted market reforms that moved from state socialism with state control of the economy to market capitalism with markets and profit-seeking corporations (Nee, 1992). One of the principal market reforms was partially privatizing state-owned enterprises (SOEs) and allowing entry of firms with no state ownership, giving many firms the goals of private enterprises (Chen, Firth, Gao, & Rui, 2006). Year 2000 to year 2012 was widely regarded as a new stage in the development of the listed firms in China when the private sector became an integral part of the socialist economy (Jiang, Yue, & Zhao, 2009), and is the time of our study. The formal structure and actual governance of the boards of Chinese listed firms were modeled on those in the USA through a series of governance reforms. Boards in Chinese firms are elected by the shareholders. The 2001 governance reform called for independent directors to take at least one-third of the board and to oversee many

specific decisions (such as director nominations) before treatment by the full board. From 2002 boards are encouraged to adopt the same committee system as boards of US listed firms. Even the size is similar: boards in our data have an average of 9.9 directors, as compared to the average of 10.8 in the current S&P 500.

The boards still have characteristics that are distinctly Chinese. The state retained ownership in many firms. Firms both with and without state ownership often have directors with experience working for state agencies. Firms also have directors with training and experience in a market economy. Both types of directors are valued for their knowledge, as firms need to handle state relations and to operate in the market economy created by the reform (Zhang & Greve, Forthcoming). Acting in its capacity as the controlling shareholder, the state selected directors of SOEs, and most SOEs had both directors with market experience and directors with state experience in order to facilitate the market reform while safeguarding state interests.

Listed firms had a variety of board compositions, and hence decision-maker experience and knowledge. The composition within each firm also changed over time as the market reform deepened, and for firm specific reasons. These firms faced variable performance, and hence formation of dominant coalitions to solve problems or pursue opportunities. We examine acquisition decisions as major actions to obtain external resources and permit the firm to engage in growth to improve the performance. Acquisitions are governed by the board of directors, so we have direct correspondence between the decision makers and organizational action we study.

State Experience

In state socialism, firms are seen as an actor in a redistributive economy that channels goods or services to the state, and in turn receives resources from the state (Szelenyi, 1978). Firms are not supposed to interact with the market or earn profits, instead they function as cost centers and

redistributive agencies that respond to central decisions through a hierarchy of government control at the local, provincial, regional and national levels. Firms organize the production in their industry and maintain balanced and stable demand and supply. In listed firms in China, directors who have experience working or are still working for state agencies are quite common. The state socialism experience makes them familiar with the actions of seeking state opinion and state help (Zhang & Greve, Forthcoming; Zhou, Tse, & Li, 2006), and they are able to estimate the benefits of these actions with confidence.

When comparison of performance and an aspiration level signals a problem or an opportunity, directors with state experience will recall state intervention and favor seeking as familiar alternatives. Even when additional assets are needed for the firm, they prefer familiar actions such as loans from state-owned banks, internal acquisition, or a state-bridged acquisition.¹ Market oriented M&As, on the other hand, require active search on the equity market, which is an unfamiliar context and set of actions for directors with state experience. Also, the post-M&A integration can imply seeking efficiency through labor force reductions, which goes against the state goal of labor market stability (Boubakri, Cosset, & Saffar, 2008). It is also problematic for them because it involves internal power changes, as the financial and managerial expertise required for post-M&A integration gives directors with market economy experience more intra-organizational power (Bunderson, 2003; Hickson et al., 1971). As a result, searching on the market for M&A targets is a distant approach for state directors when performance feedback indicates a problem or an opportunity. Seeking state advice and support through relying on the state to bridge an M&A is the more proximate choice, and consolidating through making an internal acquisition is even more proximate.

¹ We give exact definitions later, but state-bridged acquisitions are initiated by the state, while internal acquisitions among firms with shared ownership.

Market Experience

In market capitalism, firms are independent profit-seeking entities that strive for economic efficiency through market exchange and competition, and their value is determined by the cash flow provided to shareholders (Fligstein, 1990). The firm has significant autonomy because it is based on the principles of private ownership and property rights, which are valued and protected, and thus it is not linked with the state except through the effects of regulation. In most listed firms in China, the boards include directors who are familiar with markets through their education and experience, and are influenced by this experience. They see themselves as part of an established corporate governance and management system that preserves shareholder rights and ensures that these rights take priority over those of all other stakeholders (Davis & Stout, 1992).

Directors with market-related work experience and education are familiar with evaluating opportunities in the market and taking risk in order to increase firm value. Therefore, when comparison of performance and an aspiration level indicates a problem or an opportunity, they are willing to search for acquisitions in the equity market. Indeed, searching for acquisition targets is natural given the frequent use of M&As by firms in market economies (Haleblian et al., 2006; Iyer & Miller, 2008). Acquisitions are proximate strategic actions that firms employ to overcome performance problems or growth constraints, and directors with market experience assess the consequences more confidently than directors lacking such experience. Conversely, directors with market experience are less familiar with the state-related actions of internal acquisitions or state-bridged acquisitions, and they are less confident in assessing their consequences. Most boards have directors with state experience, so directors with market experience have access to knowledge on how state-related actions can be done, but they lack personal experience that gives confidence in applying them, and their experience does not suggest that such actions are effective. In addition,

market experience does not provide network ties to the state that can facilitate state-related actions, so the lower familiarity is overlaid with lower capability to execute such actions.

Firm Acquisitions

In the early stage of the privatization process and stock market in China, many internal acquisitions happened among firms with shared ownership. The state encouraged these, aiming to dispose of bad assets, write off debt, and aggregate resources to prepare for privatization. Gradually, in addition to internal acquisitions, state-bridged external acquisitions were done to solve financial or operational problems of firms, maintain employment levels, restructure the acquired firms, and integrate them into the acquiring firm. The state typically picked acquirer and the target and facilitated the acquisition. Directors with state experiences were familiar with internal acquisitions and state-bridged acquisitions as a tool for the state and as a way to solve firm problems. Both of these types continued during our study period, and they remained familiar choices for directors with experience working with the state.

SOEs and partially privatized SOEs became more market-oriented following the 2002 enactment of the Securities Law that formalized the issuance, listing, and trading of securities and ensured the efficiency of equity transactions. In addition, a growing population of private firms with no state origin emerged on the stock market. All firm categories increasingly engaged in market-oriented acquisitions, defined as M&As initiated by the firm. In market-oriented acquisitions, targets were no longer proposed by the state, instead they were chosen as potentially providing long-term financial returns or growth opportunities to the acquiring firms. This is the same as M&As in market economies, and was a familiar option for directors with education or experience from such contexts. We examine three main types of acquisition target: internal acquisitions of firms with shared ownership; state-bridged acquisition in which the external target is introduced and advised by the

state; and market-oriented acquisitions, which is the typical M&A in market economy. They follow the order from the least market-oriented to the most.

Among market-oriented acquisitions, we further distinguish the nature of acquisitions by asset only, minority equity ownership, and majority equity control. The market orientation is lowest for asset acquisitions, which involved less managerial effort to integrate into the acquiring firm, and less risk. The middle is minority ownership (less than 50 percent of shares), which became more common over time. It is qualitatively different because it requires consideration of the current equity value and its future potential, and greater risk. The highest market orientation is majority ownership (50 percent or more), which can lead to full integration of the firms. Greater market orientation implies greater financial risk and integration cost, which the state experience directors are unfamiliar with. For directors with market experience, these are a familiar form of investments with high but uncertain returns, and hence not something to avoid if the decision makers assess the target as sufficiently promising.

State Bank Loans

To investigate whether the same factors influence an alternative strategic decision, we also examine whether firms choose to borrow from state banks to solve problems or pursue opportunities. In China, the state-owned banks have policy objectives, though they also seek to make commercially viable loans (Firth, Lin, & Wong, 2008). Accordingly, we can use loans from state-owned banks as an indicator of the firm choosing state-related actions. Directors with state experience know that state-owned banks can act as a buffer for firms that are seeking to solve problems, because this was the role of state bank financing especially before the market transition, even though they also give market-oriented loans after the market transition. Conversely, directors with market experience are less familiar with the potential use of favors from state banks.

HYPOTHESES

Because our theory is premised on the dominant coalition making decisions that are triggered by organizational performance relative to aspiration levels (Greve, 1998; Hambrick & Mason, 1984), it assumes that performance deviations from an aspiration level leads to coalition building in order to shape the response. Hence, the hypotheses are interaction effects of the dominant coalition and the performance level. This distinguishes them from hypotheses based on upper echelons theory, which do not consider the performance level jointly with the formation of the dominant coalition. It distinguishes them from hypotheses based on performance feedback theory, which do not consider the composition of the decision-making group. We examine coalition building through the choice of acquisition target made by the firm, contingent on it making an acquisition. We rank internal acquisitions, state-bridged acquisitions, and market-oriented acquisitions as increasingly market-oriented and predict more market-oriented responses to performance feedback if the board builds stronger coalitions around directors with market experience than state experience.

Members of decision-making groups will apply their experience to the judgment of which alternative action is the best match to the problem or opportunity, leading to potential conflict between subgroups with different kinds of experience. The coalition-based solution to such conflicts is that the subgroup best positioned to muster its own members and allies is able to select alternatives that are proximate to its experience. Directors with market experience will advocate market oriented solutions to performance problems and growth constraints because they have greater familiarity and confidence in them (Haleblian et al., 2006; Iyer & Miller, 2008). Conversely, directors with state experience are reluctant to select market oriented actions, and will instead favor state-related solutions. In our context, these subgroups are the likely coalition builders, but boards also have directors whose allegiance is undetermined because they have neither kind of experience or both.

The decision depends on the size of each subgroup and its coalition building actions.

Our interest is in whether the potential state or market coalition is stronger, so we can model the relative strength of either one. We model the *potential state coalition* and build hypotheses on its effects. To account for its numeric strength and commitment, we subdivide the board as follows: (1) Board members with two types of state experience, resulting in higher commitment to state solutions than (2) board members with just one type of state experience. (3) Board members with both state and market experience, making them weaker parts of the state coalition building than members with only state experience. (4) Directors with only market experience are adversaries. (5) Directors having neither kind of experience are unaligned and can become potential allies through cooptation.

Recruitment of allies is a part of the coalition building process and is contingent on specific features of the decision-making group and the decision. In decision-making groups that meet occasionally, such as boards of directors, interpersonal ties gained from prior shared affiliation, experience, and interest can be used to retain existing coalitions and recruit new members. Interpersonal ties often overlap with similar knowledge and views, so they are more useful for reinforcement than for recruitment. Specific characteristics of the alternatives being considered in a decision can also shape the recruitment of allies. For example, the perceived attractiveness of each firm considered for acquisition matters because state coalition members may not back a state-related acquisition if the target firm looks weak. Strong support of an alternative that later underperforms undermine the credibility of a director. Another example is that a director may have relations to alternatives that overturn the general orientation. If a director with no experience or with market experience only considers a proposed state-directed acquisition to rescue a firm from his or her home town, state-experience directors or local politicians may be able to persuade the director to support it. Such factors specific to each decision mean that the board composition alone does not determine the

decision. Each decision will differ, but we expect that the potential coalition shapes overall board responses strongly enough for the following hypothesis to hold:

Hypothesis 1: When performance compared with aspiration level triggers organizational change, a board with a stronger potential state coalition is less likely to choose market-oriented actions.

The converse reasoning can be used to argue that the potential state coalition will be more likely to select actions that appeal more to its members. The problem with making this hypothesis is that problemistic search in response to profitability is in itself an action associated with the market coalition rather than the state coalition. Thus, a realistic null hypothesis is that boards with a strong potential state coalition will lead to the firm not searching at all, because profitability is an insufficiently important goal. We can keep this null hypothesis in mind, but note that it makes a clearer prediction on the rate of searching than the choice of action, while the state coalition preference for specific state-related solutions will still be reflected in the actions taken, if the firm has any response to performance. The prediction is:

Hypothesis 2: When performance compared with aspiration level triggers organizational change, a board with a stronger potential state coalition is more likely to choose state-related actions.

Both hypotheses state that the sensitivity to performance relative to aspiration levels is greater for the type of action that best matches the strongest potential coalition in a board, either market or state. They are based on the logic that the decision maker experience and coalition building leads to decisions that match the experience of the potential coalition. While our main test of the theory is the extent to which firms choose market-oriented acquisition targets, we also have an additional empirical test through loans from state bank, an action preferred by the state coalition.

DATA AND METHODOLOGY

Data Sources

The first data source is the China Stock Market and Accounting Research (CSMAR) database, which covers the ownership, board, and financial data of all listed firms in China to date since 1992 (Li, Moshirian, Nguyen, & Tan, 2007; Lin & Su, 2008; Rousseau & Xiao, 2008). The second is the WIND database, which provides detailed information on firm M&As and loans, and has M&A date of announcement, type of acquisition, and nature of the acquisition. Some of the acquisitions were legally defined as mergers, but the data allow us to identify those with a clear acquiring and acquired partner. Thus, all events only occur once in the data. For loans, WIND has data on the lender and the stated purpose of the loans. We merged the WIND database with one-year lagged CSMAR ownership data, board data and fiscal year performance data. The dataset covered every M&A and loan application between 2000 and 2012 by all Chinese listed firms.

Dependent Variables

Type of acquisition. We estimate the choice of what target to acquire among the options of *internal*, *state-bridged*, and *market-oriented* acquisitions. Each acquisition target can be categorized by how distant it is from the usual state versus market actions, and hence what type of board member would see it as a more proximate option of change. For a state experience director, the closest type is (1) internal acquisitions, which is movement of assets or equity between firms with at least one common shareholder, similar to how firm assets were reorganized under state socialism by transferring them from one unit to the other. The middle is (2) state-bridged acquisitions, which are like M&As by two independent firms, but with the acquiring and target firm picked and facilitated by the state. The most distant is (3) market-oriented acquisitions, which are initiated because the target is seen as an opportunity for growth and value creation by the acquiring firm. These involve scouting

targets on the market, evaluating them using financial metrics, and taking risks in the acquisition decision. Accordingly, *Type of acquisition* is zero for an internal acquisition, one for a state-bridged acquisition, and two for a market-oriented acquisition.

Nature of acquisition. We further analyzed the nature of *market-oriented* acquisitions by distinguishing asset-transactions, minority share acquisitions, and majority control acquisitions. We rank them by level of market orientation, so *Nature of acquisition* is zero for acquisition of assets without any equity stake, one for acquisition of minority equity, and two for acquisition of a controlling equity stake. This outcome takes the analysis one step further by distinguishing the level of market orientation among acquisitions that are already of the most market oriented type, making it a stringent test of the theory.

We analyze these choices as an ordered logit in which higher values mean greater distance from state related actions. Table 1 shows a cross-tabulation of *type of acquisition* and *nature of acquisition* for all 31,442 acquisitions of equity or assets in the data. All analyses have repeated observations of the same firm, so we use robust standard errors with clustering on the firm.

=== Insert Table 1 about here ===

State-bank loan. The variable for state-bank loan takes the value of 1 when the loan is taken from a state-owned bank or a policy bank,² and 0 for loans taken from a commercial bank, either Chinese or foreign. It is thus a measure of the selection of source of loan, not of whether or not a loan is taken, and hence it is equivalent to the acquisition target measures. We analyze only loans of size exceeding of 1 percent of firm assets to avoid including minor loans in the analysis.

Independent Variables

² A normal state-owned bank is a commercial bank owned by the state. A policy bank has state policy objectives in addition to state ownership.

To test the hypotheses, we first calculated the proportion of board members with market or state experience. From the CSMAR database we had complete data on the resumes of each director, including a wide range of information that could be used to make indicators of director training and experience. Given our emphasis on market experience versus state experience we narrowed the information down to four indicators. For market experience, we calculate the proportion of board members owning shares in the company or having education or work experience in an Anglo-Saxon nation. Board members owning shares are (literally) invested in the market economy, and hence view it with greater interest. This produces greater attention and experience tracking market economy outcomes and seeking to understand market economy actions and outcomes. For state experience, we calculate the proportion of board members with work experience in a state agency or in a state-owned bank. These variables serve as indicators of experience and comfort with the market and the state, respectively, and are used as components of the measure on coalition formation.

Potential State Coalition. To test Hypothesis 1 on coalition formation, we made three measures of the potential state coalition. Two are new measurement approaches that match our emphasis on coalition building as a process involving groups that recruit allies to reach their favored decision, while the third is a heuristic measure that acts as a robustness test. The first measure was made by conducting a principal factor analysis of all boards using the proportions of board members with two sources of state experience, one source of state experience, both state and market experience, and market experience. The factor analysis efficiently combines the information in these proportions because they are correlated (they sum to unity), and the correlation reflects the extent to which state experience is replaced by the adversarial market experience or the neutral no-experience or both-experience categories. So far the measure captures the strength of the coalition through the number and commitment of directors. To also take into account board member status, we weighted each

board member linearly by age, setting the zero point to the youngest board member age. Age weighting is consistent with decision-making in Confucian societies and was the best fit when compared with a board tenure weight and a composite weight of central state experience, party membership, above-average age, and above-average tenure. The findings are shown in Table 2. The first factor has positive loading of two and one sources of state experience and both experiences, and negative loading of market experience, and shows that boards can be ordered by their potential for forming a coalition of members with state experience. We use this factor as a *stateness factor* coalition variable.

==== Insert Table 2 about here ====

The second measure was based on faultline theory (Meyer & Glenz, 2013; Meyer, Glenz, Antino, Rico, & González-Romá, 2014). Market and state experience were defined as binary characteristics that a board member could have either none, one, or both of, and the board was reduced to two groups using the Average Silhouette Weight (ASW) procedure, which has the best properties of the faultline measures (Meyer & Glenz, 2013). The largest of these groups, which always had a majority of members with either state, market, or no experience, was selected as the dominant coalition, and the *stateness ASW* was defined as the proportion of board members in this group multiplied with their average state experience (set to -1 for members with market experience and zero for members with both experiences).

The third measure heuristically assigned a *stateness proportion* equal to 1 when the board had more than half members with only state experience, equal to 0.5 when the board had more members with state-only than market-only and a sum of state-only and neutral (both or none) experience members exceeding p , and conversely the value -1 for majority market experience and 0.5 for market-only exceeding state-only and the proportion of market-only and neutral exceeding p . The

remaining were assigned the value zero. We display tables with p set conservatively to the high value of 0.75, but also tried p as low as 0.6, obtaining similar findings. This measure is heuristic and only accounts for member proportions, ignoring commitment and status, but its simplicity makes it a good robustness check.

These measures have different interpretation. The *stateness factor* takes into account the entire board composition, and thus indicates a compromise between groups with the dominant coalition having greater influence. The *stateness ASW* measures dominant coalition preference only, and multiplies it with the proportion of the board that belongs to the dominant coalition to take into account that a smaller dominant coalition may choose a less extreme decision. The *stateness proportion* is a heuristic measure of the strength of the state coalition, and also assumes dominance.

Following performance feedback research (Greve, 1998), we calculate the performance as return on assets (ROA), and subtract a historical aspiration level as the weighted average of the past performance with most of the weight (0.9) assigned to the most recent ROA (historical aspiration level), or as a social aspiration level as the average ROA of all other firms in the same industry, as defined by the three-digit industry code. The historical aspiration level weight was chosen by comparing all weights in intervals of 0.1 and choosing the one with best fit to the data. Each performance relative to the aspiration level is divided into performance above and below each aspiration level and interacted with the variables indicating board member experience.

Control variables. We controlled for the age of the firm in case it affects the market orientation of its acquisitions. We controlled for firm size by taking the logarithm of the firm's total assets. We also considered the impact of a firm's growth opportunities on acquisitions, using the market-to-book ratio. We included the debt-to-equity ratio to capture the potential impact of a firm's financial leverage on acquisition decisions, and captured prior acquisition experience as the cumulative

number of acquisitions of assets only, a minority stake, and a controlling stake of equity. We enter these three because correlation among the cumulative acquisition variables is too high to allow entry of more, and preliminary analysis showed that state-bridged acquisitions had the lowest explanatory power. We enter the percentage of free cash flow to control for the inefficient investments that firms may make when holding excess resources. We also included the diversification level of a firm, operationalized as the count of industries a firm engages in. Descriptive statistics and correlations are shown in Table 3, which shows that all the correlations are low to moderate except the alternative stateness variables, which are highly correlated as they should be.

=== Insert Table 3 about here ===

Methodology

The choice of what target to acquire can be modeled as an event history analysis with competing risks in which each of the targets has a separate regression function, or as a sequential model with the first step being an event history analysis of the rate of making acquisitions, and the second being a choice analysis of the target chosen. These approaches are statistically related (Hachen, 1988), but the sequential model best captures dependencies among the alternatives such as the ranking of market to state proximity. Thus, we choose the sequential model, estimating an event history model of the acquisition rate and forming an inverse Mills ratio to control for selectivity (Heckman, 1979), which is entered as a control variable in an ordered logit model of the target choice. When a firm makes multiple acquisitions in a day, these are assigned the same Mills ratio. This modeling approach means that the findings indicate choices rather than rates of change. We use the same sample of firms and acquisitions as in our earlier paper examining how institutional logics and board composition affected the rate of making acquisitions (Greve & Zhang, 2017). The hazard rate model reported in Table 2, Model 7 (Greve & Zhang, 2017: 685) is used to form the Mills ratio.

We show findings from an ordinary ordered logit, which assumes proportional odds and estimates one set of coefficients across outcome levels, but we also estimated a general ordered logit which estimates separate coefficients, finding that this model produces equivalent findings for the type of acquisitions but stronger support of the hypotheses for the nature of acquisitions. We show models both with and without year fixed effects because average stateness decreased over time, so just as models without year effects have unmeasured effects of annual events, models with year effects may attribute some stateness effects to the year fixed effect. The correct estimate is likely to be intermediate of these models.

RESULTS

Table 4 shows the ordered logit model of acquisition target type. The main effects of performance indicate that market-oriented acquisitions are more likely to be chosen when the performance is high relative to the historical aspiration level, but less as it is high relative to the social aspiration level. Thus, performance improvements produce the confidence to choose more market-oriented acquisitions, whereas higher performance than other firms induces caution. In Models 2 through 7, the interactions with the board stateness measures show support for Hypothesis 1 for performance above the historical aspiration level both without and with year fixed effects, as every coefficient estimate of the interactions shows that a stronger state coalition weakens the effect of performance on the choice of market-oriented acquisitions. Hypothesis 1 has full support above the social aspiration level without year fixed effects, but partial loss of significance with year fixed effects. Below the aspiration levels, there are significant coefficient estimates without fixed effects, but the significance is lost when the year fixed effects are entered.

Figure 1 graphs the estimated effect of the best-fitting Model 5, for firms that have low, average, and high stateness. The graphs display the predicted probability of the most market-oriented

outcome, and show a shift toward market acquisition when performance is above historical aspiration levels. For low-stateness boards the increase is from 50% to 75% probability of a market acquisition. Decisions shift away from a market acquisition when performance is above social aspiration levels, and for low-stateness boards the probability drops from 50% to 34%. The shift is smaller for average stateness boards, but is still statistically significant.³ For low stateness the curves are level, and the slopes are not significantly different from zero. The stateness ASW measure gives similar graphs.

=== Insert Table 4 and Figure 1 about here ===

The findings show that the effects of board composition are stronger above the aspiration level, as one would expect from the greater board discretion when the firm has high performance (Hambrick & Finkelstein, 1987). This finding is consistent with the upper echelons perspective. The findings below the aspiration levels are weak for firms with high or average stateness, whereas they are strong above the aspiration level for firms with average or low stateness. Although this study is unique in examining the content rather than rate of change, this finding is consistent with past studies showing that strategic changes are highly likely when performance is below the aspiration level, but do not become more likely as the performance declines further below the aspiration level, while the likelihood of changes declines steadily as performance increases above the aspiration level (e.g., Greve, 1998, 2003a; Miller & Chen, 2004). The graphs show that the responsiveness to the performance level is greatly reduced when the board has high stateness, as predicted.

Table 5 shows the analysis of the acquisition nature for the market-oriented acquisitions. This analysis thus examines a subset of acquisitions that already are highly market-oriented. It supports Hypothesis 1 above the historical aspiration level without fixed effects for the year, and these coefficient estimates remain significant in the fixed-effect model using the faultline measure (which

³ The test uses the Stata *test* statement with the stateness of the interaction variable set to the same value as in each curve.

has best fit to the data) and the proportion measure. Hypothesis 1 has full support above the social aspiration level with and without year fixed effects. Thus, there is a shift toward the market-oriented majority control acquisitions as a main effect, but the state coalition works against this effect. Again, a weak state coalition is an opportunity for the market coalition, especially when high performance gives managerial discretion that can be used to pursue acquisitions leading to a controlling ownership share (e.g., Hambrick & Finkelstein, 1987). Figure 2 shows the effects using the best-fitting Model 6, and is similar to Figure 1 except that the effect sizes are weaker overall, and the interaction effect with stateness is so strong that high performance and stateness predict that firms will avoid taking higher market orientation such as majority acquisitions. If a high stateness firm makes a market-oriented acquisition, which is rare, it is even less likely to do so following high profitability.

=== Insert Table 5 and Figure 2 about here ===

Next we present the analysis of loans in Table 6. Both without and with fixed effects, stateness works against the main effect of performance relative to the historical aspiration level, contrary to Hypothesis 2. Boards with low stateness avoid state banks when the performance is improving, but high stateness cancels this effect. The effects are graphed in Figure 3, using the best-fitting Model 6. Performance relative to social aspiration levels cannot be interpreted as indicating firm intentions because banks use the profitability compared to other firms to assess the loan risk, making these coefficients a mixture of firm and bank decision making. The findings show that firms with high stateness do not respond to the performance by changing the source of their loans, suggesting a boundary condition on the theory. The dominant coalition is influential in the presence of performance feedback on a goal it sees as important. This is why ROA, which is important for board members with market experience, affects acquisition choices provided the state experience board members do not form a dominant coalition. It is also why ROA has less effect on choosing loans

from state owned banks, as the state experience board members who are most interested in such loans are less responsive to ROA as a goal.

=== Insert Table 6 and Figure 3 about here ===

DISCUSSION AND CONCLUSIONS

This study was motivated by the missing follow-up of dominant coalition theory, leading to a gap of evidence on coalition building and decision making. Current theory of firm decisions is split between a highly realistic but complex view of dominant coalition building in the behavioral theory of the firm and the parsimonious but simpler view of upper echelon theory. We propose a middle ground that builds on upper echelon theory and adds a model of coalition building that takes into account that decision-making groups have multiple experience-based preferences, including neutral or ambivalent members who can be recruited as allies when building a coalition. The resulting faultlines can be modeled to predict potential coalitions based on member experiences, but features of each specific choice could make the realized coalition differ in each decision. To this model of coalition building, we add considerations from current research on how organizational decision making is triggered by performance relative to the aspiration level. The result is a behavioral theory of upper echelon decisions, adding to extant theory of organizational change.

Our theoretical and empirical contributions address three issues. First, we draw on dominant coalition theory and its process of recruiting allies to make theory linking decision-maker experience to predictions of the decisions of teams based on the size, commitment, and status of each subgroup. Second, we use this theory to develop empirical measures that can be used to identify the potential dominant coalition and its preferred outcome. Third, we make upper echelons predictions contingent on performance relative to aspiration levels, and thus combine theory on the composition of a decision making team with theory on the problem or opportunity that triggers a decision.

Theoretically this means that we connect the behavioral theory of the firm with upper echelon theory, which lets us examine coalition building and experience based on subgroup size, commitment, and status, and from this predict decisions.

We use the market transition in China to examine how boards of directors act differently depending on the firm performance and the proportion of directors with market versus state experience, and also taking into account how directors with none or both of these experiences can become potential allies recruited by each side. The boards can be characterized precisely by considering how coalition formation depends on the proportions of members with allegiance to each side, and analysis using factor analysis, faultline, or proportion measures produced consistent results. Thus, the general theory can be turned into specific hypotheses on how firms respond to performance in ways that match the most prevalent experience.

The empirical findings show that decision making was strongly affected by the dominant coalition of the firm, causing the solution resulting from search to be consistent with its experience. It was also highly contingent on the performance relative to aspiration levels. This is a novel finding in support of new theory that fills gaps in upper echelon theory and the behavioral theory of the firm. The empirical evidence is not just of theoretical interest, it also shows that director experience guides very consequential organizational actions. In each step from internal to state-bridged to market-oriented acquisitions, the board is moving the firm closer to a market orientation in its acquisition activities. The choice between a state-bridged and a market-oriented acquisition is important for the firm. State-bridged acquisitions have a safety valve because the state may support a firm that gets economic difficulties after taking over a weak firm as a rescue operation. They also have limited profits because the purpose of taking over such firms is not to restructure for increased efficiency and decreased labor use. Market-oriented acquisitions are the opposite. The acquiring firm has free hands

in what it can do to profit from the acquisitions, but it is on its own if the acquisition fails.

There are great opportunities for extending this type of investigation to other experiences and behaviors. For example, firms founded on financial, technological, and market considerations will have upper echelons with clear affiliation to different organizational units and different education. Just as such differences have been shown to influence changes in the selection criteria of CEOs over time (e.g., Fligstein, 1990), one can also examine whether top management teams direct the organization differently as a result of experience and education steering decision making (Cho & Hambrick, 2006; Hambrick, Cho, & Chen, 1996; Nielsen & Nielsen, 2013). There are already suggestions that director backgrounds matter for firm choices, such as responses to deregulation (Cho & Hambrick, 2006), engagement in corporate social responsibility (Chin, Hambrick, & Treviño, 2013), initiation of competitive moves (Hambrick et al., 1996), and strategic change (Haynes & Hillman, 2010). These have not yet been coupled with coalition building and performance in the way done here. A distinct feature of our theory is that the effect of decision-maker experience is contingent on the performance relative to aspiration levels, and this has not seen sufficient examination.

This investigation started with an important theoretical gap. The theory of dominant coalitions specified coalition building that could be specific to a decision, triggered by a decision-making occasion, orchestrated by a decision-making subgroup, and involving recruitment of allies from neutral and ambivalent decision makers. This realistic view of decision making has two features that are often missing from current research. First, recruitment of allies is rarely considered, so the theory of coalition formation and the methodology of measuring potential coalitions fall short of the original treatment (Cyert & March, 1963). Second, there is little consideration of how decision-making is triggered, such as when performance relative to aspiration levels indicates a problem or an

opportunity. We have made progress on examining decision-making occasions through theoretical integration with performance feedback theory and its examination of performance relative to the aspiration level. We have also made methodological progress through changing the focus from the rate of change to the content of change. Analyzing decision choices rather than decision rates is a better match of theory and methodology. We have also incorporated more of the dominant coalition theory into our hypothesis development through our consideration of how coalitions are built. Along with this theoretical progress we have made empirical progress by constructing measures of the potential dominant coalition through three different approaches, including one that originates in the currently active research on group faultlines.

The innovations in theory and methodology made here open the door for subsequent examination of different decision-making groups, decision-making occasions, forms of experience, and dimensions of coalition building. Coalition building is central to decision making at multiple organizational levels, and likely more so for decisions that involve high stakes for the decision-making groups and alternatives that are divisive along some dimension. Such decision making deserves additional investigation. Much more work can be done linking decision maker experience and decision outcomes, and we can also learn more about the decision making processes. Boards of directors could simply discuss a decision until reaching a resolution, but it is likely that an existing dominant coalition will also try to exert its influence across decisions through agenda control, information release, order of speech, and other procedural interventions. This investigation only scratches the surface of the theoretical and empirical progress that can be made by extending the theory of coalition formation and improving the methodology for conducting empirical tests.

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Table 1: Tabulation of Type and Nature of Acquisition

Type of Acquisition		Nature of Market-oriented Acquisitions		
		Asset only	Minority share	Majority share
Internal	11,769 (37.43)			
State-bridged	3,894 (12.38)			
Market-oriented	15,779 (50.18)	3,217 (10.23)	7,298 (23.21)	5,264 (16.74)
Total	31,442 (100.00)			

Cells show number of events and percentage (in parenthesis). Assets only, minority share, and majority share are subdivisions of market-oriented acquisitions.

Table 2: Principal Factor Analysis of Boards*Panel 1: Retained Factors*

Factor	Eigenvalue	Difference	Proportion	Cumulative
Factor1	0.77905	0.75456	1.4848	1.4848
Factor2	0.02450	0.05131	0.0467	1.5315
Factor3	-0.02682	0.22524	-0.0511	1.4804
Factor4	-0.25206	.	-0.4804	1.0000

Likelihood Ratio test of independent vs. saturated: $\chi^2(6) = 0.000$; $\text{Prob} > \chi^2 = 0.0000$

Panel 2: Factor loadings (pattern matrix) and unique variances

Variable	Factor1	Factor2	Uniqueness
Proportion w/market experience	-0.6178	0.0112	0.6182
Proportion w/state experience	0.6082	-0.0301	0.6292
Proportion w/both experiences	0.0992	0.1042	0.9793
Proportion w/two state experiences	0.1327	0.1122	0.9698

Table 3: Descriptive Statistics and Correlations ^a

	Mean	s. d.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Age	11.79	5.66	1															
2. Size	21.70	1.46	.10	1														
3. Market to book	1.90	1.60	-.12	-.34	1													
4. Debt to equity	2.06	16.63	.02	.04	-.05	1												
5. Free cash flow	2.00	9.15	.03	.03	-.05	.76	1											
6. Diversification level	2.21	1.53	.18	.12	-.16	-.00	.01	1										
7. Cumulative asset	5.66	7.19	.30	.24	-.08	.01	.03	.18	1									
8. Cumulative minority	3.56	5.86	.23	.32	-.07	.02	.00	.12	.25	1								
9. Cumulative control	2.97	4.38	.26	.33	-.09	.01	.02	.17	.72	.31	1							
10. Prop. state owner	0.23	0.25	-.24	.14	-.11	.00	.00	-.02	-.16	-.15	-.15	1						
11. Inverse Mills ratio	0.06	0.22	-.02	.11	-.08	-.00	.00	.03	-.02	-.02	-.01	.19	1					
12. Stateness factor	0.16	0.59	.17	.18	-.16	.03	.04	.07	.16	.02	.13	.10	.07	1				
13. Stateness ASW	0.32	0.71	.09	.04	-.11	.02	.01	.02	.03	-.04	.01	.19	.05	.65	1			
14. Stateness proportion	0.23	0.70	.12	.08	-.13	.02	.02	.01	.04	.02	-.01	.21	.06	.68	.77	1		
15. ROA – hist. AL	3.12	9.67	-.06	.10	.18	-.02	-.01	-.02	.03	.03	.03	-.03	-.02	-.02	-.07	-.04	1	
16. ROA – soc. AL	-0.73	9.82	-.06	.09	.05	-.01	-.01	.03	-.02	.00	-.02	.04	-.01	-.03	-.04	-.06	.89	1

^a A total of 2,337 firms and 28,847 observations comprise the data

Table 4: Ordered Logit Model: Type of Acquisition

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Fixed Effects Province	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Industry	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Year	N	N	N	N	Y	Y	Y
Age	-0.015** (0.003)	-0.012** (0.003)	-0.011** (0.003)	-0.011** (0.003)	-0.021** (0.003)	-0.020** (0.003)	-0.020** (0.003)
Size	0.125** (0.013)	0.125** (0.013)	0.121** (0.013)	0.122** (0.013)	0.040** (0.014)	0.033* (0.014)	0.035* (0.014)
Market to book	0.119** (0.009)	0.109** (0.010)	0.109** (0.010)	0.109** (0.010)	0.063** (0.011)	0.062** (0.011)	0.063** (0.011)
Debt to equity	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.000 (0.001)	-0.000 (0.001)	-0.000 (0.001)
Free cash flow	0.002 (0.002)	0.002 (0.002)	0.001 (0.002)	0.002 (0.002)	0.000 (0.002)	-0.000 (0.002)	0.000 (0.002)
Diversification level	-0.012 (0.009)	-0.011 (0.009)	-0.014 (0.009)	-0.012 (0.009)	0.001 (0.010)	-0.001 (0.010)	0.001 (0.010)
Cum. asset experience	-0.038** (0.003)	-0.037** (0.003)	-0.037** (0.003)	-0.036** (0.003)	-0.039** (0.003)	-0.040** (0.003)	-0.039** (0.003)
Cum. minority experience	0.030** (0.003)	0.028** (0.003)	0.029** (0.003)	0.029** (0.003)	0.022** (0.003)	0.023** (0.003)	0.024** (0.003)
Cum. control experience	0.032** (0.004)	0.032** (0.004)	0.031** (0.004)	0.030** (0.004)	0.021** (0.004)	0.020** (0.004)	0.019** (0.004)
Proportion state ownership	-0.777** (0.055)	-0.708** (0.056)	-0.686** (0.056)	-0.691** (0.056)	-0.148* (0.061)	-0.154* (0.061)	-0.166** (0.060)
Inverse Mills ratio	-0.032 (0.064)	-0.019 (0.064)	-0.023 (0.064)	-0.035 (0.064)	-0.093 (0.065)	-0.101 (0.065)	-0.113+ (0.065)
Stateness factor		0.157** (0.033)			-0.048 (0.037)		
Stateness ASW			-0.062* (0.028)			-0.103** (0.029)	
Stateness proportion				0.003 (0.030)			-0.051+ (0.030)
ROA- historical AL, < AL	0.024** (0.005)	0.038** (0.006)	0.036** (0.007)	0.038** (0.007)	0.003 (0.007)	0.003 (0.007)	0.005 (0.007)
X Stateness		-0.031** (0.010)	-0.016* (0.008)	-0.023** (0.008)	-0.012 (0.010)	-0.011 (0.008)	-0.015+ (0.008)
ROA- historical AL, >	0.059**	0.080**	0.074**	0.074**	0.044**	0.039**	0.039**

AL	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.006)	(0.006)
X Stateness		-0.067**	-0.035**	-0.041**	-0.044**	-0.023**	-0.029**
		(0.007)	(0.006)	(0.006)	(0.007)	(0.006)	(0.006)
ROA- social AL, < AL	-0.008	-0.023**	-0.019**	-0.020**	0.011+	0.014*	0.013*
	(0.005)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
X Stateness		0.030**	0.012+	0.018*	0.012	0.006	0.009
		(0.008)	(0.007)	(0.007)	(0.008)	(0.007)	(0.007)
ROA- social AL, > AL	-0.062**	-0.064**	-0.064**	-0.067**	-0.032**	-0.030**	-0.034**
	(0.005)	(0.005)	(0.006)	(0.005)	(0.006)	(0.006)	(0.006)
X Stateness		0.035**	0.016**	0.023**	0.019*	0.006	0.012+
		(0.007)	(0.006)	(0.007)	(0.007)	(0.006)	(0.007)
Log likelihood	-26,878.93	-26,797.04	-26,672.87	-26,811.41	-26,400.83	-26,278.75	-26,424.12
Likelihood ratio test	2582.12**	2745.9**	2994.24**	2717.16**	3538.32**	3782.48**	3491.74**
Degrees of freedom	128	133	133	133	145	145	145

+p<.10; *p<.05; **p<.01; two-sided hypothesis tests. Robust standard errors below coefficient estimates. 28,847 observations.

Table 5: Ordered Logit Model: Nature of Acquisition

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Fixed Effects Province	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Industry	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Year	N	N	N	N	Y	Y	Y
Age	0.005 (0.004)	0.006+ (0.004)	0.008* (0.004)	0.008* (0.004)	0.005 (0.004)	0.006 (0.004)	0.006+ (0.004)
Size	0.036* (0.018)	0.047* (0.018)	0.040* (0.018)	0.042* (0.018)	0.034+ (0.020)	0.028 (0.020)	0.030 (0.020)
Market to book	0.027* (0.012)	0.034** (0.013)	0.030* (0.012)	0.028* (0.013)	0.073** (0.015)	0.068** (0.015)	0.066** (0.015)
Debt to equity	0.002 (0.003)	0.002 (0.003)	0.002 (0.003)	0.002 (0.003)	0.009* (0.005)	0.009* (0.005)	0.009+ (0.005)
Free cash flow	0.005 (0.005)	0.005 (0.005)	0.005 (0.005)	0.006 (0.005)	-0.004 (0.005)	-0.004 (0.005)	-0.003 (0.005)
Diversification level	0.002 (0.014)	-0.004 (0.014)	-0.003 (0.014)	-0.002 (0.014)	0.014 (0.014)	0.014 (0.014)	0.016 (0.014)
Cum. asset experience	-0.009** (0.003)	-0.008* (0.003)	-0.009** (0.003)	-0.008* (0.003)	-0.001 (0.004)	-0.001 (0.004)	-0.001 (0.004)
Cum. minority experience	-0.020** (0.003)	-0.021** (0.003)	-0.021** (0.003)	-0.021** (0.003)	-0.027** (0.003)	-0.026** (0.003)	-0.026** (0.003)
Cum. control experience	0.033** (0.006)	0.033** (0.006)	0.033** (0.006)	0.031** (0.006)	0.012+ (0.006)	0.011+ (0.006)	0.009 (0.006)
Proportion state ownership	-0.741** (0.081)	-0.719** (0.081)	-0.675** (0.082)	-0.656** (0.082)	-0.159+ (0.089)	-0.167+ (0.089)	-0.155+ (0.089)
Inverse Mills ratio	-0.186+ (0.097)	-0.181+ (0.097)	-0.183+ (0.097)	-0.199* (0.097)	-0.304** (0.099)	-0.309** (0.099)	-0.324** (0.099)
Stateness factor		-0.055 (0.049)			-0.156** (0.055)		
Stateness ASW			-0.109** (0.040)			-0.080+ (0.041)	
Stateness proportion				-0.108** (0.041)			-0.077+ (0.042)
ROA- historical AL, < AL	-0.003 (0.008)	-0.004 (0.009)	-0.011 (0.009)	-0.004 (0.009)	-0.002 (0.010)	-0.005 (0.010)	0.001 (0.010)
X Stateness		0.017 (0.014)	0.025* (0.011)	0.006 (0.011)	0.025+ (0.014)	0.019+ (0.011)	0.001 (0.012)
ROA- historical AL, >	0.017* (0.008)	0.012+ (0.009)	0.019** (0.009)	0.015* (0.009)	-0.008 (0.010)	0.000 (0.010)	-0.003 (0.010)

AL	(0.007)	(0.007)	(0.007)	(0.007)	(0.008)	(0.008)	(0.008)
X Stateness		-0.019*	-0.026**	-0.021**	-0.009	-0.020**	-0.016*
ROA- social AL, < AL	-0.000	-0.000	0.003	-0.003	-0.003	-0.003	-0.008
X Stateness	(0.007)	(0.008)	(0.008)	(0.008)	(0.009)	(0.009)	(0.009)
ROA- social AL, > AL	-0.021**	-0.020**	-0.028**	-0.023**	-0.006	-0.013+	-0.009
X Stateness	(0.007)	(0.007)	(0.007)	(0.007)	(0.008)	(0.008)	(0.008)
		0.044**	0.042**	0.037**	0.035**	0.035**	0.030**
		(0.010)	(0.008)	(0.009)	(0.011)	(0.008)	(0.009)
Log likelihood	-14,337.69	-14,320.17	-14,261.66	-14,307.92	-13,796.04	-13,757.85	-13,797.57
Likelihood ratio test	982.22**	1017.26**	1134.28**	1041.76**	2065.52**	2141.90**	2062.46**
Degrees of freedom	127	132	132	132	144	144	144

+p<.10; *p<.05; **p<.01; two-sided hypothesis tests. Robust standard errors below coefficient estimates. 14,154 observations.

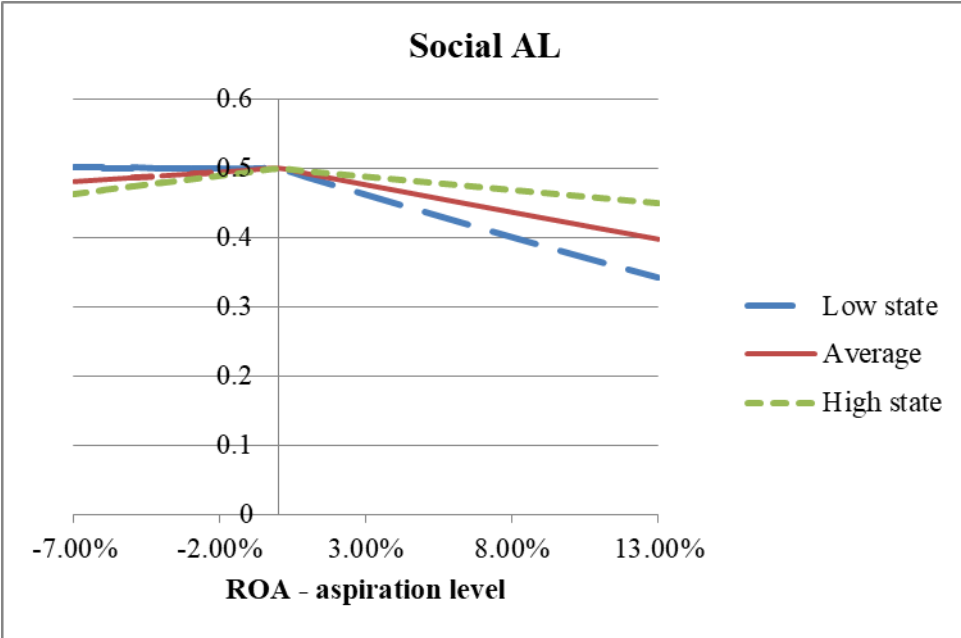
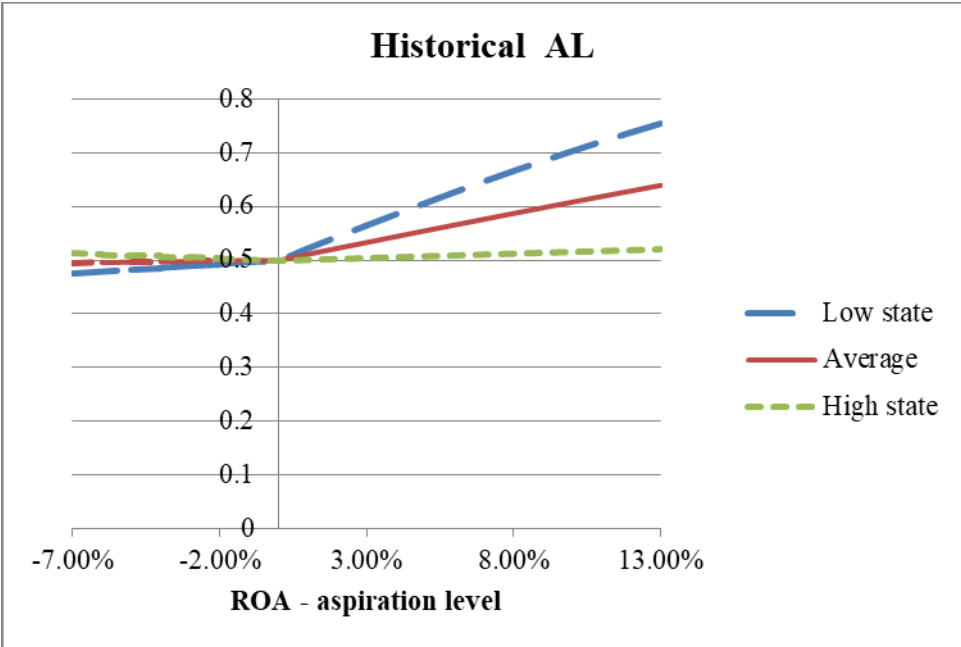
Table 6: Logit Model: State-bank Loan

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
Fixed Effects Province	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Industry	Y	Y	Y	Y	Y	Y	Y
Fixed Effects Year	N	N	N	N	Y	Y	Y
Age	-0.009+ (0.005)	-0.006 (0.005)	-0.009+ (0.005)	-0.008+ (0.005)	0.004 (0.005)	0.005 (0.005)	0.005 (0.005)
Size	-0.476** (0.026)	-0.456** (0.027)	-0.472** (0.027)	-0.469** (0.027)	-0.316** (0.029)	-0.313** (0.029)	-0.311** (0.029)
Market to book	-0.006 (0.019)	-0.002 (0.019)	0.005 (0.019)	0.011 (0.019)	-0.017 (0.023)	-0.016 (0.023)	-0.009 (0.023)
Debt to equity	0.034** (0.007)	0.034** (0.007)	0.035** (0.007)	0.035** (0.007)	0.025** (0.006)	0.025** (0.006)	0.025** (0.006)
Free cash flow	-0.073** (0.009)	-0.073** (0.009)	-0.074** (0.009)	-0.075** (0.009)	-0.055** (0.009)	-0.056** (0.009)	-0.056** (0.009)
Diversification level	0.024 (0.016)	0.011 (0.017)	0.022 (0.016)	0.019 (0.016)	-0.018 (0.017)	-0.015 (0.017)	-0.017 (0.017)
Cum. acquisition experience	-0.038** (0.006)	-0.035** (0.006)	-0.037** (0.006)	-0.037** (0.006)	-0.021** (0.006)	-0.021** (0.006)	-0.021** (0.006)
Proportion state ownership	1.317** (0.099)	1.257** (0.101)	1.265** (0.102)	1.294** (0.102)	0.262* (0.122)	0.232+ (0.123)	0.278* (0.122)
Inverse Mills ratio	-0.152 (0.100)	-0.138 (0.100)	-0.139 (0.100)	-0.152 (0.100)	-0.167 (0.105)	-0.155 (0.105)	-0.166 (0.105)
Stateness factor		-0.585** (0.070)			-0.209** (0.079)		
Stateness ASW			-0.221** (0.060)			-0.117+ (0.061)	
Stateness proportion				-0.334** (0.059)			-0.194** (0.063)
ROA- historical AL, < AL X Stateness	-0.030** (0.011)	-0.055** (0.012)	-0.053** (0.014)	-0.053** (0.014)	-0.007 (0.013)	-0.004 (0.014)	-0.004 (0.014)
		0.099** (0.020)	0.047** (0.018)	0.054** (0.019)	0.063** (0.019)	0.040* (0.017)	0.041* (0.019)
ROA- historical AL, > AL X Stateness	-0.045** (0.008)	-0.066** (0.009)	-0.067** (0.010)	-0.071** (0.010)	-0.023* (0.010)	-0.023* (0.010)	-0.025* (0.010)
		0.058** (0.015)	0.041** (0.012)	0.040** (0.012)	0.033* (0.016)	0.028* (0.012)	0.017 (0.012)
ROA- social AL, < AL	0.033**	0.061**	0.054**	0.063**	0.017+	0.009	0.018+

	(0.008)	(0.009)	(0.010)	(0.010)	(0.010)	(0.010)	(0.010)
X Stateness		-0.099**	-0.043**	-0.067**	-0.067**	-0.034**	-0.055**
		(0.014)	(0.012)	(0.012)	(0.014)	(0.012)	(0.012)
ROA- social AL, > AL	0.050**	0.052**	0.050**	0.050**	0.014	0.011	0.008
	(0.009)	(0.010)	(0.011)	(0.010)	(0.011)	(0.011)	(0.011)
X Stateness		-0.013	-0.006	0.006	0.000	0.000	0.024
		(0.017)	(0.014)	(0.014)	(0.018)	(0.014)	(0.015)
Likelihood ratio	-7,075.88	-7,032.70	-7,020.30	-7,053.60	-6,849.15	-6,810.63	-6,850.43
Log likelihood test	1810.98**	1897.34**	1830.26**	1763.66**	2264.44**	2249.6**	2170.00**
Degrees of freedom	44	49	49	49	61	61	61

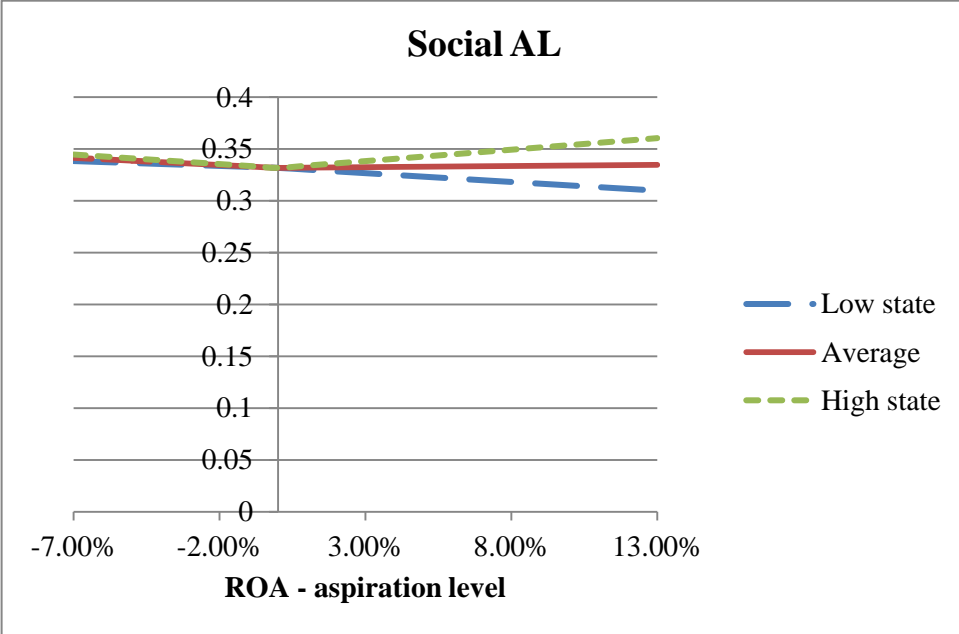
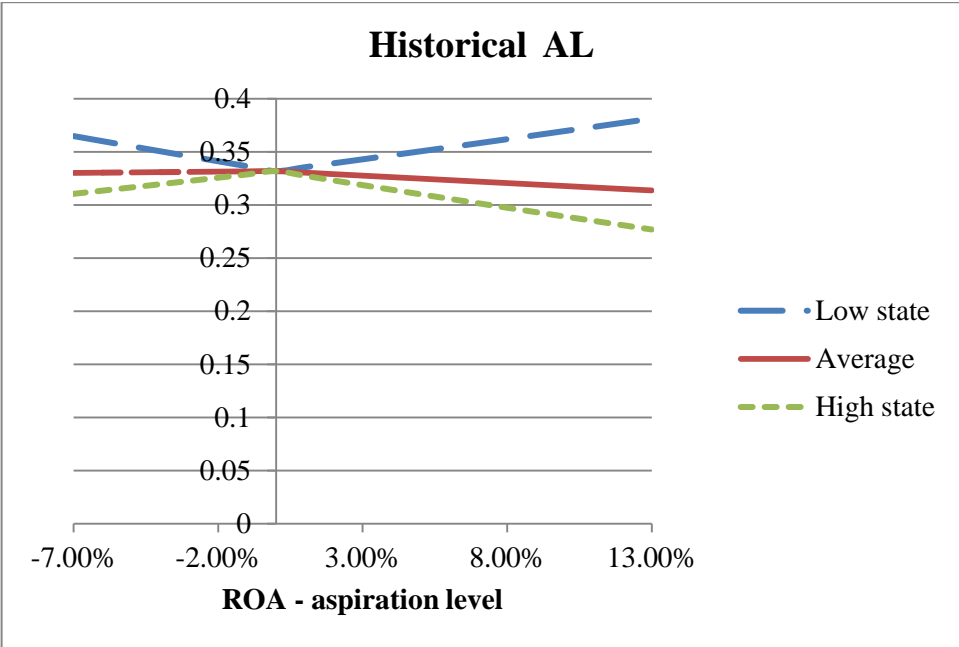
+p<.10; *p<.05; **p<.01; two-sided hypothesis tests. Robust standard errors below coefficient estimates. 16,823 observations

Figure 1: Probability of Market-oriented Acquisition by Stateness Factor



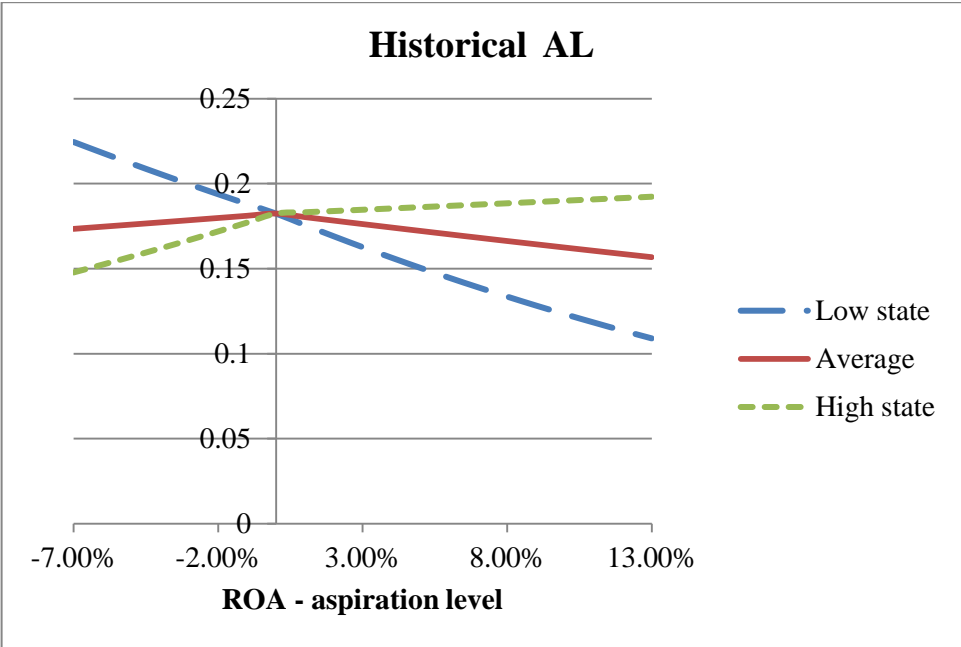
The probability is set to 0.5, which equals the full-sample proportion, when ROA equals the aspiration level. Low stateness means 10th percentile, and high stateness means 90th percentile.

Figure 2: Probability of Majority Ownership Acquisition by Stateness Factor



The probability is set to 0.33, which equals the proportion in the sample of market-oriented acquisitions, when ROA equals the aspiration level. Low stateness means 10th percentile, and high stateness means 90th percentile.

Figure 3: Probability of State Bank Loan by Stateness ASW



The probability is set to 0.18, which equals the proportion in the sample of loans, when ROA equals the aspiration level. Low stateness means 10th percentile, and high stateness means 90th percentile.

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