

< ABSTRACT >

**STAKEHOLDERS' INVOLVEMENT IN MERGERS AND ACQUISITIONS:
THREE EMPIRICAL STUDIES**

An abstract of dissertation presented

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1. INTROUCTION

This dissertation consists of three separate but inter-related studies with a common theme, namely, stakeholders' involvement in mergers and acquisitions (M&As). Different methodologies and viewpoints within stakeholder theory and the resource dependence perspective are used for the analysis. The first study investigates the market reaction of an acquisition announcement with respect to the acquirer's alliance partner and tests the negative association between the acquisition announcement and the market valuation of the alliance partner from the perspective of transaction cost. The second study addresses the influence of primary stakeholders (i.e., employees, shareholders, and lenders) on the likelihood of completing an announced M&A in order to investigate the motive for the reaction. The third study focuses on the relationship with stakeholders and its impact on the M&A. Specifically, the third study investigates why and how a common lender on both sides of the M&A influences the deal process and post-acquisition performance.

2. RESEARCH BACKGROUND AND OBJECTIVES

M&As are a popular strategic option; successful execution of an M&A and achievement of targeted financial and strategic objectives have become one of the most important issues for a firm's long-term sustainability. Therefore, how to undertake successful M&As from start to finish has garnered significant academic and business interest (King, Dalton, Daily, and Covin, 2004). Much academic literature on M&As has focused on measuring acquisition performance via strategic analyses and has paid attention mostly to the participants of M&As (e.g., Capron, 1999; Cartwright and Cooper, 1993; Chatterjee, 1986; Datta, Pinches, and Narayanan, 1992; Ravenscraft and Scherer, 1987).

On the other hand, management researchers have demonstrated stakeholders' strong influence on corporate business operations and firm performance, and have asserted the importance of appropriate stakeholder management for an organization's sustainable growth (e.g., Carroll, 1991; Freeman, 1984; Mason, Kirkbride, and Bryde, 2007). Stakeholders have a variety of channels by which to exert influence, which enables them to participate in a firm's strategic decision-making process (Preston and Sapienza, 1990). Therefore, stakeholders' responses to a firm's critical strategic decisions, such as an M&A, are one of the most important issues to manage for a successful M&A. Although researchers have recognized stakeholders' significant influence on a firm's business operations from various perspectives, only a few studies have addressed stakeholders in the M&A process.

According to stakeholder research, firms are surrounded by a variety of stakeholders who act strategically based on their relationship with the focal organization and react sensitively to situational changes that may affect their future benefits or losses (e.g., Frooman, 1999; Jawahar and McLaughlin, 2001; Rowley and Moldoveanu, 2003). Therefore, when stakeholders confront any event that accompanies massive changes in the business environment, I expect them to have a corresponding reaction to defend their existing power and benefits in their relationship with the focal organization. Furthermore, I expect the reactions of stakeholders with close relationships to firms to be clearly visible from the outside. Thus, this dissertation attempts to deepen the understanding of *why* and *how* various stakeholders respond to the focal firm's public announcement of an M&A in empirical settings by presenting three separate but inter-related studies.

The first study aims to examine the impact of post-formation events that occur to alliance partners, which are not necessarily anticipated at the formation of alliances, on the expected returns from their alliances. An M&A requires firms to engage in the restructuring of business portfolios and the integration of target firms as well as to commit enormous financial and human capital to acquisition-related activities (for a review, see Haleblian, Devers, McNamara, Carpenter, and Davison, 2009). Accordingly, an acquiring firm's alliance partners will suffer from unanticipated renegotiation or unintended dissolution of their alliances. The main proposition is that a firm's acquisition increases the governance costs of its alliance with an alliance partner, thereby reducing the expected value that the alliance partner can create through the alliance. Thus, the alliance partners of an acquirer can create less value from their alliances after the acquisition announcement.

The negative impact of the acquisition announcement of an acquirer on its alliance partner's market evaluations varies depending on the alliance and acquisition characteristics pertaining to asset specificity and transaction uncertainty. The number of past alliances between an acquirer and its alliance partner, technological alliances, industry relatedness of alliances, and acquisition transaction value influence the degree of the increase in the governance costs of an alliance, because these factors determine the asset specificity and transaction uncertainty of the alliance.

The second study focuses on three types of primary stakeholders—employees, shareholders, and lenders—and examines their influence on the likelihood of completing an announced M&A. I explore stakeholders' reactions, which reflect their anticipation of benefits and losses from the focal firm's balancing operations for the power and resources after closing

the proposed M&A, with an empirical analysis of longitudinal data for listed Japanese non-financial firms' M&As.

Employees anticipating benefits from the proposed transaction become strong supporters of the deal, making it easier for the acquirer to persuade them to cooperate and lowering the cost of closing the deal successfully. Thus, I expect that the target firm employees anticipate they would be better off after the transition, considering the higher compensation level for the acquiring firm's employees compared to that of the target firm's employees. This would encourage cooperation from the target firm's employees, resulting in a positive association with the deal completion probability. Unlike the compensation level, the larger work force of the acquirer firm could be recognized as a potential risk factor of the restructuring from the target firm employees' perspective. Therefore, the move would face resistance from the target firm's employees, resulting in a negative association with the likelihood of a deal completion. In the event of an M&A, *shareholders* eventually gain investment returns through dividends unless they sell their shares, and they automatically pay attention to the post-acquisition stage (Dorata, 2012). Since dividend propensity varies by company, owning shares in a firm that tends to offer high dividends is important for all investors. Thus, from the shareholders' perspective, the merged firm's dividend propensity is a considerably crucial point when deciding their response to the proposed transition. If the acquiring firm were to show a higher dividend propensity than the target firm, shareholders would be likely to cooperate with the deal, increasing the deal completion probability. Previous literature has demonstrated the *lenders'* benefits from the borrower's higher dependency on financial institutions (i.e., strong lender–borrower relationship), generating new business opportunities for lenders (e.g., Bharath, Dahiya, Saunders,

and Srinivasan, 2007; Drucker and Puri, 2005; Petersen and Rajan, 1994). Based on such findings, the target lenders are expected to respond positively to the proposed M&A once they recognize that the acquiring firm has higher dependency on financial institutions and potential business opportunities, thereby increasing the deal completion probability.

The third study asks the following questions. As a primary stakeholder, how does the lender react to a firm's M&A? How would the deal be influenced when the same lender advises both sides of the deal? How would this common lender's strong lender-borrower relationships influence deal progress and post-acquisition performance? Prior research on lending relationships describes various benefits to lenders and borrowers of a strong relationship, such as additional loans, fee-based advisory services, and a stable financial resource supply (Burch, Nanda, and Warther, 2005; Drucker and Puri, 2005; Yasuda, 2005). Based on such research, this study predicts that the existence of a common lender on both sides of the deal and the nature of lending relationships bring benefits and costs to the lender and borrower, such that the lender and borrower react and influence the deal progress and post-acquisition performance. I expect the common lender on both sides of the deal to reinforce the lending relationship with the borrower and, in turn, the lender's benefit, leading to the lender's cooperation in the deal. However, with the same lender on both sides of the deal, the borrower firm and its shareholders would consider the potential risks from over-centralized benefits to one lender, which may cause negative returns for the borrower, and therefore a negative association with post-acquisition performance. As for the common lender's relationships, the borrower's higher dependency on the lender in terms of loan amounts could be more beneficial to the borrower than to the lender (Dass and Massa, 2011), since a higher level of borrower dependency could imply a higher risk for the lender in

managing existing loans and business opportunities with other current “big” clients. Thus, lenders may cede profits in this relationship, probably creating a negative response to the deal from the lenders. However, a strong relationship between a borrower and lender is positively associated with the lender’s future returns.

3. MAJOR FINDINGS

The first study posed the following research question: why and how does an acquirer’s acquisition announcement influence the stock market valuation of its partner in a bilateral alliance? Using a sample of 347 alliances associated with 150 acquisition deals by Japanese public non-financial firms, I examined the research question using the event study method. The empirical findings of the study are summarized as follows. First, on average, an acquirer’s acquisition announcement leads to a negative abnormal return for its alliance partner. This finding corroborates my prediction that an acquisition conducted by a firm is expected to reduce the value the alliance partner derives from the alliance. Second, the negative impact of the acquisition announcement on the abnormal return varies depending on the alliance and acquisition characteristics. These characteristics determine the degree of unanticipated increase in an acquirer’s behavioral uncertainty caused by the acquisition and the alliance’s tolerance of the unanticipated increase. In terms of alliance characteristics, past alliance experience decreases the negative impact of acquisition announcements, whereas non-horizontal and technological alliance types increase the negative impact of acquisition announcements. As for acquisition characteristics, acquisition deal value and industry relatedness between a target and an alliance partner enhance the negative impact on the market valuation of the alliance partner. These findings suggest that the expected value of strategic alliances can be negatively influenced by

unanticipated post-formation changes, because such changes might increase the transaction hazard associated with an alliance. Through this mechanism, an acquirer's acquisition announcement triggers a negative market valuation of its alliance partners.

The second study posed the following question: do stakeholders influence the likelihood of completing an announced M&A and if so, how? This study analyzed data for M&As conducted by Japanese publicly listed non-financial companies from 1995 to 2012 in order to investigate primary stakeholders' influence on the deal completion probability. The findings from the empirical test are as follows. First, stakeholders influence the likelihood of completing announced deals. As existing stakeholder studies have indicated, stakeholders influence the focal firm's strategic decisions to defend their current benefits; this is in line with the findings in the present study, which extends the basis of this theory to include the M&A context. Second, stakeholders estimate their potential gains or losses when determining their responses to proposed M&As. Stakeholders prefer to maintain their current power and benefits in their relationship with a focal firm, even during a large-scale change, such as an M&A, and resist any potential risk of loss to their current benefits or position. However, once they recognize the potential benefits of the proposed changes, they become cooperative. The analytical results show that the target firm's employees react negatively to the acquisition process when the acquiring firm's employees outnumber them, assuring their job stability, and the lenders become supportive if the acquirer has a higher dependency on financial institutions to achieve new business opportunities.

The third study investigated the following question: does a common lender on both sides of the M&A influence the acquisition performance and if so, how? This research question

was empirically examined based on 18 years of M&A data in Japan. The findings from the empirical tests are summarized as follows. First, the existence of a common lender on both sides of the M&A has a negative association with CAR. This result corroborates the prediction reflecting the capital market's concerns over the possibility of excessive and biased benefits to the common lender. The existence of common lenders on both sides of the deal includes the possibility for lenders to wield larger power in the lender-borrower relationship. For example, through the common lending position, the lender can have "more than enough" insider information on both M&A participants, and this information monopoly may enable the lender to amend a loan agreement to their advantage when renewing the agreement or request for immoderate interest rates. In addition, the lender's monitoring authority may result in lender-oriented financial management decisions such as reducing dividends or investments, which could result in a negative response from the capital market to the existence of the common lender in the M&A deal.

Second, higher dependency of the borrowers on a common lender has a positive influence on the acquirer's CAR. In this case, the implication is that the capital market recognizes the acquirer's benefits in this strong relationship with the common lender. Specifically, the fact that the lender's awareness of the potential risk of losing all business post M&A potentially encourages the lender to forgo profits to maintain the relationship. Moreover, the acquirer may also gain the benefit of expanded service offerings from the lender in terms of corporate finance, which may enable the acquirer to obtain additional financial resources. Further, the acquirer could benefit from the lender's role as agent in the capital market to encourage other financial institutions and investors to positively view the acquirer's operating

performance and creditworthiness.

These findings describe the dynamics of stakeholders' reactions to M&As based on the lender–borrower relationship. In particular, the study accounted for common lenders' influence on M&As. Thus, the analysis found that each stakeholder in the M&A responded to its own future benefit or loss by considering the power of the common lender or borrower after the acquisition. Thus, these can be interpreted as M&A principles for stakeholder management.

4. THEORETICAL AND PRACTICAL IMPLICATIONS

The first study provides several theoretical and practical implications. As the first theoretical implication, I successfully proposed the dynamic view of strategic alliances and its performance implications by using the shift-parameter framework (Williamson, 1991). Previous studies of alliances have focused on the pre-formation conditions of alliances and their performance implications. In contrast, this study shifted its research focus to the impact of the post-formation conditions. From this viewpoint, I theoretically and empirically revealed the increase in the behavioral uncertainty caused by unanticipated changes, and how it shifts the transaction hazard of alliances, thereby influencing their expected performance. The findings of this study illuminate a novel antecedent of expected alliance performance: alliance partners' acquisitions. Although this study showed only acquisitions as significant changes, it surely enriches the alliance literature.

Second, I theoretically and empirically indicated that alliance partners' acquisitions, which are changes in contracting parties' preconditions for their transactions, work as a transaction shift parameter. The main research focus of TCE has been on transaction attributes and institutional environments as determinants of transaction costs (Chiles and McMackin, 1996;

Williamson, 1991). Pioneering work in TCE sheds light on the roles of contracting parties' characteristics in the governance mode choice, such as transaction-related capabilities (e.g., Hoetker, 2005; Leiblein and Miller, 2003; Mayer and Salomon, 2006). I further extended this line of research from a dynamic viewpoint: *Changes* in contracting parties themselves shift transaction hazards and influence performance consequences. If contracting parties' preconditions for a transaction change in an unanticipated way, this raises transaction uncertainty. This rise in transaction uncertainty increases transaction hazards and causes the alliance to incur additional transaction costs.

Third, this study successfully revealed the negative spillovers of acquisitions to alliance partners. The study is complementary to the work of Gaur *et al.* (2013), which empirically demonstrated the positive impact of an acquirer's acquisition announcement on the market valuations of its rivals. In other words, Gaur *et al.* (2013) examined the impact of a foe's acquisition and found the acquisition produces positive spillovers to its competing firms by signaling the presence of growth opportunities in their industry. In contrast, my study examines the impact of a friend's acquisition and finds that cooperative relationships can be spoiled by the negative spillovers of alliance partners' acquisitions because of unanticipated increase in behavioral uncertainty. As shown, acquisition spillovers have diverse aspects. By examining acquisition spillovers in a different context, the study contributes to the literature on acquisitions' spillover effects.

Practitioners can gain useful insights from the findings of this study. First, a firm engaging in an alliance has to pay attention to its alliance partner's actions outside the alliance. The stock market may react sensitively to acquisition actions by discounting the expected return

from the alliance. If a firm senses that an alliance partner is planning an acquisition, it should prepare for the negative spillovers arising from the acquisition. Second, a firm needs to design an alliance such that it can accommodate the disturbances generated by unanticipated events. In my analysis, non-horizontal alliances and technological alliances may have narrower tolerance zones for unanticipated uncertainty. Firms would be advised to form alliances that are either non-horizontal or technological, but not both, to make their alliances somewhat tolerant. Likewise, choosing reliable partners with previous alliance experience will make alliances more tolerant to unexpected disturbances provoked by external shocks.

The second study has several theoretical and practical implications. In terms of theory, this study successfully demonstrated the influence of external determinants on the success of an M&A, which enables an outward perspective in addition to the existing internal focus of existing research. This study concentrated on and provided empirical support for the role of stakeholders surrounding focal firms and M&As, previously not regarded as influential factors in management research.

In addition, this study successfully proposed dynamic settings when approaching stakeholders' interactions with firms. The management literature addressed stakeholder issues in a static business environment, and this study induced a dynamic perspective to capture the extemporary but fundamental motivation of stakeholders' responses. Moreover, this study considered stakeholders' motivations in their reactions from a dyadic viewpoint by addressing both the acquiring and target firms' stakeholders and comparisons to measure the influence on dependent variables.

For practitioners, the results of this study provide meaningful strategic screening criteria

when performing due diligence on a target firm. During the due diligence stage, the acquirer focuses on corporate valuation, risk assessment, and synergy estimation (Steynberg and Veldsman, 2011), with the scope now expanding to include integration and operational due diligence. However, this focus on the financial aspects and economic benefits of the acquisition and risk calculations rarely consider stakeholders, though they have a considerable influence after the announcement stage and into the post-acquisition period. Thus, this study demonstrated that firms need to consider stakeholders as potential obstacles to deal completion and devise effective plans to utilize them as valuable resources for a successful M&A.

The third study provides several theoretical and practical contributions. First, as a theoretical contribution, the findings expand the existing lender-borrower research horizon to include M&A events. In particular, by observing the influence of the common lender on both sides of the M&A, the study empirically examined and supported the role of the common lender as a reinforcing factor in the lending relationship. In addition, although existing lender-borrower relationship theories focus on the “static” status of the relationship (e.g., Bharath *et al.*, 2007; Dass and Massa, 2011; Drucker and Puri, 2005), this study sheds light on the “dynamics” of the changing relationship through the acquirer’s strategic transformation. Thus, this study provides insights on how the existing lending relationship is utilized based on a firm’s strategic actions.

Second, this research provides insights regarding stakeholder management theory. The findings describe the dynamics of stakeholders’ reactions to M&As based on the lender-borrower relationship. In particular, the study was able to account for the common lenders’ influence on an M&A. The role of the common lender on both sides of the deal has been found to reinforce the lender-borrower relationship and various lender benefits while there is a negative stock market

reaction to the acquirer due to the concerns around potential excessive lender benefits. In addition, the influence of the extent of the lending relationship and borrower dependence on the common lender was found to have a positive influence on the acquirer's post-acquisition performance. Thus, the analysis found that all stakeholders in the M&A responded to their own future benefits or loss by considering the power of the common lender or borrower after the acquisition. Thus, these can be interpreted as M&A principles for stakeholder management.

Last, the findings of this research offer practical management implications for the lender-borrower relationship. Beyond simply understanding the "static" characteristics of the relationship and potential benefits, the outcome here suggests a way to manage the relationship and related stakeholders. For example, when a common lender is identified in the beginning of the deal process, by understanding the nature of the lender-borrower relationship based on this study, proactive steps can be taken, such as requesting necessary advisory services from the common lender before asking other financial institutions, and thereby gaining stronger support from the lender for the deal. At the same time, based on the findings, the acquirer should control in advance its dependency on the common lender to avoid unnecessary concerns in the capital market.

5. LIMITATIONS AND DIRECTONS FOR FUTURE RESEARCH

Each of the three studies inevitably includes several limitations that illuminate potential avenues for future research. First, the first study did not reveal the long-term performance consequences of strategic alliances after acquisitions. Event study is an ideal method for capturing the immediate effects of acquisition announcements on the expected returns from alliances, but the method is heavily based on the market efficiency assumption. My results are subject to a caveat:

I assume that the stock market recognizes an acquirer's alliance partners and is able to compute the expected value from their alliances. If the stock market is not efficient, the abnormal returns of an alliance partner following an acquisition announcement would not accurately reflect the effects of the acquisition (Oler, Harrison, and Allen, 2008). In order to estimate acquisitions' impact on alliances more accurately, future research can confirm my findings by focusing on the long-term consequences of alliances, such as alliance performance and termination.

The Japanese context may be a second limitation of this study, because it may lower the generalizability of my findings. The Japanese societal culture is characterized as collectivism and long-termism (Hofstede, 2001). Accordingly, since firms in Japan may have stronger intentions to maintain interfirm cooperation than would those in countries with individualism and short-termism cultures, the negative impact of an acquisition on the market valuation of an alliance partner may appear smaller in the Japanese context. To check the generalizability of my findings, the same hypothesized relationships should be tested in different national contexts.

The second study is not without weaknesses. First, the research model in this study does not sufficiently account for all independent variables, since knowledge in the field is limited to finance scholars assessing post-announcement market pressures, such as competing bids and financial status (Weston, Siu, and Johnson, 2001), which demonstrated a strong influence in my analyses as well. Future studies could complement this research model by narrowing the research focus to specific stakeholder issues, including more subspecialized situations or sub-categorized stakeholder characteristics.

Second, the sample of this study is restricted to listed Japanese non-financial firms. The deal completion probability of my sample was extremely high (0.96), possibly due to the well-

mannered Japanese business culture (Cartwright and Cooper, 1993), especially the tendency to observe a commitment. Furthermore, employees' attitude toward job security, as well as the relationship with lenders and shareholders, should be considered in conjunction with the Japanese cultural context. This may decrease the overall generalizability of the findings. An analysis using data from another cultural context would add to this study's accountability and generalizability. Additionally, considering the increasing number of cross-border transactions (Muehlfeld, Sahib, and Witteloostuijn, 2012), a study of stakeholders and M&As in a cross-border setting would be interesting. Cross-border transactions are more complex, involving stakeholder relationships, cultural differences, and so on. Several earlier studies have noted the issue of culture in cross-border transactions and deal completion probability (Muehlfeld et al., 2012), but have not been able to exhaustively account for the effect of these factors on a successful acquisition. Thus, future research on cross-border transactions addressing stakeholder issues with deal completion would be meaningful and contribute to stakeholder, M&A, and international business research.

Finally, as an extension of this study, it would be interesting to examine the events following a deal's closure. This study postulated completion as a successful transaction in the short term. However, completion does not guarantee a successful integration process or increased firm performance. There remain some risks after closure, especially due to the remaining concerns from the surrounding stakeholders. This study explored stakeholders' immediate and extemporal responses to an announcement based on their anticipation of upcoming changes. However, during the integration stage, stakeholders will face a reality that diverges from their expectations. Thus, the predictors of higher deal completion probability may not be good

predictors of post-acquisition performance. Extending my research horizon to the post-deal stage would help clarify the dynamics of influential factors affecting the success of an M&A.

The analysis of the third study is based on listed firms' M&As in Japan. Japanese firms have a strong dependency on long-term bank loans, with a long history of maintaining the main banking system for economic development following the post-war period (Ogawa et al., 2007). Therefore, based on such national, regional, and cultural characteristics, the findings here could be misleading in terms of the overall lender-borrower relationships. In future research, these potential problems could be generalized by introducing more samples from various countries.

In this study, additional business opportunities for lenders, such as investment banking services, were regarded as among the most attractive future benefits that could arise from a strong lender-borrower relationship. However, in reality, many M&A participants hire independent M&A advisors such as investment banks and boutique firms, or accounting, tax, and legal advisors (Kale, Kini, and Ryan, 2003). If the borrowers on both sides of the deals have already hired those advisors independent of the lender, the expectation of benefits from the lender decreases. Future study could consider the independent advisor issue when addressing the lender-borrower relationship in M&As, and this could be theoretically and practically interesting and meaningful.

In summary, these three studies have built on prior theoretical and empirical foundations to prove and develop M&A and stakeholder research through various standpoints and methodological lenses. Overall, the analytical results have important theoretical and practical implications, and support the argument that stakeholders have significant influence on the process and results of a focal firm's M&A.

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