COMMENTARY: HOW GOVERNANCE MODES INTERTWINE OVER TIME: BEYOND AN EMBEDDEDNESS-BASED APPROACH TO POST-ACQUISITION DIVESTITURES

<table>
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<tbody>
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<td>Abstract:</td>
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</tr>
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</table>
COMMENTARY: HOW GOVERNANCE MODES INTERTWINE OVER TIME:
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DIVESTITURES

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Commentary on “Embeddedness across Governance Modes: Is There a Link between Pre-Merger Alliances and Divestitures?” by Oliver Schilke and Han Jiang (Academy of Management Discoveries, 2018)

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HOW GOVERNANCE MODES INTERTWINE OVER TIME:
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The paper “Embeddedness across Governance Modes” by Oliver Schilke and Han Jiang (2018) studies whether and how governance modes are intertwined over time. As such, this paper belongs to the literature in corporate strategy that aims at developing our understanding of firms’ sequential use of alliances, acquisitions, and divestitures (Villalonga & McGahan, 2005; Shi & Prescott, 2011). Combining insights from the literature on pre-acquisition alliances with arguments proposed by research on post-acquisition divestitures, the authors develop a very interesting approach to the impact of the use of pre-acquisition alliances on post-acquisition divestitures. In this commentary, we extend their analysis by revisiting their assumption on the factors driving post-acquisition divestitures. Instead of adopting a “reactive approach” to divestitures, considering that firms divest recently acquired entities when they cannot manage them, we develop a complementary argument based on the reconfiguration literature.

Schilke and Jiang argue that firms divest recently acquired entities when they are unable to successfully integrate them. Schilke and Jiang note that pre-acquisition alliances allow the acquirer and the target to have pre-acquisition interactions. They add that such interactions may generate interfirm trust, as well as providing fine-grained information regarding the compatibility of the firms’ corporate cultures, business procedures, and future strategic plans. Thus, pre-acquisition alliances can help eliminate many of the common hurdles associated with post-acquisition integration (PMI) processes. Based on this argument, the authors contend that there is a negative relationship between the use of pre-acquisition alliances and the likelihood of post-
acquisition divestitures. Using data retrieved from SDC, Schilke and Jiang provide support for their argument, which leads them to suggest that pre-acquisition alliances decrease the likelihood of post-acquisition divestitures by helping the acquirer to manage the acquired entity.

It is noteworthy that Schilke and Jiang assume that firms divest recently acquired entities when they cannot manage them. These authors thus consider that acquisition decisions are primarily motivated by anticipations about the quality of PMI processes. The authors claim that if a focal firm expects a smooth PMI with a given target (due, for instance, to pre-acquisition alliances), it is more likely to buy that firm, which is thus less likely to be subsequently divested. In contrast, if a firm expects that the acquisition of a given target firm will result in a hard and complicated PMI, it is more likely to refrain from that acquisition, anticipating that if acquired, the entity will eventually be divested. This argument is based on the assumption that in a corporate acquisition, an arms-length acquirer is less able to evaluate in advance how compatible the target is. As emphasized by Schilke and Jiang, a firm can use alliances to gather valuable informational clues regarding the corporate cultures, business procedures, and future strategic plans of a potential target (see also Balakrishnan & Koza, 1993; Reuer & Koza, 2000). The firm can then use this information to maximize the quality of the PMI phase. This, in turn, reduces the likelihood that the newly acquired entity will eventually be divested.

Even though Schilke and Jiang’s view provides key insights concerning the sequential use of alliances, acquisitions, and divestitures, it mostly pays attention to compatibility levels between the target and the acquirer. Schilke and Jiang’s view thus underestimates the role of information asymmetries as an alternative explanation. Specifically, numerous scholars have observed that it is very difficult for a firm to have complete information regarding the actual value of potential targets before the deal completion (Reuer, Shenkar, & Ragozzino, 2004; Chari & Chang, 2009) as
well as regarding the targets’ behaviors in the PMI phase (Malhotra & Gaur, 2014). This difficulty, in turn, may either discourage firms from entering into acquisitions or result in the newly acquired entities being eventually divested (Akerlof, 1970; Capron & Shen, 2007). This idea is important because when combined with the RBV-based reconfiguration literature (Karim & Capron, 2016), it provides an alternative explanation regarding the impact of pre-acquisition alliances on post-acquisition alliances to the one proposed by Schilke and Jiang.

The resource-based view of the firm suggests that firms may pursue growth opportunities if they are able to mobilize the resources that such opportunities require. Hence, given constant environmental changes, firms’ ability to sustainably pursue growth opportunities hinges upon their ability to alter their resource bases. Building on this idea, the reconfiguration literature highlights that firms may add, redeploy, and recombine resources via internal development, alliances, and acquisitions (Karim & Capron, 2016). In essence, this literature suggests that 1) firms undertake acquisitions in order to access sought-after resources from targets and 2) firms divest entities that mobilize useless resources, that is, resources that do not provide any synergistic gains. We next examine the impact of pre-acquisition alliances on post-acquisition divestitures by combining this literature with the work on the existence of information asymmetries in corporate acquisitions.

The first building block in the logic is that the use of pre-acquisition alliances helps reduce information asymmetries regarding the resources owned by potential target firms as well as regarding the way these resources may be combined with the acquirer’s resources to yield synergistic gains (Balakrishnan & Koza, 1993; Porrini, 2004; Uhlenbruck, Hitt, & Semadeni, 2006). Along this line of reasoning, Zaheer, Hernandez, and Banerjee (2010: 1075) emphasize that “A prior alliance with the target can give the acquiring firm detailed information about the organization that allows the acquirer to assess how much synergy to expect.” We advance this
view one step forward by suggesting that the use of pre-acquisition alliances reduces the likelihood of post-acquisition divestitures. Specifically, pre-acquisition alliances, by providing informational clues regarding the possession and location of the sought-after resources as well as regarding the behavior of the target in the PMI phase, minimize the likelihood that the acquisition of the target does not produce the expected synergies, because of either hidden information or hidden action. Ultimately, pre-acquisition alliances may allow firms to maximize their likelihood to extract synergistic gains from the acquisitions which, in turn, may reduce their likelihood to engage into post-acquisition divestitures.

It is worth mentioning that both our view and Schilke and Jiang’s relate to the accumulation of information via alliances. While Schilke and Jiang focus on information regarding the target’s compatibility—as thoroughly discussed through the role of embeddedness on PMI processes—, we focus on information about the target’s resource endowment and expected post-deal behavior. Both types of information are likely to influence the role played by pre-acquisition alliances on post-acquisition divestitures. Specifically, pre-acquisition alliances do not only provide informational clues about the compatibility of the firms’ cultures, routines, and processes; they also provide valuable information about whether potential target firms own the sought-after resources and whether the acquirer will be able to extract synergies from these resources. In other words, firms have to deal with coordination issues (stemming from misfit and incompatibility) and cooperation issues (stemming from misaligned incentives of self-interested agents), both through the *ex-ante* problem of adverse selection and the *ex-post* problem of moral hazard (Gulati, Wohlgezogen, & Zhelyazkov 2012; Malhotra & Lumineau, 2011). Coordination and cooperation issues are likely to coexist and be reinforced by the same contingencies. For instance, geographic distance is likely to hamper efforts by potential acquirers to assess the target firms’ compatibility;
it is also likely to limit their abilities to assess whether sought-after synergistic gains will be achievable. In contrast, the use of financial intermediaries, such as investments banks, is likely to provide key information regarding both compatibility-related issues and issues related to hidden information and hidden action (Reuer, Tong, & Wu, 2012; Sleptsov, Anand, & Vasudeva, 2013).

To summarize, we applaud Schilke and Jiang’s analysis as it clearly advances our understanding of how governance decisions are socially embedded in ongoing social relationships. However, their compatibility-based argument could be extended with a reconfiguration logic: pre-acquisition alliances help alleviate information asymmetries about the resources owned by the acquisition target and how achievable the expected synergies are. Our hope is that these two complementary approaches and further consideration of both cooperation and coordination issues will serve to broaden directions for future inquiry into governance trajectories (Argyres & Liebeskind, 1999; Anand, Mulotte, & Ren, 2016; Oliveira & Lumineau, 2017), as how different governance modes may be intertwined over time has not been thoroughly elucidated to date. Specifically, we encourage research aimed at distinguishing the pre-acquisition alliances that provide information regarding compatibility-related issues and the pre-acquisition alliances that provide information regarding potential targets’ resource endowment and post-acquisition behavior. For instance, scholars could conduct qualitative research to identify the type of information collected in different pre-acquisition alliances. Scholars may also examine whether equity vs. non-equity alliances provide a potential acquirer with similar information about its partner. More generally, we welcome more research investigating how fine-grained information regarding potential alliances partner or acquisition targets influences firms’ decisions to sequentially undertake various governance modes, including internal development, alliances, acquisitions, and divestitures.
REFERENCES


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