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## Article

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POINT OF VIEW

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# When firms learn from prior acquisition experience

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## Abstract

Acquisition experience is commonly viewed as an important determinant of subsequent acquisition success. Yet, empirical evidence suggests that acquisition experience may not be positively associated with acquisition performance and could even hurt performance. In this article, we highlight specific practices that facilitate and impede learning from acquisitions and draw implications for managers. In particular, we suggest that managers (1) expand time between acquisitions, (2) implement strong governance mechanisms and top management team diversity, (3) use similar-context experience, (4) avoid herding behavior in acquisitions, and (5) minimize blind reliance on financial advisors to effectively transfer prior acquisition experience into acquisition success.

**Keywords:** Acquisition experience, Acquisition transfer, Acquisition performance

## Introduction

Acquisitions are major strategic initiatives allowing the firm to grow, gain access to valuable assets and know-how, redeploy existing capabilities to new and underexplored markets, and achieve competitive advantage (see for review, Haleblan et al. 2009). Evidence shows the volume of global acquisition activities has seen a steady growth over the last decade with recent statistics showing that 2017 marked the fourth consecutive year of annual M&A deals exceeding 3 trillion dollars (Massoudi et al. 2017). Not surprisingly, acquisitions have received considerable attention by academics and practitioners. An important question that drives a significant amount of research is focused on approaches to extract greater acquisition value.

One seemingly obvious factor that should enhance acquisition performance is acquirer acquisition experience. Intuition, as well as theory on organization learning, suggests firms with more acquisition experience should perform better on their acquisitions than firms with limited acquisition experience. Specifically, it would be expected that firm managers learn from prior experiences and should encode such experience into organizational routines and practices (Nelson et al. 1982), which should benefit firms on subsequent acquisitions. Yet, empirical findings on the relationship between acquisition experience and acquisition performance show that acquisition experience is not associated with positive performance and is often even negatively related (see for review, Barkema and Schijven 2008). This finding suggests that learning from acquisitions is not automatic and is a complicated endeavor (Zollo and Singh 2004; Zollo and

Winter 2002). Acquisitions are idiosyncratic and distinct from each other, so applying acquisition experience to a current acquisition may be harmful. Firms assume they can learn from their experiences and attempt to do so even when those experiences are likely to be uninformative or otherwise ambiguously related to future decisions (Kardes et al. 2005). This is akin to the concept of “superstitious learning” from learning theory, which takes place when the connection between the cause of an action and the outcomes experienced are misattributed (Levitt and March 1988). Contrary to expectation for the positive benefits of acquisition experience, then, managers often inappropriately generalize acquisition experience to subsequent dissimilar acquisitions (Haleblan and Finkelstein 1999), which often hurts acquisition performance. Empirical findings also show that experience with prior small related acquisitions is negatively related to post-deal performance of large acquisitions (Ellis et al. 2011). Hence, if managers have conducted small, related acquisitions and transfer that experience to subsequent large deals, the firm loses value.

Although these are discouraging findings, we argue that under specific circumstances firms can effectively learn from acquisition experience. Specifically, we make the case that firms should not blindly follow the acquisition experience of external actors. Moreover, firms should emphasize internal arrangements that provide executives with sufficient time, skills, and motivation to diligently apply prior experience to subsequent acquisitions. We integrate extant research on acquisition experience in order to outline organizational design practices that facilitate managers to learn more effectively from acquisition experience.

## **Practices undermining successful learning from acquisition experience**

### **Herding behaviors**

Research outside the context of acquisitions shows that firms benefit from vicarious learning, which is learning through the observation of other firms’ strategic choices (Ingram and Baum 1997; Shaver et al. 1997). The vicarious learning rationale behind these arguments is that a focal firm can explore different ways of conducting tasks without experiencing the costs and risks associated with experimenting with those tasks (Miner and Haunschild 1995). In terms of acquisitions, the focal acquirer can observe and then repeat the acquisition choices of other firms. However, observing others does not automatically translate into learning because “knowledge does not transfer easily between organizations” (Baum and Ingram 2002: 5). Trying to follow rivals without understanding the motives and underlying capabilities behind rivals’ behaviors often damages the focal firm, especially in contexts of intense competition.

One such context is merger waves (defined as periods of time with increased rate of activity which is sustained for a limited time period before returning to the previous level of merger frequency). Over 50% of acquisitions that occurred over the last century took place in merger and acquisition waves (Stearns and Allan 1996). In fact, the observation that mergers and acquisitions often occur in waves is one of the “most consistent empirical features of merger activity” (Andrade et al. 2001: 104). During acquisition waves, later movers within the wave tend to follow the actions of early movers (Haleblan et al. 2012). However, research suggests that follower firms who succumb to competitive pressures and engage in herding behavior by pursuing acquisitions are

penalized by the market (Carow et al. 2004; McNamara et al. 2008). Thus, in the context of acquisitions, attempting to learn from the experience of other firms carries a high risk of merger and acquisition failure. To prevent this, firms might design manuals with detailed instructions and guidance on prioritizing due diligence, and avoid following the crowd in acquisition processes.

### **Relying blindly on financial advisor acquisition experience**

It has been speculated that acquirer acquisition experience is unreliable because firms lack objectivity and would be better served by more objective outside advisors, such as investment banks. However, research shows that markets are also suspicious of investment bank acquisition experience and react negatively rather than positively to such experience (Steinbach, Haleblan & McNamara, WP). A caveat to this finding is that when investment banks have a significant amount of focused experience in the target industry, this increases experience relevance and, under such conditions, the effects of advisor acquisition experience are more likely to become positive.

Research also shows that the degree to which firms follow investment bank recommendations or “discount” that advice and rely instead on their own insights to make their final decision impacts whether acquisition experience has positive effects (Brehmer and Hagafor 1986; Harvey and Fischer 1997; Yaniv 2004). Acquirers knowledgeable regarding their decision are more likely to discount advice and rely on their own set of information to make a decision (Godek and Murray 2008; Yaniv 2004; Yaniv and Choshen-Hillel 2012), which results in better decisions. Research shows that acquirers pursuing a target in their own industry are equipped with the industry-specific experience that can contribute to their own decisions and enable them to discount the advice of their investment advisor. Relatedly, prior research has shown that related acquisitions perform better than acquisitions of targets in industries in which the acquiring firm has no prior experience (Morck et al. 1990; Schijven and Hitt 2012; Seth 1990), which provides evidence that such acquirers do not need to rely on irrelevant experience brought forth by investment advisors. Thus, when assessing investment banker advice, focused, relevant experience from advisors yields acquisition benefits, especially when supplemented with own firm experience on related acquisitions. The creation of and adherence to codified tools and manuals (Heimeriks et al. 2012; Zollo and Singh 2004) containing blueprint for balancing financial advisors’ acquisition expertise with firm’s own acquisition experience are likely to lead to successful application of prior acquisition experience to subsequent acquisition deals.

### **Practices facilitating successful learning from acquisition experience**

#### **Expanding time between acquisitions**

There has been a long-standing argument that the time between subsequent acquisitions is of essential importance to the impact of prior acquisition experience on subsequent acquisition outcomes (see for review, Shi et al. 2012). Scholars have argued that when acquisitions are equally paced in time (about 6- to 12-month intervals), managers are better able to utilize prior experiences to obtain positive acquisition returns (Hayward 2002). If acquisitions are too close to each other and conducted over a short period of time, it is hard for managers to assess what worked and what did not work in

prior acquisitions (Haunschild et al. 1994) because they have to jump to the next deal. If acquisitions are too distant from each other, the inferences from prior deals might be obsolete or unavailable because people that were engaged in acquisitions have left the firm (Hayward 2002).

Emerging research is also showing that progressively expanding intervals—when time between subsequent acquisitions systematically expands over time—might be the most appropriate approach for capturing prior acquisition experience (Bingham et al. 2015b). Interviews with experienced acquirers show that expanding practice may result in strong acquisition performance for multiple reasons. First, expanding practice reduces the cognitive overload by providing managers with more time to learn from prior acquisitions and absorb new knowledge (Cohen and Levinthal 1990); as a result, each subsequent deal is given greater priority and can be conducted more diligently. In addition, expanding practice can confer benefits of stability by allowing executives to develop rules and routines necessary for the transfer of collective knowledge on how to conduct acquisitions. Moreover, expanding practice facilitates preparation and coordination of resources. As time between deals progressively expands, executives have more opportunities to coordinate the various functions involved in the acquisition process and thus improve the likelihood of acquisition success (Bingham et al. 2015a). Finally, increasing time between deals helps the acquiring firm to integrate and assimilate target firm personnel which is key to capturing synergies between the two firms (Graebner 2004). Accordingly, the manner in which firms schedule their acquisitions over time—especially if the time between deals is increasing—appears to enhance the likelihood of firms benefitting from acquisition experience. Building dedicated corporate teams from the acquiring and target firms (Bingham et al. 2015b; Kale et al. 2002) provides the necessary human resources to slowly and diligently digest existing acquisition experience and effectively apply it to future acquisition deals.

#### **Drawing on strong governance mechanisms**

Emerging research is beginning to show that managerial oversight enhances the relationship between firm acquisition experience and acquisition performance (Schijven et al. 2017). Two broad motives drive acquisition behavior: value enhancement and private interest. CEOs that pursue acquisitions and view them as opportunities to increase firm value tend to argue for synergies, access to superior information, and/or attempts to obtain market power. By contrast, personal interests such as increasing compensation, discretion, and bargaining power may also drive CEO acquisition decisions (Devers et al. 2013). Recent work shows that where there are strong internal and external governance mechanisms firms are more likely to have positive results from their acquisition experience because those governance mechanisms compel managers to use their acquisition experience for firm value enhancement (Schijven et al. 2017). As a result, firms should structure boards of directors that are independent of managerial influence, design CEO compensation that is heavily stock-based, and facilitate the presence of institutional investors as monitoring mechanisms.

#### **Facilitating top management team diversity**

The quality of top management teams makes a difference as to whether the firm benefits from its acquisition experience. Top management teams are directly involved in

various stages of the acquisition process, such as target identification, negotiation and price determination, and post-merger integration (Parola et al. 2015). Research also shows that the composition of the top management team is a key determinant as to how team members utilize prior firm acquisition experience. Top management team tenure and educational heterogeneity have been shown to reduce the likelihood of mis-transferring lessons from prior acquisitions and aid managers to optimize lessons from acquisition experience (Nadolska and Barkema 2014). Specifically, diversity among top management teams allows for sharing of different ideas and viewpoints, thorough evaluation of multiple alternatives, and effective problem detection and solution (Cox et al. 1991; Wiersema and Bantel 1992), which leads to improved team effectiveness (Gruenfeld et al. 1996). As a result, a diverse top management team can comprehensively compare various acquisitions, diligently identify the differences between them, and correctly transfer skills and experiences from prior acquisitions to current ones. Indeed, top management team diversity positively moderates the impact of prior acquisition experience on acquisition success. Hence, firms should actively try to build heterogeneous top management teams that play a positive role in the relationship between acquisition experience and acquisition performance.

Summary of the practices that facilitate and undermine firm ability to learn from acquisition experience is presented in Table 1 below.

## Conclusions

In sum, although prior research provides evidence that acquisition experience often has a negative impact on acquisition performance, this negative impact can turn positive (see Table 1).

Acquisitions are inherently complex strategic actions in which each acquisition is unique. Accordingly, prior acquisition experience cannot be applied in a wholesale manner to a current acquisition. However, key factors may appropriately generalize from one acquisition to another. Prior research shows that such appropriate application of experience occurs more frequently when a target is (a) more related to the acquirer's industry (Haleblan and Finkelstein 1999) or (b) more similar to prior targets the acquirer has bought (Finkelstein and Haleblan 2002). Appropriate generalization of experience may also be more likely to occur when the timing of acquisitions is sufficient for prior experience to be absorbed. The existence of good governance mechanisms, such as independent boards and significant amount of shares owned by the CEO and institutional investors, and quality top management team, such as one with greater diversity, are also conditions in which acquisition experience is more likely to yield positive outcomes. However, generalizing experience from external actors has not led to expected benefits. Simply following the lead of other firms that also acquire, such as during merger waves, or relying on the experience of experienced investment banks, does not contribute to positive outcomes from acquisition experience. Thus, firms need to reflect on its

**Table 1** Practices that facilitate and undermine firm ability to learn from acquisition experience

Practices facilitating successful learning	Practices undermining successful learning
<ul style="list-style-type: none"> <li>- Expanding time between acquisitions</li> <li>- Drawing on strong governance mechanisms</li> <li>- Facilitating top management team diversity</li> <li>- Using similar-context acquisition experience</li> </ul>	<ul style="list-style-type: none"> <li>- Applying acquisition experience to dissimilar contexts</li> <li>- Herding behaviors</li> <li>- Relying blindly on financial advisor acquisition experience</li> </ul>

own acquisition experience with sufficient time to digest the experience in which differences of opinion and careful oversight of the application of experience lead to the best outcomes.

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