ADVANCES IN MERGERS AND ACQUISITIONS

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ADVANCES IN MERGERS AND ACQUISITIONS

EDITED BY

CARY L. COOPER
Alliance Manchester Business School, UK

AND

SYDNEY FINKELSTEIN
Tuck School of Business, USA

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ABOUT THE EDITORS

Cary L. Cooper is the Author and Editor of more than 175 books and is one of the Britain's most quoted business gurus. He is The 50th Anniversary Professor of Organizational Psychology and Health at Alliance Manchester Business School, University of Manchester, UK. He is the Past President of the Chartered Institute of Personnel and Development, Past President of the British Academy of Management, a Companion of the Chartered Management Institute and one of only a few UK Fellows of the (American) Academy of Management, past President of the British Association of Counselling and Psychotherapy and Past President of RELATE. He was the Founding Editor of the *Journal of Organizational Behavior*, former Editor of the scholarly journal *Stress and Health* and is the Editor-in-Chief of the *Wiley-Blackwell Encyclopaedia of Management*; now in its 3rd edition. He has been an Advisor to the World Health Organisation, ILO, and EU in the field of occupational health research and well-being, was Chair of the Global Agenda Council on Chronic Disease of the World Economic Forum (2009–2010, and a Member of the Global Agenda Council on mental health of the WEF) and is Immediate Past Chair of the Academy of Social Sciences (comprising 47 learned societies in the social sciences and 90,000members). He was awarded the CBE by the Queen in 2001 for his contributions to organizational health and safety; and in 2014 he was awarded a Knighthood for his contribution to the social sciences.

Sydney Finkelstein is the Steven Roth Professor of Management and Director of the Center for Leadership at the Tuck School of Business at Dartmouth College, where he teaches courses on Leadership and Strategy. He also has experience working with executives at Dartmouth and other prestigious universities around the world. He holds degrees from Concordia University and the London School of Economics, as well as a PhD from Columbia University in Strategic Management. Professor Finkelstein has published 23 books and 85 articles, with several bestsellers, including the #1 bestseller in the USA and Japan, *Why Smart Executives Fail*. On *Fortune Magazine*'s list of *Best Business Books*, the *Wall Street Journal* called it "a marvel – a jargon-free business book based on serious research that offers genuine insights with clarity and sometimes even wit … It should be required reading not just for executives but for investors as well." His latest bestselling book is *SUPERBOSSES: How Exceptional Leaders Master the Flow of Talent*, which was named one of Amazon's "Best Books" on business and leadership for 2016. LinkedIn Chairman Reid Hoffman calls it "a leadership guide for the Networked Age." Professor Finkelstein is a Fellow of the Academy of Management. He has had three books nominated for the Academy of Management's Terry Book Award, the most prestigious such honor in the field. He is a recognized thought leader on leadership, strategy, and corporate governance, and is listed on the "Thinkers 50," the most prestigious ranking of management thinkers in the world. He is well known for his keynote speeches and television appearances, and is a regular columnist for the *BBC*.

ABOUT THE AUTHORS

Mohammad Faisal Ahammad is a professor of International Business & Management at Leeds University Business School, University of Leeds, UK. He is the director of JEL India & South Asia Business Centre (ISABC) at the University of Leeds. He is an Active Researcher in the field of international business, particularly in the area of cross-border mergers and acquisitions and the sustainability of MNEs and SMEs in South Asia. He is a Member of the Editorial Board of the *Journal of World Business*, the *British Journal of Management*, and the *Journal of Management Studies*. He won the "IBR 2016 Best Paper Award" for his paper "Knowledge Transfer and Cross-Border Acquisition Performance – The impact of cultural distance and employee retention" published in the International Business Review. His work has appeared in the *British Journal of Management, Journal of World Business, Human Resource Management* (USA), *Journal of Organizational Behaviour, International Business Review, International Marketing Review, Journal of Corporate Finance*, and elsewhere.

Urs Daellenbach is a Professor of Strategic Management at Te Herenga Waka | Victoria University of Wellington's Business School. His research interests focus on competitive advantage, the resource-based view, governance, and strategic processes for managing R&D and innovation. He is currently Co-leader of a research team within New Zealand's Science for Technological Innovation National Science Challenge which addresses the barriers and enablers of engagement with/by key stakeholders of science research.

João Pedro Delgado is a candidate to a PhD in Management at Nova SBE. Among other accreditations, he holds an MBA, Master in Finance, Master in Business Intelligence, and Master in Engineering. As a Senior Manager with more than 20 years of international experience, he worked for large MNC organizations in the management of business units and execution of M&A transactions.

Dries Faems holds the Chair of Entrepreneurship, Innovation, and Technological Transformation at WHU – Otto Beisheim School of Management. He is a Visiting Professor at the LUISS University and Ghent University. His current research focuses on data-driven entrepreneurship and innovation ecosystems. He is the Academic Co-director of the WHU Entrepreneurship Center and Coordinator of the WHU Innovation Ecosystem Hub. The core purpose of these initiatives is to further nurture the entrepreneurial spirit in the WHU ecosystem.

Theresa M. Floyd is an Associate Professor of Management at the University of Montana College of Business. She earned her PhD from Gatton College of Business and Economics at the University of Kentucky in 2014. Her research interests encompass two main streams, both of which incorporate social network theory and analysis. The first stream, in the realm of business management, focuses on social cognition, social influence, and the effects of organizational change on organizational identification and attachment. The second stream, in the realm of natural resource governance, focuses on how psychological processes operate within the social networks of resource stakeholders to influence attitudes and outcomes. Prior to her doctoral studies, she worked in retail merchandising for industry giants such as Gap and PetSmart. She loves bringing her business experience and research experience to her teaching and has a passion for preparing her students for successful business careers.

Emanuel Gomes is an Associate Professor at Universidade Nova, Nova School of Business and Economics (Portugal). He is a Regional Editor for the *Journal of Knowledge Management*. He is the Author of three books on mergers and acquisitions and several papers published in international refereed journals like the *Journal of International Business Studies*, *British Journal of Management, Journal of World Business*, *Journal of Organizational Behavior*, *Long Range Planning, International Journal of Production and Operations Management*, *International Business Review*, and *Regional Studies*.

John A. Howard, CFA, ASA, is a Partner at High Rock Partners in Raleigh, NC, USA, a boutique firm of strategic and M&A Advisors serving middle market companies. His previous background in the securities industry working as a Sell-side Equity Analyst has provided him with a strong foundation in mergers and acquisitions, business valuations, and capital market theory and applications. Over his career, he has completed several hundred valuation assignments, covering a wide variety of industries, and has served as an Expert Witness in the area of business valuation numerous times. He obtained his undergraduate degree from Wake Forest University and an MBA from the University of South Carolina. He has achieved his Chartered Financial Analyst (CFA) designation from the CFA Institute and his Accredited Senior Appraiser designation (ASA) in Business Valuation from the American Society of Appraisers.

Huma Javaid (PhD, University of Bath) is a Research Associate at the University of Manchester, Alliance Manchester Business School, and the Manchester Institute of Innovation Research. Her research focuses on corporate strategy, mergers and acquisitions, alliances, corporate venture capital, and innovation performance in technology firms. Her latest research as a postdoc is on the impact of digital technologies and skills transformation in the UK.

Svetlana N. Khapova is Professor of Organisational Behaviour at the Vrije Universiteit Amsterdam. She is the Past Division Chair of the Careers Division of the Academy of Management. Her research focuses on strategic leadership topics, including leadership development, career mobility, emotions in organizations, and board dynamics. Her research has been published in various top-tier journals. She is the Author (together with M. B. Arthur and J. Richardson) of the book *An Intelligent Career: Taking Ownership of Your Work and Your Life*, published by Oxford University Press in 2017.

David R. King is the Higdon Professor of Management in the College of Business at Florida State University. His research interests involve corporate restructuring, including acquisitions and divestment.

David P. Kroon is an Associate Professor of Strategy and Organisation at the Vrije Universiteit Amsterdam and an Affiliate Member of the European M&A Institute. He received his PhD from Tilburg University, in the Netherlands. His current research focuses on inter-organizational collaborations, organizational change, and post-M&A integration with a particular emphasis on identity/identification, justice, culture, communication/language, emotions, and trust. His research has been published in various top-tier journals and edited books.

Kenneth H. Marks, CM&AA, CFq, is the Founder and Managing Partner of High Rock Partners in Raleigh, NC, USA, a boutique firm of strategic and M&A Advisors serving middle market companies. He is the Lead Author of the first and second editions of *Middle Market M&A: Handbook for Advisors, Investors, and Business Owners*. He is also the Lead Author of two editions of the *Handbook of Financing Growth: Strategies, Capital Structure, and M&A Transactions*, all published by John Wiley & Sons in their Finance Series. He has an electrical engineering background and obtained an MBA from the Kenan-Flagler Business School at the University of North Carolina Chapel Hill. He is a Certified Merger & Acquisition Advisor (CM&AA) and holds a Corporate Finance Qualification (CFq) from the Institute of Chartered Accountants in England and Wales.

Olimpia Meglio (PhD in Business Administration) is currently an Associate Professor at the University of Naples "Federico II." Her research interests revolve around growth strategies focusing on mergers and acquisitions. Her works are regularly presented at international conferences and published in leading academic journals, including the *Journal of Management Studies, Business Research, and Long Range Planning*.

Pedro Neves is a Full Professor at Nova School of Business and Economics. He has published in journals such as the *British Journal of Management, Human Resource Management, Journal of Applied Psychology, Journal of Occupational and Organizational Psychology, and The Leadership Quarterly*, and (co)authored/edited six books. He currently serves as Associate Editor of the *Journal of Applied Behavioral Science*. His research interests focus on leadership and interpersonal relationships in the workplace, change management, and entrepreneurship.

Timo Paumen started to pursue a PhD program at the Vrije Universiteit Amsterdam parallel to working in the M&A Advisory Section at KPMG in Cologne, Germany. After three years of M&A consulting experience, he joined the M&A Department of the REWE Group, one of Germany's leading retail and tourism groups, as a Project Manager. His research focus lies on M&A failure and whether there are factors impacting the outcomes of M&A transactions. His research particularly evolves around private equity funds' processes and operations, as well as M&A team roles and structures.

Taco H. Reus is a Professor in Global Strategy at the Rotterdam School of Management, Erasmus University. He received his PhD in Strategic Management from Florida State University. His research focuses on the curious psychology behind critical strategic events such as mergers and acquisitions. His research appears in top-tier management journals such as the *Academy of Management Journal*, *Academy of Management Review*, *Administrative Science Quarterly*, *Journal of Management Studies*, *Strategic Management Journal*, and the *Journal of International Business Studies*.

Sally Riad's research is positioned at the intersection of organization and difference. It is based on critical approaches to a range of organizational topics, including value, mergers and acquisitions, culture, identity, and leadership. Her work has been published in international journals, for example, *Culture & Organization*, *Gender Work & Organization*, *Journal of Management Studies, Journal of Management History, Leadership, Leadership Quarterly, Organization, Organization & Environment*, and *Organization Studies.* She teaches knowledge management, research methods, and strategic management and has held several leadership roles in the School of Management.

Lars Schweizer holds the Chair of Strategic Management at Goethe University Frankfurt. He acts as the Academic Director of the Master of Pharma Business Administration at Goethe Business School. His main research interests are Strategic Management and M&A. His publications appeared among others in journals such as the *Academy of Management Journal*, the *Strategic Management Journal*, the *Journal of Management*, *Long Range Planning*, as well as *Industrial and Corporate Change*.

Elio Shijaku is an Assistant Professor at the University of Barcelona. His research interests include social networks (individual and organizational), human resource management (systems), and corporate strategy (alliances and acquisitions).

Anthony Stevenson teaches at the University for the Creative Arts and the University of Derby, both in the UK. Subject areas include corporate finance, M&A, economics, and accounting. He began his career in the chemical industry and had operating positions within industrial companies; one of those positions included being a Director of Mergers and Acquisitions. He has published articles in the Studies in Economics and Finance and in the *Journal of Business and*

Economics. He is a Certified Practicing Accountant (CPA), a Member of the CFA Institute, obtained an MSc and MBA from the University of Leicester, and completed his PhD Finance Banking at Loughborough University.

Wookje (UJ) Sung is an Assistant Professor of Management at Hong Kong Baptist University. He earned his PhD from the University of Kentucky. He is mainly interested in how individuals' struggle to survive and for power may bring about group-level and organizational-level performance and changes. He is particularly interested in employees' changing social relationships during organizational change. Corporate mergers and acquisitions are one of the organizational change contexts that his research is focused on, and he has published papers on the topic.

Jean Wang has been a doctoral graduate of the Chair of Strategic Management with Professor Dr. Lars Schweizer at Goethe University Frankfurt. Before joining the Chair, she has been a frontline business practitioner of Strategy and Corporate Finance in China and overseas markets on both corporate development and investment banking. Her research focus is primarily on Chinese cross-border M&A integration issues, especially with human factors, knowledge transfer, and remote R&D management. She holds an MBA degree in high-tech management from the University of Saskatchewan in Canada and a bachelor's degree of Science in Pharmacy from China Pharmaceutical University in China.

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INTRODUCTION

Cary L. Cooper and Sydney Finkelstein

The last year has seen unprecedented global events: the pandemic, the cost of living crisis, energy insecurity, the war in Ukraine, and rising inflation and interest rates in most developed economies. This has led to pushing many countries into recession or minimally to a 'no growth' situation, which will adversely affect the global economy, on top of everything else. This has led, and will continue to lead in 2023, to more downsizing, restructurings, and inevitably to an increase in mergers and acquisitions.

As a consequence of these trends, recent research into mergers and acquisitions has focused on a range of topics relevant to this changing landscape. This volume will highlight interesting behavioral themes as well as timely practical solutions to the dilemma of M&A failures. The first chapter by Olimpia Meglio, David R King, and Elio Shijaku explores information asymmetries in acquisitions, with an emphasis on the role of social ties. They develop a typology of informal and formal social ties "to develop how social ties with stakeholders influence acquisitions and can increase their success."

Chapter 2 by Mohammad Faisal Ahammad highlights the increasing role of sustainability in M&As. The author reviews the global literature on the role of sustainability in the context of mergers, acquisitions, and other partnering relationships. He uses "proxies of sustainability such as environment, social, and governance (ESG) and corporate social responsibility (CSR) and attempted to examine the relationship between ESG/CSR performance with stock market reaction or returns" – and ultimately on the role of sustainability fits into the landscape of M&As.

Chapter 3 by Jean Wang and Lars Schweizer provides a very interesting case study of a Chinese cross-border M&A where the authors explore the effects of human factors on knowledge sharing during an integration. They explore three acquisition-related human factors: (1) the communication programme with top management involvement; (2) professional competence-based trust between Chinese acquirers and their overseas acquired subsidiaries; and (3) the impact of high turnover of key staff at the Chinese acquirer on the effectiveness of knowledge transfer.

Chapter 4 by Dries Faems and Taco H. Reus explores, through a case study, the triadic relationship between divestors, targets, and acquirers. As the authors highlight "the case sheds light on how divestors and acquirers together shape synergy realization efforts and identity building by targets, causing dramatic shifts in perceptions of success throughout the acquisition process." They also highlight the impediments that shape post-acquisition choices and processes.

In Chapter 5, Kenneth H. Marks, John A. Howard, and Anthony Stevenson explore survey data and the experiences of buyer and sellers from due diligence to the completion of middle market M&As. They sampled 130 buyers and sellers from 2013 to 2022 and found a range of factors driving the selling (e.g., economic buoyancy and retirement) and buying behavior of these businesses, as well as differences in those who act, consult, and guide the selling process. Understanding the process of mid-market M&As is very helpful in making it work, on both sides.

Huma Javaid, in Chapter 6, examines the use of signaling mechanisms to identify promising acquisition targets. She explores various inter-organizational relationships of target firms, based on the characteristics of target firms and characteristics of their partners. This helps acquirers understand the quality of the target firms.

Theresa M. Floyd and Wookje (UJ) Sung's chapter suggests that "post merger success depends heavily on the social and cultural integration of the two legacy organizations." They highlight the importance of taking a social network approach in understanding the dynamics of integration post-merger. They explore the obstacles to this approach, how they can be overcome them and how this process can make a real difference to post-merger success – not easy but important.

Chapter 8 by Sally Riad and Urs Daellenbach explores the pace at which merger integration takes place. There have been debates about whether it is better to approach integration slowly or whether fast integration is more effective. The authors explore the arguments for both views and review the research that has been done. They highlight the gaps in the research by "attending to the respective tensions between a prosocial service ethos on the one hand and a managerialist ethos on the other hand."

Timo Paumen, David P. Kroon, and Svetlana N. Khapova explore in the next chapter the role of private equity in driving M&A success and performance. Although M&A failure rates remain high, the authors suggest that the recent evidence is that private equity investors tend to be more successful. This is due to three factors: their better organisational set-up; their professional identities; and their incentive-based systems.

The final chapter by João Pedro Delgado, Emanuel Gomes, and Pedro Neves highlights the micro-foundational factors that might influence M&A performance, that is, the individual and team level issues. The chapter focusses on the importance of emotions in terms of this major workplace event. They reviewed 41 papers and came up with 19 themes related to individual emotions involved in the M&A process. They show how positive emotions by employees involved can have a positive impact on acquisition performance and success.

All of these chapters help us to better understand why M&As have such a high failure rate, and how we can better work toward enhanced outcomes for the individual and the organization. We hope you will find this volume useful in creating more successful M&As.

CHAPTER 1

ADDRESSING INFORMATION ASYMMETRY IN ACQUISITIONS: THE ROLE OF SOCIAL TIES

Olimpia Meglio, David R. King and Elio Shijaku

ABSTRACT

Acquisitions are complex and ambiguous events fraught with information asymmetries emphasizing market failure before an acquisition or organizational failure during integration. While often treated in isolation, market and organization failure are intertwined in acquisitions as integration planning starts before a deal is closed. Effective integration begins with a deep understanding of the target to be able to share assets and knowledge. However, acquiring firms currently have limited solutions to address information asymmetries. Most remedies primarily aim at market failure using due diligence and external advisors, leaving information asymmetry due to organizational failure primarily unattended. The authors develop a typology that leverages informal and formal social ties to address information asymmetries across the acquisition process that jointly considers market and organizational failure. The typology of this study combines existing research to develop how social ties with stakeholders influence acquisitions and can increase their success.

Keywords: Mergers; acquisitions; information asymmetries; market failure; organizational failure; social ties; stakeholders

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INTRODUCTION

Acquisitions are complex events fraught with complexities and ambiguities that are typically related to information asymmetries that emerge across the entire acquisition process as parties hold unequal information regarding target selection or acquisition completion and integration (Haspeslagh & Jemison, 1991; Jemison & Sitkin, 1986; Welch, Pavićević, Keil, & Laamanen, 2020). Information asymmetries generally result from market failure, adverse selection before an acquisition announcement, and organizational failure during integration after the acquisition announcement. The resulting organizational impacts can be dramatic and are generally measured in terms of high failure rates, typically between 50% and 80% (see, for instance, Papadakis & Thanos, 2010).

Besides poor figures, actual experiences point to the relevance of information asymmetries in acquisitions. By way of example, in 2011, HP announced the purchase of Autonomy in a deal worth $10 billion, including a 60% premium, that was criticized for being too high (Sayer, 2022). These critiques proved correct less than a year after the deal with HP was complete. Indeed, Autonomy's CEO departed over concerns about accounting practices (Sayer, 2022). Problems subsequently uncovered led to the removal of HP's CEO and an $8 billion write-down of Autonomy's purchase price (Sayer, 2022).

HP's experience offers a cautionary tale. It illustrates the problem of adverse selection due to information asymmetry. As target managers know more about their firm's assets and may be motivated to avoid disclosing negative information, acquiring managers must be wary of partial or erroneous information regarding target firm assets (Puranam, Powell, & Singh, 2006).

While experienced acquirers can restrict it, sellers often benefit from information asymmetry to extract more value from a transaction (Cuypers, Cuypers, & Martin, 2017).

Information asymmetry's influence is not limited to the pre-acquisition but extends to the post-acquisition phase, contributing to organizational failure during integration, which can lower acquisition performance (Graebner, Heimeriks, Huy, & Vaara, 2017; Haspeslagh & Jemison, 1991). Beginning with due diligence, an incomplete or erroneous understanding of a target firm's assets hinders acquisition integration and value creation. However, information asymmetry can persist as it becomes internal, reflecting differences and distance between acquiring and target firms (Graebner, 2004) or a target firm's lingering ties (Amiri, King, & Duesing, 2022). For example, following Cardinal Health's acquisition of Cordis, a divestment from Johnson & Johnson (J&J), Cardinal Health managers recognized that they underestimated the complexity of continued ties with J&J (Cardinal Health, 2017). Associated problems led to a $1.4 billion write-down in 2018 of Cordis' $1.99 billion 2015 acquisition (Cardinal Health, 2018) and its divestment in 2021 (Cardinal Health, 2021). While its role with Cordis is unclear, management turnover following acquisitions exacerbates the negative impacts of information asymmetry during integration (Graebner, 2004; Jemison & Sitkin, 1986; Krug & Shill, 2008).

The preceding considerations support that market and organizational failure sources during acquisitions benefit from a conjoint analysis of different information asymmetries across the acquisition process and associated remedies. We propose a typology to address information asymmetries in acquisitions that combines a process perspective with insights from social ties research. More specifically, we argue that social ties can reduce information asymmetry between the acquirer and target, as connections increase trust and information flow (Guo, Li, Seeger, & Vagenas-Nanos, 2019). Social ties can influence acquisition decisions (i.e., target selection; Rogan & Sorenson, 2014) and integration choices (Feldman & Hernandez, 2021; Hernandez & Shaver, 2019; Mirc, 2012; Zaheer, Gözübüyük, & Milanov, 2010). For example, social ties increase acquirer-target knowledge of each other's operations and culture (Cai & Sevilir, 2012).

The remainder of this work is organized as follows. First, we summarize the background and context for acquisition information asymmetries. Next, we develop how social ties can serve as a remedy for information asymmetry. We then propose a 2×2 matrix typology to address information asymmetries during acquisitions. Finally, we conclude with implications for research and practice.

THEORETICAL BACKGROUND

In this section, we describe different information asymmetries sources in acquisitions and analyze how information asymmetries are magnified under specific contextual conditions. Next, we discuss how social ties, formal and informal, can aid in getting more accurate information and offer a remedy to this longstanding problem in acquisitions.

Information Asymmetries in Acquisitions

Information asymmetries occur when one party in an economic transaction has information that another party does not (Stiglitz, 2002). In describing information asymmetry, Akerlof (1970) detailed the problem of "lemons" in buying a used car, as a seller had better information about a car's history than potential buyers, providing an incentive to sell low-quality products at high prices. Uneven information on the quality of goods can result in an adverse selection where a buyer pays a higher price for something of a lower rate. Not knowing another party's intentions also increases risk or introduces a moral hazard where there is limited opportunity to redress opportunism.

Acquisitions offer a unique context, as they involve single transactions that are not repeated between combined firms and involve multiple decisions at different points. For example, decisions involve whether to pursue an acquisition, whom to acquire, how much to pay, and how to integrate a target. Each decision also involves different sources and quality of information. Coff (1999) disentangles various sources of uncertainty into the quality of assets, the extent assets will transfer, and prospects for planned synergy. Significantly, these different decisions are intertwined, leading acquirers to miss critical information and make poor decisions before and after an acquisition (e.g., Connelly, Certo, Ireland, & Reutzel, 2011; Puranam et al., 2006).

Before an acquisition, decisions relating to the price paid and how to pay for an acquisition (i.e., stock or cash) and poor choices on either criterion can have negative consequences (Cheng, Li, & Tong, 2016; DiGeorgio, 2002). Despite this recognition, since abandoning announced acquisitions damages managers' credibility (Dikova, Sahib, & Van Witteloostuijn, 2010), managers can become overcommitted to completing an acquisition (Haunschild, Davis-Blake, & Fichman, 1994; Shi, King, & Connelly, 2021). Unfortunately, escalation of commitment may also hinder due diligence, making it less effective (e.g., Shi et al., 2021). For example, HP allegedly conducted only six hours of due diligence in examining Autonomy's financial information (Jolly, 2019), resulting in missing crucial pieces of information.

After the acquisition announcement, planning and implementing integration depends on uncertain information on how to combine firms best. Integration involves multiple decisions, such as what, how, and when to integrate, combining intertwined firms and often at cross-purposes. Senior managers engaging in human and task integration confront the delicate task of accommodating conflicting goals (Cording et al., 2008) and need to interpret and frame meaning for others (Bansal, King, & Meglio, 2022; King, Bauer, Weng, Schriber, & Tarba, 2020). As a result, comprehensive and detailed integration plans can be of limited usefulness when they are based on biased or incomplete information. In other words, information asymmetries before and after acquisition announcement are intertwined with firm and individual ties playing an essential role in reducing or magnifying information asymmetries.

Contextual Conditions Affecting Information Asymmetries

Information asymmetries are contingent upon different contextual conditions affecting acquisitions. Traditionally, information asymmetries are more problematic for small and private firms (e.g., Becchetti & Trovato, 2002; Shen & Reuer, 2005). This is because such firms have less incentive to audit and share financial information and display earnings manipulation to reduce their tax burden (Krukowski & DeTienne, 2022). As a result, acquirers often wait until following an initial public offering to complete an acquisition, as a publicly traded target lowers information asymmetry (Reuer, Tong, & Wu, 2012). This reflects that private firms have less public data available, and any information available will have been voluntarily disclosed. For example, advisors may find it challenging to obtain thorough information for small, private firms during due diligence. As a result, the reputation of investors and investment bankers signals a private firm's quality (Reuer et al., 2012). Still, difficulties associated with information asymmetry are magnified when knowledge and intangible assets play a prominent role in a firm. As a result, managers rely on filtered information from indirect social ties to assess a target firm's assets, culture, know-how, and technology (Burgelman & Doz, 2001).

Another crucial contextual condition is an acquisition involving a cross-border target (Cuypers, Ertug, & Hennart, 2015). The host and home country institutional environment influences formal disclosures' quality and overall reliability (Jensen, King, & Zámborský, 2022; Sun, Zhang, Xu, & Zhang, 2021). For example, the host country's formal institutions and informal rules influence firms' ability to address information asymmetry (Reddy & Fabian, 2020). Associated problems increase with greater integration (Slangen, 2006). In cross-border acquisitions, firms generally experience linguistic, religious, or cultural distance that negatively affects the flow of information from and to the market. While cultural distance has received extensive research attention (cf. Morosini, Shane, & Singh, 1998; Popli, Akbar, Kumar, & Gaur, 2016), psychic (Yildiz & Fey, 2016), linguistic or religious differences are pervasive and more difficult to address (Dow, Cuypers, & Ertug, 2016). For linguistic distance, research finds a negative impact on acquisition performance (Kedia & Reddy, 2016) and mitigating it may require employees with the appropriate language and technical skills and knowledge. Additionally, religious differences can cause misunderstandings and lower the willingness of people to interact and communicate with one another (Alesina, Devleeschauwer, Easterly, Kurlat, & Wacziarg, 2003). National differences underscore a recognized need for acquirers to hire consultants with relevant local knowledge in cross-border acquisitions to overcome information asymmetries (Shimizu, Hitt, Vaidyanath, & Pisano, 2004; Westbrock, Muehlfeld, & Weitzel, 2017).

Social Ties as Tools to Address Information Asymmetries

Social ties offer a potential solution to information asymmetries. Social ties are known to alleviate information asymmetry as the quality of the information is higher between socially connected parties. Still, not all social ties are alike; we classify them into formal and informal ones. Formal ties imply a contractual agreement, but informal ties do not. Formal ties are contractual agreements of two types: *embedded* or *arm's-length* (Uzzi, 1999).

Embedded ties help problem-solving among transaction partners, limit opportunism, and favor altruism (Boussard, Godechot, & Woloszko, 2019). In this sense, embedded ties effectively remedy the information asymmetry problem by enabling related actors to share private resources and information that would otherwise be unavailable (Uzzi, 2018). Embedded ties can be observed throughout the acquisition process. In the pre-phase (i.e., announcement), embedded ties are contractual agreements with the target, such as equity-based strategic alliances that provide real options for future successful acquisitions. For example, Zaheer, Hernandez, and Banerjee (2010) find that international acquisitions following alliances show significantly better returns than acquisitions without prior and domestic acquisitions. Additionally, acquirers are known to use external advisors or investment bankers they have prior experience with (Hunter & Jagtiani, 2003). Prior ties create mutual trust and understanding between the merging parties.

Meanwhile, arm's-length ties are characterized by lean and sporadic transactions in which a long relationship is not required to engage with another actor

(Uzzi, 1999) and help to determine information opportunities from social ties. Direct social ties include connections between directors and senior executives (Ishii & Xuan, 2014) and board interlocks (Xia et al., 2014). For example, board interlocks enable sharing of information about an acquisition (Palmer & Barber, 2001).

Informal ties are non-contractual relations that actors establish within and across their networks. Informal ties reflect social capital (Aklamanu, Degbey, & Tarba, 2016) that we categorize as *informative*, *collegial,* or *special* (Lopes Morrison, 2005). Low trust levels and low personal feedback characterize informative ties. Informative ties may take the form of political connections that affect successful acquisition deals (Schweizer, Walker, & Zhang, 2019). These may enable the firm to obtain privileged information on potential market regulations by appointing ex-politicians to the board of directors (Hillman, 2005). Additionally, informative ties may concern membership ties, especially when dealing with industry or club ties to which the acquirer may belong.

Collegial ties are those informal relationships with a heightened degree of self-disclosure and trust but whose levels are not less close than friendship or family connections. Organizational collegial ties are best represented by employee ties, where informality is guaranteed by a degree of acquaintance (Lopes Morrison, 2005). Collegial ties may also be characterized by the social exchange between the organization's employees. For example, Allatta and Singh (2011) find that employee communication routines via email exchange persist well into the post-phase (i.e., integration), highlighting the importance of collegial ties. Further, social media such as LinkedIn or Twitter may represent an essential source of acquaintances and a source of reasonable reliability to access information for a potential target.

Special ties include relationships that require the highest degree of trust and self-disclosure and therefore are limited to friends and family interactions. Typically, this informal social tie is characterized by intimacy, stability, and continuity based on frequency and tie strength (Lopes Morrison, 2005). In the acquisition process, special ties are seen as relevant. For example, friendship may promote advice-seeking behavior that could improve a firm's strategic decision-making (Westphal, 1999).

In summary, information asymmetries are widespread before and after the acquisition announcement. We combine existing research to show how information asymmetries in acquisitions can be addressed by considering social ties. Below, we identify a range of solutions that can help to acquire firms to address these issues by leveraging social ties.

A TYPOLOGY OF SOCIAL TIES-BASED SOLUTIONS TO INFORMATION ASYMMETRIES

We advance a four-quadrant framework combining social ties and a process perspective of acquisitions. Jemison and Sitkin (1986) first offered the process perspective by showing that acquisitions did not end with signing an agreement between an acquirer and a target and that post-acquisition issues involved ambiguity and complexity. Building on this insight, we distinguish the intertwined processes before and after the acquisition announcement. For example, announcing a deal implies a series of formal activities/tasks toward completing the agreement that is particularly relevant regarding the information needed and related asymmetries. Moreover, we conceive acquisitions unfold through "actors" sensemaking and sense-giving that depend on social ties (Bansal et al., 2022; Buono & Bowditch, 1982; see Fig. 1). Each quadrant reflects a process stage, before (pre-acquisition) and after an announcement (post-acquisition), and formal or informal ties. For each combination, we propose different solutions from research across acquisition stages.

Addressing Information Asymmetries Before the Acquisition Announcement

The upper quadrants (Q1 and Q2; Fig. 1) address information asymmetries that rely on formal and informal ties before an acquisition is announced. Formal embedded ties are an essential solution for information asymmetry. Once a potential target has been identified, due diligence as a formal process is the traditional tool to gain information. Due diligence is an objective, independent examination of the acquisition target, and it is typically performed with the help of external advisors (Parvinen & Tikkanen, 2007). In addition to assessing financial

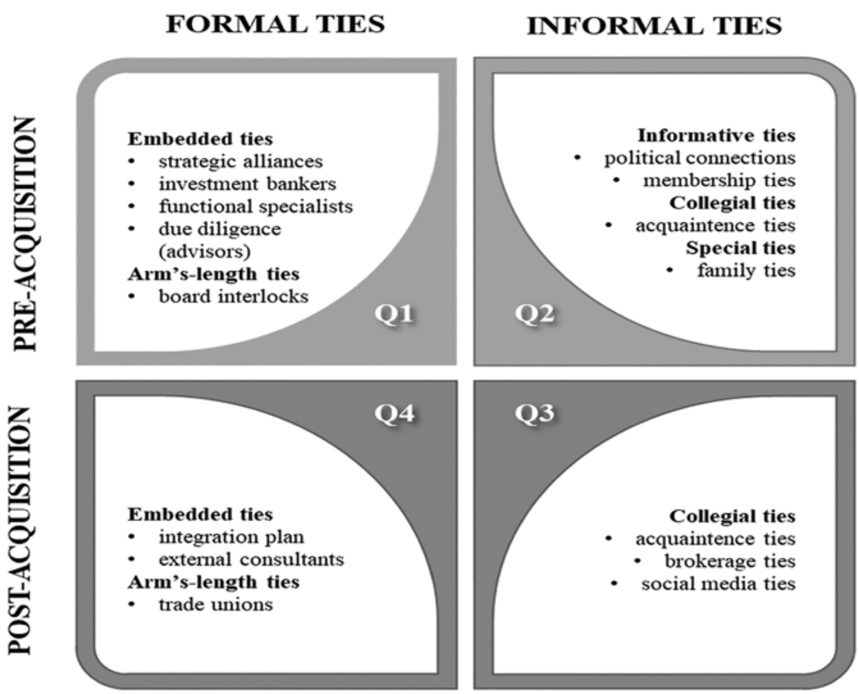

Fig. 1. Addressing Information Asymmetries in Acquisitions With Social Ties.

information and asset valuation, adequate due diligence should uncover issues that may lead to failure during integration, such as a target firm management lacking vital capabilities (Angwin, 2001). Due diligence ascertains the extent a target can meet its current and future business needs and the compatibility of firms for integration (Marks & Mirvis, 2001). However, confidentiality before an acquisition announcement can limit who is involved in due diligence, hindering information gathering and integration planning (Saorin-Iborra, 2008).

Due diligence represents a signal detection problem as target firms attempt to signal information. Less clear is what signals from potential targets are helpful to acquiring firms in reducing information asymmetry. One indication of quality in the face of uncertainty is a seller's willingness to retain a partial equity stake in the organization (Cheng et al., 2016) or accept stock as payment to share risk (Seo, Gamache, Devers, & Carpenter, 2015). In addition, target firms may voluntarily disclose value-relevant information to stakeholders through regulatory financial statements, management forecasts, sustainability or corporate social responsibility (CSR) reporting, press releases, or conference call meetings (Siougle, Spyrou, & Tsekrekos, 2014). Reduced analyst forecast errors, especially for small firms, provide evidence that these events lower information asymmetry (e.g., Kimbrough, 2005). Having similar clients (Rogan & Sorenson, 2014) or disclosures from bankruptcy proceedings (Jory & Madura, 2009), or initial public offerings (Renneboog & Vansteenkiste, 2019) also lower information asymmetry.

Formal embedded ties, such as alliances between firms or intermediaries (e.g., investment banks), support information sharing, reducing information asymmetry and the chances of opportunistic behavior. Further, network positions arising from these ties will lead to brokerage positions that promote information gathering, monitoring, and evaluation, ultimately increasing the firm's capacity for value appropriation (Hughes-Morgan & Yao, 2016).

When acquisitions follow previous inter-organizational arrangements, such as alliances (Inkpen, 2000; Porrini, 2004; Vanhaverbeke, Duysters, & Noorderhaven, 2002), the acquisition of small stakes, or joint ventures (Xia et al., 2104), relationships with a prospective target firm can reduce information asymmetries. Following an alliance, an acquirer can better discern the quality of the "venture's" underlying resources to lower the risk of adverse selection. Wu and Reuer (2021) also highlight that a "firm's" alliances can enhance its visibility among prospective investors and exchange partners because alliances are observable and indicate a firm has valuable resources and capabilities.

Another possible solution involves external advisors (e.g., consultants or investment bankers). Working with an existing client provides a certification effect if a banker has ties to a target firm (Allen, Jagtiani, Peristiani, & Saunders, 2004). For example, Shipilov (2009) finds that investment banks with broader experience are better able to handle heterogeneous information and provide acquisition advice. Involving consultants and functional specialists (e.g., human resources, information technology, operations) in due diligence can provide a comprehensive analysis to avoid overlooking issues. Accessing needed information hinges on knowledge of people involved in different tasks/activities and their relationships and ties to make needed connections. For example, Dau (2018) finds that acquisitions are more profitable when a firm's subsidiary networks are more centralized and provide better information flow.