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Effect of institutional heterogeneity in partnership configuration on M&amp;A performance

Andrew Papadopoulos  
Université du Québec à Montréal  
Email: papadopoulos.andrew@uqam.ca

Ali Taleb  
MacEwan University  
Email: TalebA@macewan.ca

**ABSTRACT**

Developing countries' importance as national economies and as actors in foreign direct investment (FDI) has increased over the past decade. Concepts and models of international business have focused on developed-nation firms moving to developing nations. One such mode is through mergers and acquisitions that lead to the developed firm governing the developing acquisition. However, with the FDI trend reversing, there is a need to better understand how developing nations may use corporate governance, with all its institutional trappings, in developing-developing and developing-developed relationships. Our paper offers four propositions to better conceptualize these relationships.

**KEYWORDS:** Conceptual, Corporate governance, Mergers & acquisitions, International

**INTRODUCTION**

Liberalization of trade and investment coupled with economic growth of many emerging market economies has created opportunities for firms to engage in greater foreign direct investment (FDI) through mergers and acquisitions. In 2012, the United Nations Conference on Trade and Development (UNCTAD) reported in their World Investment Report (WIR) that developing countries accounted for 52% of all FDI flows – surpassing developed nations for the first time - while in 2013 that number rose to 54% of total flows. Developed nation total flows fell from 42% to 39% over the same period. Transitioning economies (South-East Europe, the Commonwealth of Independent States and Georgia) accounted for about 6% and 7% of flows, in 2012 and 2013, respectively. The role of developed-country multinationals in FDI is beginning to take a back seat to developing nations.

However, while developed nations still dominate merger and acquisition (M&A) activity, a major component of FDI, one of the important trends to emerge is the FDI outflows from developing countries towards developed and developing countries. These transnational corporations from developing economies have become important regional acquirers. In 2013, developed countries accounted for 69% of net M&A cross-border sales and 44% of net purchases, down from 88% and 83% in 2007, respectively. Over the same period, developing economies increased their share of M&A activity from 9% to 32% from 2007 to 2013 of net sales and from 14% to 37% of net purchases. The message is clear: development economies are playing a greater role in global cross-border M&A activity, either as a target nation or as the acquiring nation.

When the decision to undertake a cross-border acquisition is made, the interaction between the parties leads to an additional level of complexity with respect to performance that begins with the negotiation of the price, the future employment and roles, if any, of executives, and the

integration of the target firm within the acquiring firm. The success or failure of an M&A can be linked to the degrees to which the two organizations were integrated and their resources were optimally leveraged. In a cross-border deal, the difference in institutional contexts between transacting parties may facilitate or hinder fruitful interaction (Dikova, Sahib et al. 2010, Mtar 2010) and thus determine the ultimate success or failure of the venture. The institutional distance between head-office and subsidiaries is a major determinant of performance (Berry, Guillén et al. 2010) stemming from the ability of employees of two companies to share knowledge and interact effectively (Kostova & Kendall 2002). Since the institutions of developing and advanced economies are embedded in dissimilar contexts and entail different dominant logics of decision-making (Taleb 2010), it would be interesting to focus on the study of M&A ventures that involve partners from both developing and developed economies.

While M&As have been found to at best have an insignificant short-term effect on value creation for the acquiring firm, and a negative impact over longer-term (Aybar & Ficici, 2009; Fuller, Netter, & Stegemoller, 2002; King, Dalton, Daily, & Covin, 2004), their persistent use as a strategic growth instrument continues to intrigue researchers and raises fundamental questions such as why executives continue to seek them, why corporate governors approve them, and why they fail to generate promised value.

With respect to success, the board has an important role to play in the decision, execution, and possibly integration aspects of M&A transactions. The constraints and incentives put in place to shape and guide executive decisions, namely corporate governance mechanisms represent an external contingency upon executives and the board. Second, individuals' personal and professional experiences shape their preferences and motivations that represent an internal force upon decision-makers – the strategic value of the board. Thus, on one hand there are control mechanisms, structural and institutional, that constrain board action, while on the other there are directors' personal experiences and motivations that may provide strategic advice to corporate executive.

Moreover, firms from developing markets may use different governance mechanisms which do not even exist in more advanced economies. For instance, local firms in certain emerging markets relied on the formation of "business groups" to deal with institutional voids and imperfections in their home markets. This type of partnerships is unique to developing countries and entails specific governance mechanisms as well as it affects the financial performance of its members (Carney et al. 2011). Therefore, a partnership involving partners using different governance mechanisms – due to differences in their respective institutional contexts – may be of great interest to study.

Firms from emerging markets (EMNEs) may behave differently from their counterparts from more developed economies (DMNEs) owing to the distinctive institutional conditions of their home markets (Ramamurti 2012). This conferred them comparative advantages (Taleb 2010) which allow them to redraw the picture of international trade (Inkpen & Ramaswamy 2007) as their home-grown E-MNEs outperform D-MNEs both at home (Bhattacharya & Michael 2008) and abroad (Cuervo-Cazurra & Genc 2008). In fact, a quick look at the recent evolution of the Global Fortune 500 or Financial Times 500 lists of the most powerful global companies suffices to realize that E-MNEs are steadily gaining a strong and unprecedented foothold in the global economy. While some scholars suggest that E-MNEs may not represent a homogeneous population (Ramamurti 2009), we argue that they do share comparable experiences as they grew up in institutional environments that exhibit a number of similarities from poor physical infrastructure and regulatory apparatus (Khanna & Palepu (2006) to unpredictable "mood" of government officials (Wells, 1983) to highly informal institutions (Jütting, Drechsler et al. 2007).

Given the phenomenon at hand, the explicit separation of institutional effects from other influences may be fruitful (Dunning & Lundan 2008) especially because institutional diversity calls for both strategic adaptability and managerial versatility (Taleb 2010).

These realities have significant implications for research dealing with developed-developing nation firm interactions, governance perspectives, and performance. We believe, therefore, that focusing on M&As involving partners from both developing and developed economies has several theoretical merits. The primary theoretical frameworks for this research are agency theory (Jensen & Meckling 1976, Fama & Jensen 1983), and resource-based theory with a particular focus on learning (Kogut & Zander, 1992, 1993, 1996) and competencies (Hamel & Prahalad, 1994).

Our research suggests a paucity of interest in this area. From September 2002 to September 2014, 106 journal articles in ABI/Inform were found where the terms governance and merger or M&A appeared in the abstract (14 articles where the terms appear in the title) compared to 1672 results where governance and performance are in the abstract (282 articles where the terms appear in the title) and this for all of finance, management, strategy, and accounting fields, suggesting a limited understanding of how governance impacts performance in M&A transactions. When we then look at a cross-border context to contemplate institutional differences in an international context, we find that the institutional perspective to governance and cross-border M&A is very limited. Investigating contexts that are not necessarily inspired by Anglo-American governance regimes as we may find in many developing nations leads to an unexplored area as we only found, using the same abstract research approach as above, 11 articles dealing with institutional issues in M&A of which only five investigated corporate governance issues and none performance. Similarly, we found 21 articles where resource-based theories, including learning/knowledge, competencies and capabilities, were found in the abstract along with merger or acquisition and the board in the whole document; only two are international in flavour. Nevertheless, most research in the domain tends to focus on developed markets (Graham, Martey, & Yawson, 2008). Accordingly, our primary research question is:

*How does corporate board supervisory and strategic strength impact acquirer financial performance in acquisitions involving emerging markets?*

## LITERATURE REVIEW

### Cross-border M&A and Performance

Performance in M&A transactions has been studied from two broad perspectives: performance at the time of announcement (event study) and performance sometime in the short, medium and/or long term at a point after the announcement, the completion of the transaction or at some other point in the future. Performance upon announcement captures the anticipated performance as determined by market agents based on characteristics of the acquirer, target, and the transaction details, among others. Other approaches to performance seek to capture performance based on the acquirer's ability to integrate the target and realize the expected cost or revenue synergies.

Bratianu & Anagnoste (2011) show that acquirers in emergent countries primarily undertake a merger to cut costs and create growth opportunities whereas acquirers from developing countries focus more on gaining access to production and new technology; the stakes are not similar. Regardless, foreign acquisitions improve shareholder value (Gregory & McCorrison,

2005; Seth, Song, & Pettit, 2002), especially in emerging markets (Chari, Chen, & Dominguez, 2012). In another study, US firms acquiring overseas businesses in developing countries are considerably better compared to those that acquire overseas businesses in developed market (Liu & Qiu, 2013).

One of the dominant perspectives that underpins performance in M&A transactions is organizational fit (Capron & Pistre, 2002, Cartwright & Cooper, 1993) in facilitating cooperation and integration. Sirmon and Lane (2004) outline national, organizational, and professional differences as the relevant levels of to consider in inter-firm relations. However, the literature, both alliance and M&A streams, has predominantly focused on national considerations given various well-established and readily available measures. Hofstede (1991) suggests that culture is a programmed mental model of a collective in a specific environment that conditions and guides processes, behaviors, and actions. This translates to unique organizations, practices, and coordination mechanisms that managers need to address. However, geo-political change has influenced many nations challenging the ongoing relevance of culture in international business. Homogenizing influence of information technologies, international tourism, financial institutions, market philosophy, IMF/World Bank activism combined with better education and informed managers have all led to a gradual narrowing of perceived cultural differences. (Menon, 2004, Micklethwait & Wooldridge, 2000, Stiglitz, 2002). Various studies have suggested a certain amount of cultural convergence (Levitt, 1983, O'Reilly, 1991) as a result of these effects.

### **Corporate Governance & Mergers and Acquisition**

Rooted in agency theory (Jensen & Meckling, 1976), corporate governance frames the relationships among investors, the board and management as a mechanism to limit and check managerial action. This mechanism has taken various forms, including, chairman and CEO duality, remuneration, board size, importance of outside directors, and shareholder structure, among others. One such managerial action with strategic and operational consequences is the mergers and acquisition (M&A). The M&A has often been seen as mechanisms to increase market share, enter into new product and geographic market, acquire from and deploy to the target resources, capabilities and competences of both a tangible and intangible nature with the expectation to create value for the acquirer. However, others see M&A transactions as conduits for managerial opportunism (Chatterjee & Hambrick, 2007). Chief executives seek to minimize business and thus unemployment risk (Amihud & Lev, 1981) or to increase their own finances and power (Kroll, Wright, Toombs, & Leavell, 1997) through such transactions because of legitimacy-seeking isomorphism (DiMaggio & Powell 1983) or hubris (Hayward & Hambrick, 1997; Roll, 1986).

Corporate governance structures seeks to limit such behaviors and is thus seen as playing an important role in M&A outcomes (Wright, Kroll, & Elenkov, 2002) by minimizing the potential for overbidding through its structural composition (Rani, Yadav, & Jain, 2014) in the exercise of its fiduciary duty and by mitigating information asymmetries for investors of an acquiring firm's external environment (Kang, 2006). Failure to generate value for M&A transactions may be attributed to poor governance from the moment of target identification to integration an area lacking particular focus in the literature (Gaughan, 2005).

More recently, the role of boards has expanded to include a more strategic function. They are seen as offering operational (Krause, Semadeni, & Cannella, 2013) and strategic advice (Bouzinab, 2013), being a conduit for information for their firm's benefit through their networks (Carpenter & Westphal, 2001) or even signaling firm quality (Certo, 2003). However, in the

context of the M&A this aspect has garnered limited attention (Bouzinab, 2013), particularly in emerging markets.

When undertaking an M&A transaction in complex or turbulent environments, boards may be able to provide an additional level of comfort to investors than weaker boards (Kang, 2006). As board members are closer to management and privy to information about the transaction, they are able to better assess the context and the target. Similarly, institutional investors – the buy side – are not only more sophisticated than non-institutional investors but also dispose of resources and employ professional that would be able to provide sufficient analysis as to evaluate the benefits and risks of an M&A transaction.

If we are were to juxtapose the concept of complexity and turbulence at an industry level to a country level, we are able to appreciate how boards and investors may provide similar advantage when a firm decides to engage in a cross-border transaction, specifically with a firm that finds itself in an environment deemed complex or turbulent by the acquirer. Sources of complexity may include geographic separation (Ghemawat, 2001), cultural differences (Kogut & Singh, 1988) and other institutional differences (Kostova & Zaheer, 1999). We develop below a series of propositions based on agency and resources arguments below.

## **PROPOSITION DEVELOPMENT**

### **Corporate Governance Mechanisms**

The board's role is to act as the representatives of ownership with management. This supervisory capacity takes the forms of periodic board meetings and committees. The effectiveness of such oversight has been linked to a number of factors that lead some boards to provide stronger governance, including having a separate chair and CEO (the duality argument), greater representation on the board from individuals not executives of the firm (outside directors), and a board whose size is commensurate with the business that it is overseeing. Reinforcing these mechanisms is also the structure of ownership: manager-owners and block holders. Below we discuss each in turn.

The importance of holding simultaneously the dual role of CEO and chair in the finance and strategy literature upon performance is well documented. From an agency perspective, the additional power that a CEO gains by also holding the chair role translates into greater control over the board and an ease to pursue self-interested goals rather than to make decisions privileging shareholders (Amihud & Lev, 1981). Given that M&A activity has been viewed, as a mechanism for CEO's to pursue their personal interests, holding onto both positions would facilitate such actions while a separation of such tasks would minimize the risk for opportunism. However, opposing this view, stewardship theory argues that the duality role allows for a better functioning organization as the CEO is seen as acting out in the best interest of the firm and stakeholders (Davis, Schoorman, & Donaldson, 1997). Research looking specifically into the M&A context and evaluating competing hypothesis under both theoretical lenses (Desai, Kroll, & Wright, 2003) found evidence that duality negatively impacts the performance of acquirers.

Moving beyond the CEO's role, in cases where boards are populated primarily by executives of the firm that have been hired by the CEO or their predecessor, we may expect for the CEO to exercise additional control over such members because of their structural and prestige power that they may have within the organization. Consequently, given this relationship, these internal directors, given the power that the CEO has over them with respect to hierarchy and employment, are likely to behave in a manner consistent with the CEO's desires. On the other

hand, as stewards of the firm, we may expect that cohesion and intimate knowledge of the firm may enhance their oversight role. Similarly, their future prospects on the labour market (Cannella Jr. & Hambrick, 1993; Fama & Jensen, 1983) may mitigate poor decision making and execution by such insiders. The presence of outside directors – a hallmark of good governance (Geletkanycz, Boyd, & Finklestein, 2001) - would minimize the aforementioned effects from a structural perspective, leading to higher returns. There is also evidence to suggest that outside directors are more likely to fire a CEO for poor performance. Moreover, as discussed further below, outside directors may also provide strategic qualities.

The final structural aspect of the board relates to its size. The impact of any one director's ambivalence or reticence to challenge management would increase as the board size increases as the individual's impact is diluted over a larger number of individuals sitting on the board. Moreover, the cohesion of board members is more likely to decrease as board size increases as each director would have less time to interact with other members and the cost of establishing and maintaining ties in a bilateral or multilateral basis would increase geometrically as each additional board member increases the number of ties in an exponential form. While this is a desirable outcome from a connectivity perspective with respect to network ties and thus possibilities for greater information transfers, under a strategic perspective, it poses a challenge with respect to structural coordination. Under such circumstances, we may expect the CEO to take on a more dominant role (Jensen & Zajac, 2004), again increasing agency issues and leading to lower performance (Eisenberg, Sundgren, & Wells, 1998; Xie & Fukumoto, 2013; Yermack, 1996). However, the caveat being that large boards may seek more consensual or middle-of-the-road positions, their actions lead to less performance variability (Cheng, 2008).

As we have worked from management and the CEO to the board, the missing piece in the agency construct are shareholders: the beneficiaries of the board's fiduciary duties and of management's strategic and operational efforts. From this perspective there are two qualities that are important to discuss: significant controlling interest and alignment of purpose.

In the first case, the underlying argument supporting the relationship between increasing block shareholdings and performance rests with the power that such shareholder can wield on the board through direct representation, voting power or by pressure on management to align managerial and ownership interests (Shleifer & Vishny, 1998). However, once ownership reaches a certain threshold, significant positions lead to lower returns as entrenchment may set in (Shleifer & Vishny, 1998; Thomsen & Pedersen, 2000). Moreover, the nature of block holders needs to be considered as the implication for strategy varies among them (Thomsen & Pedersen, 2000). Such block holders may include other firms, financial investors (e.g. mutual funds, pension funds) or families owning a significant position in a firm.

In the case of firms, there are a few contextual distinctions. There are situations where a firm will own a minority or a majority stake in another firm through a partial acquisition or spin-off and circumstances where a network of firms is intertwined through conglomerate structures, cross-holdings or business groups. In the former case, equity ownership in another firm for the purposes of closer integration for development or resource reasons differs in nature than the conglomerate structure in a number of ways. First, the purpose of the relationship is to seek operational efficiencies in a related, vertical or horizontal manner. Second, ownership and management structures of each firm differ providing multiple instances for oversight. Generally speaking, these latter structures often lead to lower financial performance because of conglomerate discounts, cross-subsidization or dominant logic failures.

When family-owned firms are on equal footing with other shareholders, in single share class structures outperform dual-class firm market valuations by 17% on average relative to widely held firms, despite having similar returns on assets (King & Santor, 2008) – families may run firms for their private benefits in detriment of other shareholders (Fama & Jensen, 1983). Arbitrage opportunities arise where family members may prefer to increase their personal wealth at the detriment of other stakeholders. One such example is Frank Stronach, leading shareholder of Magna, a car parts manufacturer that used the firm as a vehicle to purchase racehorse tracks in the late 1990's (Cowan, 2012).

For institutional investors, they are primarily focused on financial returns their singular focus. While they may not be able to exact direct and timely control in shaping managerial decisions, they may be able to exercise latent power on strategic decisions but this power is moderated by the interaction of other shareholders in the structure (Chaganti & Damanpour, 1991) and on the country's legal traditions (Jara-Bertin, López-Iturriaga, & López-de-Foronda, 2012). In the case of differing legal tradition, the inverted-U relationship found between increasing ownership levels and firm performance is also confirmed for institutional investors.

It is also not surprising that privately owned enterprises outperform state-owned firms (Goldeng, Grünfeld, & Benito, 2008). Moreover, when dealing with emerging markets, state-owned shareholdings may also play an important role. In many cases, governments will use corporations to achieve political goals (e.g. employment, national security) that would not necessarily reflect shareholder maximizing actions. In many cases, governments have invested in organizations that would otherwise be insolvent or consistently unprofitable – permanently failing organizations - to fulfill their goals (Meyer & Zucker, 1989). However, a more recent yet subtle phenomenon has begun to emerge over the past decades where government ownership has bifurcated into direct ownership of state-owned enterprises and sovereign fund ownership of corporations. The latter case being investment and pensions funds that manage assets in the name of their respective governments but generally operate at arm's length but not always (Bernstein, Lerner, & Schoar, 2013) – operating like institutional investors most of the time.

The second aspect of ownership relevant to firm performance is that of insiders. In an effort to enhance the alignment of executives and directors with those of shareholders, remuneration in the form of stock and stock options has been used. These forms of pay vest the interest of such insiders to the market performance of the firm – the performance that shareholders are concerned most about. In seminal work, Morck et al. (1988) found that there is a convergence of interests at middle-range levels of ownership, particularly in the 5-25% range but not at lower levels or higher levels (they empirically determine this to be about 25%). They argue that inconsequential ownership levels do not offset the potential for private benefits at low levels while entrenchment effects on managers outweigh the convergence of interest effects at higher levels.

There is also a distinction to be made between insider and outside directors who both may be offered partial ownership in an effort to align interests. It is important to distinguish the interests of each type. While ownership for insiders, at certain levels, may provide for interest alignments, competing factors may mitigate those effects, including the potential for managers to find other employment outside their firm – the labour market effect – or that social or pecuniary benefits may outweigh the value of ownership offered. For external board members, the ownership that they may own may not be sufficient to dampen any status-seeking effects (Khan, Mather, & Balachandran, 2014).

Based on the existing literature and research, the preponderance of the evidence suggests that stronger mechanisms will support higher returns in general because of the constraining effects on managerial opportunism. In the specific case of mergers and acquisitions, stronger corporate governance mechanisms should also diminish the effects of managerial opportunism, constraining firms to undertake transactions that are most likely to benefit shareholders. Consequently, stronger overall governance will result in better monitoring and decision making leading to superior outcomes for the acquirer firm from the agency theory perspective (Kroll et al., 1997; Wright et al., 2002).

***Proposition 1:** Stronger corporate governance mechanisms will be positively associated with acquisition financial performance.*

### **Strategic Corporate Governance**

As many researchers looking at agency theory noted, board members can also facilitate transactions through their competencies. Directors engage in a strategic function through their ability to increase access to resources and to leverage competencies in increasing firm performance. While insiders play an important role in the daily operations of the firm than external directors, outsiders can have important roles to play providing strategic and operational guidance on a variety of issues. These abilities come in the form of various competencies that have been developed over time. International and M&A experiences appear to be the most relevant as the M&A context has the potential for a transformational impact on the firm (Miletkov, Moskalev, & Wintoki, 2015) and is thus of great consequence.

While some have drawn on the psychological literature on expertise (McDonald, Westphal, & Graebner, 2008), others have used upper echelon theories to evaluate board M&A performance finding mixed results depending on the characteristic studied. Hagendorf and Keasey (Hagendorff, 2012) found that occupational diversity had a positive impact, age and tenure a negative one, and gender no impact on acquirer performance; same industry experience was not a factor in explaining performance. This might arise for two reasons. First, having different dominant logics may be useful in board settings (Bettis, 1986) as it may provide unconventional views to the prevailing wisdom for a particular industry (DiMaggio & Powell 1983). The fact that industry-specific experience is a non-factor lends support to this explanation. Furthermore, having different industry experience may provide complementary skills that would not be otherwise available from same industry directors.

The discussion below will develop a theoretical justification for considering a resource-based perspective for the value that directors bring to firms. Before embarking on the development, it is important to establish our theoretical posture of what the resource-based view. It is our contention that the resource-based view is a general perspective that captures the resources that a firm has at its disposal and that may provide it with a competitive advantage. It is our view that a resource may be tangible or intangible as long as it meets the conditions of it being valuable, rare, inimitable and non-substitutable (Helfat, 2003). The notion of intangibility encompasses far more than what may be contemplated by accountants (e.g. brand) or measured by financiers (e.g. Tobin's Q). In a strategic sense, we consider capabilities and knowledge to be specific cases of the resource-based view and not mutually exclusive theories – experience leads to valuable expertise (McDonald et al., 2008).

While reflecting an industry dominant logic (Bettis & Prahalad, 1986; DiMaggio & Powell 1983) may be considered as providing legitimacy, it is worthwhile to consider when board members

that do not have this baggage. In order for this situation to arise, the experiential component provides competencies rooted in *extra-industry* experiences (Krause et al., 2013). While the development of this expertise may rest in psychological or learning perspectives, the use of that expertise to provide value to the acquiring firm is rooted in the resource-based view. There are two reasons why this may be beneficial in a cross-border merger: expertise and networks.

First, operational diversity provides focal firm managers with access to a broader set of resources and skills in a variety of functional areas (Hagendorff & Keasey, 2012). More specifically, acquisition experience provides important skills for target selection, evaluation, valuation and integration (Haleblian, Kim, & Rajagopalan, 2006) and the propensity to make acquisitions (Peng & Fang, 2010). While the relationship with performance is subject to various contextual factors, including size and timing (Hayward, 2002), as well as strategic factors, including relatedness (McDonald et al., 2008), the experiences that directors have leads them to develop a competency that can be leveraged for the focal firm (McDonald et al., 2008). In the same vein as above, international experience, in the context of cross-border acquisitions, provides a third experiential pillar of expertise. Transactions involving firms from different contexts adds an institutional layer of complexity, often absent in domestic acquisitions. Such complexity may arise because of cultural barriers – an often studied concept in M&A research (Berry, Guillén, & Zhou, 2010). However, these challenges go beyond culture to include other institutional, economic and geographic disparities, often referred to as distances (Mtar, 2010) that experienced directors may help focal firms navigate. Thus, the combination of experience provides both general and specific expertise in providing needed competencies to acquiring firms.

Finally, the external ties that directors have boards - networks – may provide access to key resources (Carpenter & Westphal, 2001; Hillman & Dalziel, 2003). These are two key concepts that emerge from networks: centrality and network participation. Centrality would advance that the director is at the center of a network where information passes through the director with the amount of information, and thus value, increasing with the number of ties. Moreover, being a central figure may allow the director to exert influence over their ties (Astley & Sachdeva, 1984). In the second perspective, connectedness suggests that the variety of networks that a director participates in, for example through multiple board appointments, would provide that director to multiple and heterogeneous sources of possibly valuable information (Harris & Shimizu, 2004). In the context of an M&A transaction, this phenomenon may allow the focal firm to benefit from minimizing information asymmetries. In a cross-border or increasingly complex environment, such benefits may allow the focal firm greater returns (Kang, 2006),

*Proposition 2: Stronger corporate board strategic capability will be positively associated with acquisition financial performance.*

However, there are some conflicting results with respect to M&A performance that would suggest that the agency theory argument is not supported unequivocally and in all circumstances. Environmental complexity (Kang, 2006) seems to play an important role in moderating outcomes. Kang (Kang, 2006) found that for domestic acquisitions under high environmental complexity or industry dynamism monitoring plays a greater role as boards are able to bridge information asymmetries for investors more so than in stable environments. Moreover, an important consideration in mitigating this complexity comes from the M&A and international experience of board member in helping firms navigate this complexity. This notion of environmental complexity and dynamism parallels well to transactions involving firms that are embedded in complex environments.

### **Effect of institutional heterogeneity in partnership configuration on M&A performance**

Governance structures of firms are embedded in their institutional context (Capron & Guillén, 2009). For this reason, atypical forms of governance emerge in particular settings. For instance, strategic groups are specifically designed to fill in gaps that result from institutional voids which are common in developing markets (Khanna & Palepu, 2006). Similarly, more advanced economies have strong formal institutions (Jütting et al., 2007) such as laws which shape governance systems of indigenous organizations.

The strategic ability of a board of directors to foster access to resources and leverage the capabilities and competencies of its members is also essential to corporate performance (Leiblein, M., 2003). However, not all capabilities are deemed equal. Relationship networks and context-specific knowledge are less mobile than more generic technical skills. This is particularly true in the context of developing markets where informal institutions prevail (Jütting et al., 2007) and where trust-based relationships matter more than contracts.

Several comparative studies have contrasted the strategies and performance levels of multinational enterprises from emerging markets (EMNEs) and their counterparts from developed markets (DMNEs) (e.g., Ramamurti, 2012). While significant work has been done on the drivers behind the performance of M&As, very little attention has been paid to whether the fact that one or both partners is/are from emerging markets affects the performance of the acquirer. Indeed, the comparison of governance mechanisms and board strategic capabilities of firms from developing and developed markets are likely to differ due to the significant differences in the institutional conditions in which they are embedded (Uzzi, 1996). Accordingly, two configurations of partnerships may be worth comparing. We will call the first type “institutionally homogeneous partnerships” because both partners are from emerging markets. In contrast, the second type will be called “institutionally heterogeneous partnerships” as one the partners is from emerging markets and the other partner is from developed markets.

The corporate board of a company resulting from a merger between partners from developed and developing markets is expected to include directors from both companies. Such diversity would bring varied institutional norms into the boardroom which may mitigate the self-interest temptations of board members. In the same vein, diversity in the institutional backgrounds of board members will likely increase the range of the firm’s strategic capabilities. This is likely to improve the performance of the acquirer compared to a more homogeneous institutional background of board members that would result from a merger between partners that are both from emerging markets. Therefore, we propose:

***Proposition 3:** Overall, the performance of institutionally heterogeneous partnerships (one partner firm is from developing markets and the other is from developed markets) will be lower than the performance of institutionally homogeneous partnerships (both partnering firms from developing markets only).*

In the case of heterogeneous partnerships, the dynamics may vary within the board of directors depending on whether the acquirer is from developed or developing markets. The assumption is that dominant management logics that prevail within a firm mirror the institutional settings of its home country. For this reason, emerging and developed markets nurture different logics of thinking and operating (Khanna & Palepu 1997). EMNEs, for instance, tend to venture into other developing markets with institutional conditions that are similar to – or less developed than – the ones they are used to in their home markets (Cuervo-Cazurra & Genc, 2008). When they make acquisitions in more developed markets, they usually seek to boost their image by association.

In this paper, we are interested in what happened when the partners are driven by different and sometimes opposing logics. As suggested earlier, heterogeneous partnerships are likely to outperform homogeneous partnerships thanks to the wider span of capabilities and skills resulting from such diversity. Operating in unfamiliar institutional conditions often requires significant learning. While this principle applies to all firms regardless of their market of origin, EMNEs may have an advantage over DMNEs. The literature has distinguished between developed, developing and least-developed countries (World Bank, 2007). Moving from one of these markets to another requires significant learning. DMNEs have been successful in bridging their “learning gap” between developed and emerging markets and EMNEs can outperform DMNEs in least developed markets. For this reason, EMNEs have more incremental value to add – in terms of institutional learning – to a heterogeneous partnership between firms developed and developing markets. As a result, we suggest that mergers where EMNEs are the acquirer are likely to perform better than those involving DMNEs as acquirer. More formally:

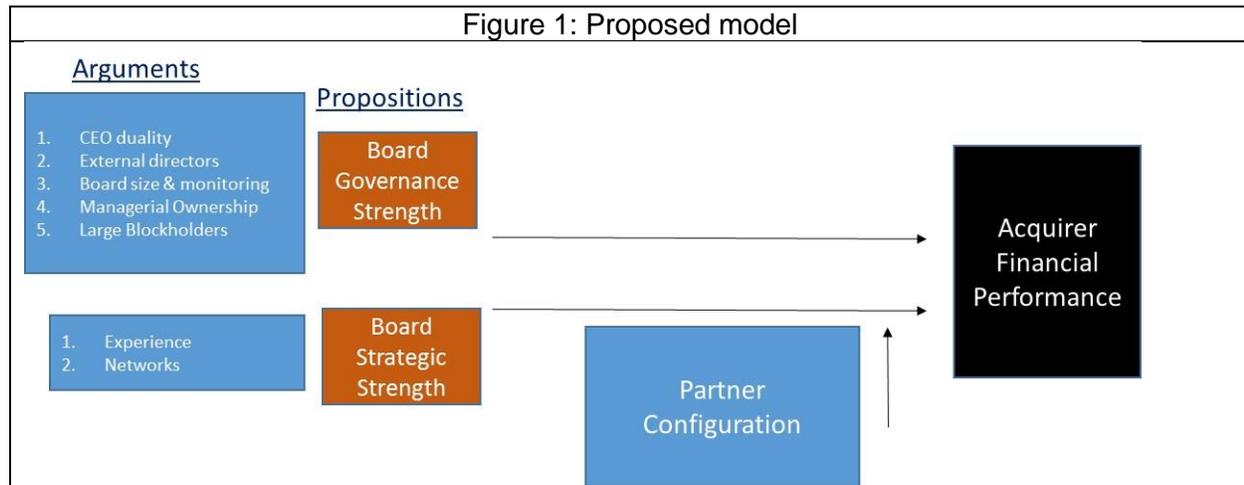
*Proposition 4: All being equal, the performance of institutionally heterogeneous [developing-developed] partnerships will be higher when the acquirer is from emerging markets and the acquired is from developed markets.*

## CONCLUSION

The theories developed in this paper advance our understanding of the performance of M&As depending on how the post-merger organization is governed and on how the pre-merger partnership was configured in the first place. On the one hand, the first two propositions contribute to the debate on the determinants of post-merger performance through a governance lens. Both strong governance mechanisms and board strategic capabilities are suggested to affect the financial performance in a positive way. On the other hand, the last two propositions extend and deepen the debate by submitting that partnerships should not be viewed as a rigid black box that fits it all. Instead, we suggest that configuration of the partnership matters to the performance. Specifically, we used extent comparative literature suggesting that multinationals from emerging markets (EMNEs) may behave differently from their counterparts from developed markets (DMNEs) to discuss the nature of partnerships from an institutional perspective. While unwrapping the black box of partnerships, we categorized them into institutionally homogeneous and institutionally heterogeneous which we hope will incite other scholars to take a more fine-grained approach to the analysis of partnerships in general. Another close but different contribution resides in recognizing that the differences in the institutional environments in which EMNEs and DMNEs have grown will affect the performance of mergers in which they are the acquirer positively. Researchers may find such market of origin perspective of diversity in board of directors more useful than the traditional country of origin. Practitioners may also find our findings especially the partnership configuration of interest. Diversity has traditionally been considered in M&A from an organizational fit perspective. In contrast, this paper takes a dominant logic and capability centric approach.

This paper has limitations. We elected to focus on partnerships that have at least one partner from emerging markets. The performance of institutionally homogeneous partnerships involving partners from developed economies only may be worth studying from a governance structure and strategic capabilities perspectives. However, future research may wish to explore the performance of partnerships involving EMNEs using different predictors than those here. Finally, emerging markets are not homogeneous either. Looking at subsets of countries within emerging markets would be insightful. A regional perspective may help distinguish between Latina American, African, Asian, and East-European countries for instance. And, of course, testing and refining our propositions would constitute a tangible contribution in its own right.

## APPENDIX



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