Opening M&A Strategy to Investors: Predictors and Outcomes of Transparency during Organisational Transition

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Our study theorises and tests why organisations engage in more external transparency as an open strategy practice and the share-price related outcomes associated with these practices. Drawing from literature on information asymmetry, we suggest that organisations that depart from their existing strategy or deviate from industry norms are more likely to open up their strategy in order to escape negative evaluations by analysts and scrutiny by investors. We further investigate how the stock market responds to more openness in strategy. In a dataset comprising of a sample of 472 M&A deals and 886 associated corporate voluntary communications over a five-year period, we find that the likelihood of organisations engaging in open strategy practices that contribute to external transparency is associated with the degree to which an organisation's strategy differs from industry norms, but is not associated with how much it varies from its existing one. Regarding organisational outcomes of increased openness in strategy, we illustrate that increasing the transparency of M&A strategy to investors through voluntary communications can bring share-price related benefits. Our research contributes to literature on open strategy, information asymmetry, and managing M&A.

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Introduction

A recent movement within strategic management has begun to advance ‘open strategy’ as an umbrella concept that envelodes open innovation and other open forms of strategy making (Whittington et al., 2011). Whittington et al. (2011) describe open strategy as “a concept involving a bundle of practices, the mix varying across contexts” (p. 535). The opening of strategy is the result of organisations' movement towards widening inclusion and increasing transparency both inside and outside the boundaries of organisations (Whittington et al., 2011). While existing research provides examples of what these bundles of practice are (i.e. blogging, jamming, strategy presentations, crowd-sourcing), it only infers the value openness brings to an organisation in terms of widening the search for strategy ideas, sharing knowledge and engaging in strategic conversation. With the exception of a few recent publications (see for example, Whittington et al., 2015), there is a lack of research that provides empirical evidence of the reasons why organisations engage in open strategy or the organisational outcomes associated with these practices. We believe that understanding why organisations choose to open up their strategy and what happens when they do so furthers our understanding of this concept and helps us derive practice-related outcomes. We therefore focus on a specific form of open strategy practice in a highly critical strategic context: namely, external transparency during mergers and acquisitions (M&A). M&As are very widespread in the business world, accounting for more activity in dollar terms than many of the world’s largest economies. For organisations, M&A can mean life or death (Angwin, 2007).

There are several reasons why external transparency can play a critical role during M&A. The strategic direction of an organisation comes under intense scrutiny from outside constituents (Gilson, 2000). For instance, stakeholders may possess many concerns for the future of the protagonists and it is well reported in the financial literature that information about impending M&A can move financial markets (see Sudarsanam, 2010 for a review). Apart from the deal premium, issues such as potential synergies between organisations entering the deal, integration issues, and restructuring plans may be specific investor concerns (Angwin, 2001). Also, given the lengthy time period that M&A can span, investors may be nervous about deal completion (Angwin, 2004; Angwin et al., 2015). External transparency during M&A can act as a mechanism to ease possible investor anxiety regarding the process and the outcome of the deal.

Compared to the process and the timeline of the deal, of equal importance is the ability of analysts and investors to interpret and evaluate the M&A (Zenger, 2013). Organisations which adopt ‘unique’ strategies have been shown to be penalised...
by negative market reactions (Feldman et al., 2014; Litov et al., 2012; Zenger, 2013). These negative market reactions may be explained by the existence of information asymmetry between managers of organisations and outside investors (Gilson, 2000). Specifically, investors’ lack of understanding of the value of an acquirer’s strategy (Feldman et al., 2014), narrow specialisations by analysts (Zuckerman, 2004), and numerous cognitive limitations attached to covering diversified firms or firms with unique strategies (Feldman et al., 2014; Litov et al., 2012) result in depressed share prices.

Drawing from information asymmetry theory (Ambarish et al., 1987; Miller and Rock, 1985; Myers and Majluf, 1984), we put forward and test hypotheses concerning the likelihood of organisations undertaking M&A engaging in open strategy, and the likely outcomes of such strategies. We suggest that a fundamental difference in the pattern of present and future resource deployments is likely to act as a reason for financial analysts to publish unfavourable earnings forecasts or not to cover the organisation. Both of these scenarios are likely to lead to negative share price reactions and these negative reactions are likely to be heightened during acquisitions (Haleblian et al., 2009). Our hypotheses are therefore built on the premise that organisations are likely to be motivated by, and succeed in, offsetting existing or anticipated negative market reactions by opening their strategy externally.

We therefore argue that organisations are more likely to be engaging in forms of open strategy during M&A to reduce information asymmetry. We also argue that due to information asymmetry and its negative consequences, organisations with strategies characterised by greater strategic variation and deviation are more likely to be externally transparent. They are likely to move away from being opaque in an attempt to alter negative portrayals of analysts or to fill the voids left by analysts that do not issue earnings estimates after an organisation has announced a merger or acquisition.

In order to study increased transparency as an open strategy practice in an M&A context we examine M&A announcements during the deal process. These announcements come in two types: ‘mandatory’ and ‘voluntary.’ There are many studies of ‘mandatory’ (those required by law) announcements (Andrade et al., 2001; Goergen and Renneboog, 2003) that are required when a deal is to be launched. In these studies a 25% increase in target company share price is not uncommon (Baker and Limmack, 2002; Sudarsanam and Mahate, 2003). However ‘voluntary’ announcements (those made when a company decides on its own volition to design and release information) have received much less attention and those that occur post-deal announcement, but before deal closure, have received no attention. These communications, which we term ‘voluntary M&A announcements’ and define as public, voluntary communications carried out by organisations involved in M&A are the subject of this paper. Separate from the initial M&A announcements, these disclosures take place after the initial deal announcement and before its closing. Authors of these announcements can be bidders, targets, or both parties. Between deal announcement and the closing date, an intended acquisition can be made or broken by share price adjustments as investors react to deal-specific information released during this post-announcement period. Therefore, during M&A, top management teams of firms that are undergoing strategic variation or deviation are likely to try to win support for their strategy through increased transparency directed at analysts and investors. By focusing on share price reactions tied to voluntary M&A announcements, we measure how external forms of open strategy can be employed by organisations to manage short-term market responses during M&A rather than the eventual economic returns of the deal itself (Oler et al., 2008).

A shift towards external transparency and asymmetry reduction implies an active orientation to shaping investor perceptions. It offers a choice about whether and how to communicate. External forms of open strategy in the M&A context are in line with what Rindova and Fombrun (1999) have termed ‘strategic projections’, the various kinds of statements about intended strategy (i.e. published in corporate press releases and annual reports). Open strategy, therefore, contributes to how audiences evaluate a firm and allocate the resources they control. Similar to strategic projections, practices associated with external forms of open strategy not only offer information about strategic investments, but also have additional symbolic content in providing ready-made and desirable interpretations of strategic moves for key audiences (Whittington and Yakis-Douglas, 2012). Our research focus therefore is not on the compulsory, non-discretionary forms of communication required by law that involves strategy (i.e. mandatory M&A announcements) but rather on voluntary, discretionary communications of strategy (i.e. voluntary M&A announcements). Existing research suggests that these voluntary announcements have symbolic and reputational value for analysts and investors and that they are used widely by established organisations and entrepreneurs (Rindova et al., 2004; Vaara and Monin, 2010; Zott and Huy, 2007). Our research takes this one step further to move beyond the symbolic value of voluntary corporate communications and assesses the market value associated with them.

Our paper proceeds as follows: we first discuss open strategy in the context of M&A, emphasising that increasing external transparency as an open strategy practice can help combat information asymmetry. We then build our hypotheses using literature on information asymmetry and construct predictions on the likelihood of, and outcomes associated with observing organisations with strategic variation and deviation carrying out voluntary M&A announcements. After our hypotheses, we present our data and methodology, followed by the results. The final section includes our discussion and conclusion in which we address possible outcomes of open strategy in practice as well as limitations of the study and directions for future research.

Theory and hypotheses

Our research focus is on the external transparency aspect of open strategy. More specifically, our research falls into one of the four broad principles of open strategy identified by Whittington et al. (2011): namely, external transparency. Traditionally, strategy has been ‘secret’ — elitist and opaque. Keeping strategy undisclosed can be associated with numerous advantages...
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