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Supply-chain corporate venturing through acquisition: Key management team retention

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ABSTRACT

Acquisitions are often used as a way to engage in corporate venturing. The value of these ventures tends to reside in the knowledge and capabilities of the key management team members who have and maintain key inter-organizational relationships. Because their knowledge and/or relationships may be tacit and therefore difficult to transfer, retaining the key managers in the acquired organization is often a critical issue for the human resource management of the acquiring organization. They are also frequently thought to be critical elements in the future performance in global supply chains and therefore, should be a key concern of human resource management after the acquisition has been culminated. Using a unique dataset of corporate acquisitions in supply-chains, we examine how the development of the psychological contract elements affects retention of critical key global managers. We find that higher retention of the key management team members leads to higher performance after acquisition. We also find that the development of the psychological contract has a positive impact on the retention of key managers with global supply-chain relations.

1. Introduction

In 2007, merger and acquisition (M&A) deals worth $4.367 trillion were announced, up from $3.4 trillion in 2006 to $2.9 trillion in 2005 (Moshieri & Campa, 2009; Wall Street Journal, 2006). The total value of global M&A fell by $1.1 trillion due to the global economic crisis for 2008, with volume dropping from 15,256 deals throughout 2007 to 12,018 deals in 2008 (Hodges, 2009). Within a broader corporate context, the motivation for acquisitions can vary. For example, in the 1980s, much of the M&A activity was focused on hostile takeovers as a means to restructure poorly performing conglomerates (Montgomery, 1994). But, in November 2009 M&A buyout activity rebounded to $323 billon the highest month since July 2008 (Kalwarski, 2010).

From an agency perspective, this acquisition activity in the 1990s was motivated through the market for corporate control with an ultimate goal of restructuring these firms for efficiency and discipline over management through the reduction of free cash flows (Jensen, 1986). More recently as global competition is now the norm, acquisition activity has been seen as a means by which an organization can extend its competencies incrementally (Chang, 1996). This view of M&A activity is consistent with the resource based perspective (Barney, 1986, 1991) wherein an organization seeks to increase their capabilities relative to skills as well as increase their scope of operations through strategic acquisitions. Because a firm typically possesses unused capacity, diversification to extend the use of the firm's resources and frequently capabilities generates net benefits (Penrose, 1959; Wright, Dunford, & Snell, 2001). Additionally, acquisitions from this perspective provide the opportunity to develop new capabilities both within the acquired unit and within the corporate parent particularly when the acquisition is in a global supply chain (Markides & Williamson, 1994).

It is apparent that the merger and acquisition strategy continues to be popular for competing in the fast paced global marketplace of the 21st century. This is typically true in global acquisitions that are centered on global supply-chains. The Council of Supply Chain Management Professionals state that global supply chain encompasses the planning and management of all activities involved in sourcing, procurement, conversion and logistics management. The operational expectations of global supply chain management include the crucial components of coordination and collaboration with channel partners, which can be suppliers, intermediaries and third-party service providers, as well as consumers (Hult, Tomas, Hurley, & Knight, 2004).

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The bottom line is that global supply chain management integrates supply and demand management within and across companies (Flint, 2004; Handfield & Nichols, 2004; Vickery, Calatone, & Droge, 2006). Recently, the acquisition of global supply chains has been seen as a way for firms to engage in obtaining and leveraging new resources through corporate venturing (Thomson & McNamara, 2001). In particular, acquisitions may form a critical component of external corporate venturing (Miles & Covin, 2002). Within this stream of research, acquisitions serve many purposes including: as a means to overcome learning distance between supply-chain members (Busenitz, Hoskisson, Arthurs, & Hansen, 2006), supply-chain members to learn about new markets and channel members (Handfield & Nichols, 2004; Hult et al., 2004), and as a way to engage in corporate renewal when that renewal involves learning from supply-chain partners (Dess et al., 2003; Palmatier, Dant, Grewal, & Evans, 2006). Acquisitions may also be a means by which a larger supply-chain member can place an option on a smaller firm pursuing new technology (McGrath, 2001). Indeed, larger firms often engage in acquisitions in order to ensure that they are able to appropriate the rents from new resources and new technology (Pisano, 1990). The key issue in examining acquisitions of global supply chain members is that some of the values are the interorganizational relationships that have been created by the key management team (KMT) of the acquired organization (Flint, 2004; Handfield & Nichols, 2004; Stank, Keller, & Closs, 2001). Relationship marketing has created a high level of interest in interorganizational relationships with 400 articles being published on the topic since 1990 in the marketing literature (Palmatier et al., 2006)

Examining acquisitions from this perspective has significant implications on the response of the acquiring firm vis-à-vis the acquired firm. Although earlier research has identified the acquisition process as critical to the overall success of the acquisition (Jemison & Sitkin, 1986), we submit that this becomes even more critical in the context of acquisitions as a means of corporate venturing. In particular, we argue that the ability of the acquiring firm to maintain the active support of the key talent in the acquired firm is critical to the success of the corporate venturing. Because human assets cannot be owned like a piece of equipment or a technology license (Coff, 1997, 1999), the human capital of an organization is not bound to the company after the acquisition. They (the acquired firm's human assets) may decide to leave after the acquisition especially if they perceive that the acquiring firm is mistreating or else neglecting its responsibilities towards them. This perceived neglect often grows out of a violation of the psychological contract between the employing organization and the employees (Morrison & Robinson, 1997; Rousseau, 1989).

The psychological contract represents the employees' beliefs about the reciprocal rights and obligations between them and the acquiring organization. After the acquisition, employees may feel that these obligations have been repudiated. In the end, if an organization acquiring a firm as part of its corporate venturing activity fails to embrace the new employees and to reestablish the psychological contract, defection may occur. This is of particular interest in acquisitions where relationships are central to the value of the management team (e.g., marketing relationships in supply-chains) (Harvey & Richey, 2001; Joshi, 1993).

Because important knowledge is often embedded in the human assets of an organization (Lepak & Snell, 1999), the ability to learn through acquisitions within a corporate venturing context would tend to magnify the importance of the human assets in the acquired supply-chain organizations. With this in mind, we seek to identify first whether the retention of the key management team (KMT) in acquired firms as part of corporate venturing activity is associated with stronger post-acquisition performance in those units. Second, we seek to identify whether the development of psychological contract elements leads to greater retention of the key management team. Lastly, we seek to examine how the external environment affects the implementation of the psychological contract elements. Greater dynamism (e.g., interorganizational relationships) within a corporate venturing context, requires a need for greater human resource attention to the entire acquisition process (De Wulf, Odekerken-Schroder, & Iacobucci, 2001; Wright et al., 2001).

Our theoretical contribution is focused on extending resource based theory by identifying how organizations engaging in corporate venturing through supply-chain acquisitions preserve the embedded value (e.g., critical human capital) of the acquisition. We begin to address issues concerning the coping mechanisms used by organizations to retain greater value when that value is derived from human assets (cf. Coff, 1997; Wright et al., 2001). If the psychological contract can be used as a device to retain critical inter-organizational talent and limit post-acquisition turnover, our results will have practical significance as well (Gruen, Summers, & Acito, 2000).

This paper follows the logic of: first, target firm's key management team (KMT) retention and the subsequent effect of post-acquisition performance from a resource based view are explored. Second, contract theory and the development of psychological contracts and how they evolve between the target firm's KMT and the acquirer are examined. Third, hypotheses are developed to explain post acquisition performance, which is centered on the effects of KMT retention and psychological contract development on post acquisition performance. Fourth, the hypotheses in the sample of acquisitions are tested. Fifth, the results of the study are discussed.

2. Key management team (KMT) ongoing value

The resource based view of the firm suggests that organizations accumulate and develop a bundle of specialized resources that are both tangible vs. intangible and internal vs. external to the firm. These resources, when applied appropriately, should generate above average returns and can create a sustainable competitive advantage (Barney, 1986, 1991; Peteraf, 1993; Wernerfelt, 1984). When it is impossible to develop such human resources organically (internally), firms often will attempt to obtain these relational resources through acquisition (externally).

The focus of research in the resource based view is probably best restricted to those differences between organizations that competitors cannot (or do not) duplicate for whatever reasons, or that competitors cannot duplicate loosely enough to eliminate the advantage (Hunt & Morgan, 1994; Palmatier et al., 2006). Due to inimitability and the dependent variable as competitive advantage, competitor's inability to duplicate successful (rare, non-substitutable, inimitable, and valuable) strategies will create a sustainable competitive advantage. Examples of these resources/assets are: key management team, brand names, in-house knowledge of technology, employment of skilled personnel, trade contacts, machinery, efficient procedures, and capital.

The resource based view offers that physical, human, and organizational resources are an organization's source of competitive advantage when they are valuable, rare, non-substitutable and inimitable (Barney, 1991). These resources can be modified as an organization's knowledge of markets, technologies, and consumer needs and attitudes are affected by external inputs (Penrose, 1959). The KMT has control over all organizational resources, human resources and physical assets to one degree or another (Goetz & Scott, 1981). As new knowledge is developed or obtained, the KMT reacts to modify strategy. The KMT plus their expert knowledge (Lippman & Rumelt, 1982) can be seen as a valuable, rare, non-