ACQUISITION PERFORMANCE: EXPERIENCE OR COMPETENCE?

Steven E. Phelan, University of Nevada Las Vegas, Las Vegas, Nevada, USA
Tomas Mantecon, University of Nevada Las Vegas, Las Vegas, Nevada, USA

ABSTRACT

In a study of over 10,000 acquisitions between 1991 and 2002, we find evidence that past success raises future performance in private, or semi-private, bids but not in public bids. We also find that past success was not associated with the number of prior acquisitions. We attribute this past success to an unobserved acquisition competence and argue that acquisition competence must be based on some sort of informational advantage that is dissipated in public bidding situations.

Keywords: acquisitions, experience, competence, event study

1. INTRODUCTION

The sheer volume of acquisition activity and the availability of data on acquisition announcements have conspired to make the study of acquisitions a central topic in the management and finance literature (Hitt, Ireland, and Harrison, 2001). However, the results of this research have not been kind to the view that managers undertake acquisitions that add value to their firms (King et al., 2004). The prevailing wisdom is that acquirers seldom gain from their acquisitions, with the bulk of the gains being appropriated by stockholders of the acquired firm (Datta, Pinches, and Narayanan, 1992; Jensen, 1988). Similarly, recent meta-analytical studies have failed to find any relationship between acquisition performance and key management decision variables, such as prior acquisition experience, method of payment, and relatedness of acquirer and target (King et al., 2004). Furthermore, the percentage of variance explained by management variables in acquisition studies has been depressingly low (King et al., 2004).

Strategists in the resource-based tradition have responded to these findings by attempting to identify additional behaviors that may explain the observed heterogeneity in acquisition performance (Capron and Pistre, 2002; Coff, 1999; Hayward, 2003). According to the resource-based view (RBV), acquisitions represent an opportunity to acquire a bundle of resources in a target firm that may be combined synergistically with resources from a bidder firm to create added value (Harrison et al., 1991). The RBV also maintains that some firms may possess an acquisition competence that enables them to identify, negotiate, or implement acquisitions more efficiently than their rivals (Hitt, Harrison, and Ireland, 2001; Hitt, Ireland et al., 2001).

Although the synergy issue has been explored in some depth in previous studies (Capron, 1999; Capron and Pistre, 2002), the second question, whether firms possess an acquisition capability or competence, has not fully addressed in the literature. The current study attempts to address this issue in several ways. First, we distinguish acquisition competence from acquisition experience. Second, we present evidence for the existence of an acquisition competence. Finally, we demonstrate that this acquisition competence may be an information-based advantage that yields superior performance in the acquisition of private firms and subsidiaries but not in the acquisition of public firms.

2. THEORY AND HYPOTHESES

2.1 Acquisition experience

There has been a small but growing literature on the role of prior acquisition experience on acquisition performance (Zollo and Reuer, 2003). Experience is a convenient variable in acquisition studies because a) it is relatively easy to calculate for large samples, and b) is thought to be associated with greater competence.

The first prediction of a positive relationship between acquisition experience and acquisition performance was made by Lubatkin (1983). This was followed an empirical test of the relationship between prior experience and performance by Kusewitt (1985). Kusewitt posited that “…higher acquisition rates led to greater success due to greater experience” (p. 152). On the other hand, companies that made too many
acquisitions a year risked what he termed ‘corporate indigestion’ – a state where the company’s acquisition resources would be spread too thinly to negotiate and implement effective deals. Utilizing a sample of 3,500 acquisitions between 1967 and 1976 by 138 companies, Kusewitt found that higher acquisition rates were negatively associated with annual stock market returns and accounting return on assets (ROA). In fact, negative performance started to occur whenever companies exceeded one acquisition per year on average. Kusewitt argued that this lent support to the ‘corporate indigestion’ hypothesis.

However, later studies by Fowler and Schmidt (1989) and Bruton et al. (1994) found slight positive relationships between acquisition experience and performance, albeit with much smaller sample sizes (41 and 52 acquisition events respectively). Additional work by Lahey and Conn (1990) found no difference in performance between firms making single acquisitions and multiple acquisitions in a six-year window surrounding the focal acquisition event.

More recent work by Halebian and Finkelstein (1999) reported a U-shaped relationship between the number of prior acquisitions and focal acquisition performance. They criticized the simplistic view that acquisition capability grew linearly with acquisition experience. Rather, they argued that firms tended to generalize too readily from limited past experience leading to lower performance but that these generalization errors reduced over time thus improving performance in the longer term. In a similar vein, work by Zollo and Reuer (2003) found no relationship between the quantity of experience and performance while finding a negative interaction between perceptions of past acquisition success and subsequent acquisition performance. They associated high perceptions of past success with ‘superstitious learning’, a situation where confidence in one’s ability outstripped one’s actual ability. They argued that the resulting complacency and faulty inferences led to poor subsequent acquisition performance.

Hayward (2002) was the first to advise researchers to examine the quality rather than the quantity of prior experience. While his study found no relationship between quantity of experience and performance, he presented evidence that performance was enhanced when acquisitions were not too similar or dissimilar, were not too temporally close or distant, or followed a run of small losses. In reviewing the past literature on prior experience in their meta-analysis of acquisition performance, King et al (2004) also found no evidence for the link between prior acquisition experience and performance across seven studies and 1,300 cases. They advised researchers to look for new moderators of acquisition performance while retaining any explanatory variables from previous research. As a result of the previous work on prior acquisition experience, we expect that:

**Hypothesis 1:** There will be no relationship between prior acquisition experience and performance.

### 2.2 Acquisition competence

Despite the negative findings on the relationship between prior experience and performance, there is considerable anecdotal evidence (and perhaps a widespread belief) that some firms (e.g. General Electric, Cisco, Cooper Industries) are particularly good at the acquisition game; possessing some sort of acquisition capability or competence (Campbell, Goold, and Alexander, 1995; Hitt, Harrison et al., 2001). Sanchez and Heene (2004) define competence as “…the effective deployment and coordination of a system of interrelated, interdependent resources and capabilities” (p. 37). As such, an acquisition competence includes the ability to effectively identify, negotiate, and implement specific acquisitions (Hitt, Harrison et al., 2001).

Previous research (Capron, 1999; Capron, Mitchell, and Swaminathan, 2001; Capron and Pistre, 2002) has focused on the ability of acquisitions to augment the resource stocks of both the acquiring and acquired firms. However, an acquisition competence does not operate at the level of individual resources and capabilities. Rather, an acquisition competence represents an example of a meta-resource or dynamic capability that enables the firm to extend and leverage its operational or zero-level resources and capabilities (Eisenhardt and Martin, 2000; Teece, Pisano, and Shuen, 1997; Winter, 2003).

Both Halebian and Finkelstein (1999) and Zollo and Reuer (2003) point out that acquisition competence may not grow linearly with acquisition experience. Halebian and Finkelstein (1999) argue that the ability to generalize from similar acquisitions and discriminate among dissimilar acquisitions is the key to success. This ability takes time to learn and often leads to lower performance in the short run. Zollo and
Reuer (2003) argue that success breeds superstitious learning, which causes confidence in one’s ability to grow faster than the competence itself. Hayward (2002) also demonstrates that large successes and failures seem to suppress later performance, while small losses may be associated with greater learning and thus superior performance. In all of these cases, competence lags experience due to learning-related issues.

2.3 Detecting competence

Raw experience has not proven to be a good proxy for acquisition competence. There has been an assumption that competence grows linearly with experience but competence itself has never been directly measured. Although experience is easy to measure, we agree with Hayward (2002) that the focus needs to go beyond simple measures of experience to consider more qualitative factors because “experience is but a crude approximation of the mechanisms that lie at the foundation of building...capability” (Kale, Dyer, and Singh, 2002, p. 750).

Differential technique

There are several arguments that can be used to explain the weakness of the purported relationship between competence and experience. One line of argument is that certain firms possess a talent or aptitude for acquisitions that precedes experience. Just as taller people make better basketball players, it may be that some firms are pre-disposed to perform well in acquisitions. Of course, this begs the question of where such a talent resides in a firm and how it got there in the first place.

Another possibility is that some firms stumble upon more effective acquisition capabilities by accident. For instance, Chambliss (1989) reported that Olympic swimmers did no more training than swimmers at lower levels of competition. Chambliss argued that talent represented only an “entry level” of physical characteristics but that qualitative differences in performance were more attributable to differences in technique, discipline, and attitude. He went on to argue that excellence is mundane -- that “superlative performance is really a confluence of dozens of small skills and activities, each one learned or stumbled upon” (p. 81). The widely held belief that “practice makes perfect” or “experience breeds competence” was not borne out by the facts. In fact, Chambliss goes so far as to argue that “no inherent personal qualities are required for achieving excellence” (Chambliss, 1992, p. 103).

In the context of acquisitions, this would imply that while firms need only a basic level of competence to compete in the acquisition market (i.e. the ability to identify targets, conduct due diligence, and fulfill accounting and legal requirements), superior performance may be attributable to dozens of small qualitative differences in technique that may have been learned or created by accident. Thus, differences in technique/competence (and performance) will be only loosely correlated with experience (if at all). This leads us to hypothesize that:

Hypothesis 2: There will be a positive relationship between acquisition competence and performance.

Hypothesis 3: There will be little or no correlation between acquisition competence and experience.

Differential learning

Another possible explanation for the observed heterogeneity in acquisition performance is that some firms learn faster or more effectively from their prior acquisition experiences. Acquisition competence would thus rest upon “how effectively the firm is able to capture, share, and disseminate...management know-how associated with prior experience” (Kale et al., 2002, p. 750).

Zollo and Winter (2002) point out that the ability to organize and disseminate knowledge within the firm has been discussed within a number of theoretical traditions, including absorptive capacity (Cohen and Levinthal, 1990; Lane and Lubatkin, 1998), architectural knowledge (Henderson and Cockburn, 1994), combinative capabilities (Kogut and Zander, 1992), and dynamic capabilities (Eisenhardt and Martin, 2000; Teece et al., 1997). While definitions and emphases vary slightly from one tradition to the next, there is a widespread view that the ability to recognize, assimilate, and apply knowledge from acquisitions should result in superior performance (Hitt, Ireland et al., 2001).

The limited empirical work on the subject has generally concurred with theoretical predictions. For instance, work in the area of strategic alliances has demonstrated that a dedicated position to manage or coordinate alliance-related activity was associated with positive stock market announcements and
alliance success (Kale et al., 2002, p. 754). The development of an acquisition competence may be uneconomical at low levels of acquisition activity. In addition to the direct cost of developing the competence, there may also be insufficient data to produce accurate generalizations which may result in poor performance (Haleblian and Finkelstein, 1999). At higher levels of activity, an firm will be able to a) generate valid insights from experience, b) amortize the cost of obtaining those insights over a number of acquisition events, and c) use the insights to add value by engaging in profitable acquisitions and avoiding unprofitable targets. As such, we hypothesize that:

**Hypothesis 4:** There will be a positive interaction between acquisition experience and competence.

### 2.4 Type of acquisition

In general, the finance literature does not expect to find positive performance outcomes for acquiring firms because they assume that markets are reasonably efficient and that potential gains will be eliminated through competition (Lubatkin, 1983). However, recent research has discovered that bidders often make positive returns when they acquire private firms (Fuller, Netter, and Stegemoller, 2002; Moeller, Schlingemann, and Stulz, 2003).

If acquisition competence reflects, even in part, a superior ability to identify targets and negotiate better terms then the effectiveness of these skills must be affected by the contestability of the market and the information held by other (potential) bidders. A tender bid for a publicly listed firm immediately reveals information to the market about both the attractiveness of the target in general and its particular attractiveness to the bidder (in terms of potential synergies). This has the effect of negating the benefits of superior target identification because private information immediately becomes public.

The average premium (weighted by deal value) paid to public acquisition targets between 1976 and 1990 was over 40% (Hayward and Hambrick, 1997; Jensen, 1993). Bidders are usually forced to offer a premium to deter challengers and discourage speculators. In some cases, the bid may be contested and additional firms will bid for the assets, forcing up the acquisition price. In both cases, the winner may be forced to either pay too much (the winner’s curse). Competitive forces will thus have a tendency to diminish any superior negotiation skills possessed by the original bidder.

As such, we expect that:

**Hypothesis 5:** Acquisition competence will be less effective for public targets

Competitive forces are more restrained in private acquisitions or in the acquisition of subsidiaries of public firms, because details of the bid can generally be kept secret until they are concluded (Fuller et al., 2002; Moeller et al., 2003). This allows any competence in target identification and negotiation to be more fully exploited. As such, we conclude that:

**Hypothesis 6:** Acquisition competence will be most effective in private bids or acquisitions of subsidiaries.

### 3. SAMPLE AND METHODS

#### 3.1 Sample

The initial sample consisted of all reported acquisitions between 1991 and 2002 with a positive transaction value in the Securities Data Corporation (SDC) US Mergers & Acquisitions database. We then eliminated firms that did not maintain stock price data with the Center for Research in Security Prices (CRSP) database at the University of Chicago. We also excluded spin-offs, recapitalizations, leveraged buy-outs, and events contaminated by other concurrent announcements. Following Hayward (2002), deal values that were less than 0.5% of the bidder’s pre-announcement market capitalization were also excluded. This screening process yielded a final sample of 10,574 mergers and acquisitions, which consisted of 5,734 private targets, 1,465 public targets, and 3,375 acquisitions of subsidiaries. Table 1 shows the frequency of acquisition events by year.

The study’s design called for the sample to be divided into two time periods to compare the effect of prior period acquisition competence and experience on later performance. For the purposes of this study, the sample was divided into two time periods of equal six-year duration, the first from 1991 to 1996, and the second from 1997 to 2002 (although the results were also consistent for different time divisions).
3.2 Dependent variables

If markets display semi-strong form efficiency, then share prices will quickly impound public information so that stock price reactions to new information provide an unbiased valuation of the effects of the event. A positive relationship between the dependent variable and the explanatory variables would suggest that the market places a positive valuation on the focal firm’s experience and/or competence.

Following the methodology of recent acquisition studies (Haleblian and Finkelstein, 1999; Hayward, 2002; Zollo and Reuer, 2003), we determined cumulative abnormal returns (CAR) for all acquisitions in the second half of our sample (1997-2002). CAR was calculated as the sum of the difference between actual and expected stock price movements in a three-day window around the announcement of the focal acquisition.

The expected performance was estimated using standard event study methodology described by Brown and Warner (1980; 1985). It was estimated using data from day -210 to day - 61 where day 0 was the date when the news initially appeared in the newswires, typically the day before the news appeared in the written press. The resulting data were examined for normality and returns above 50% and below – 50% were excluded to eliminate outliers. A total of 62 cases were excluded in this manner.

3.3 Explanatory variables

**Acquisition competence.** The calculation of acquisition competence followed several steps. First we calculated the cumulative abnormal returns for all firms in the first six years of our sample (1991-1996) using the same technique as that for the dependent variable (see above). We reasoned that firms that possessed an acquisition competence would outperform those that did not (see Powell, 2001 for a discussion of the logical relationships between performance and competence). We then calculated the mean and median CAR for all firms undertaking at least one acquisition in the first half of the sampling period (the results were also broadly consistent for firms with 3 or 5 qualifying acquisitions). We also calculated the mean and median performance for an “adjusted” CAR. Adjusted CAR was the residual value of CAR after removing the variance attributable to the control variables (discussed below). Adjusting CAR enabled us to control for factors that are known to affect performance but are not related to the experience or competence of the acquirer.

**Prior acquisition experience.** Prior acquisition experience was determined by the number of acquisitions undertaken in the initial six-year period of the sample (1991-1996). This period was chosen to parallel the same period used to determine the level of acquisition competence. An alternative approach is to calculate the cumulative number of acquisitions from the start of the sample period to the focal deal (Hayward, 2002). We found no significant difference between the cumulative and prior period techniques in our sample. Reported results reflect the prior period technique.

<table>
<thead>
<tr>
<th>Year</th>
<th>All</th>
<th>Private</th>
<th>Public</th>
<th>Subsidiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>366</td>
<td>166</td>
<td>56</td>
<td>144</td>
</tr>
<tr>
<td>1992</td>
<td>534</td>
<td>289</td>
<td>48</td>
<td>197</td>
</tr>
<tr>
<td>1993</td>
<td>659</td>
<td>333</td>
<td>57</td>
<td>269</td>
</tr>
<tr>
<td>1994</td>
<td>885</td>
<td>468</td>
<td>104</td>
<td>313</td>
</tr>
<tr>
<td>1995</td>
<td>1,000</td>
<td>511</td>
<td>157</td>
<td>332</td>
</tr>
<tr>
<td>1996</td>
<td>1,191</td>
<td>662</td>
<td>157</td>
<td>372</td>
</tr>
<tr>
<td>1997</td>
<td>1,482</td>
<td>869</td>
<td>174</td>
<td>439</td>
</tr>
<tr>
<td>1998</td>
<td>1,320</td>
<td>753</td>
<td>208</td>
<td>359</td>
</tr>
<tr>
<td>1999</td>
<td>1,052</td>
<td>600</td>
<td>176</td>
<td>276</td>
</tr>
<tr>
<td>2000</td>
<td>819</td>
<td>484</td>
<td>125</td>
<td>210</td>
</tr>
<tr>
<td>2001</td>
<td>635</td>
<td>287</td>
<td>122</td>
<td>226</td>
</tr>
<tr>
<td>2002</td>
<td>631</td>
<td>312</td>
<td>81</td>
<td>238</td>
</tr>
<tr>
<td>All</td>
<td>10,574</td>
<td>5,734</td>
<td>1,465</td>
<td>3,375</td>
</tr>
</tbody>
</table>
3.4 Control Variables

It is common in event studies to control for a wide range of factors known to influence returns (Hayward, 2002; King et al., 2004). The controls in the current study closely follow those of Hayward (2002) and include: event year, relative acquisition size, firm performance, contested bids, business similarity, method of payment, and use of advisor. Information on how these variables were operationalized is available from the authors.

4. RESULTS

Descriptive statistics and correlations for the 1997-2002 sample are presented in Table 2. In general, the signs of the correlation co-efficients are in the expected direction. Contested bids were associated with lower returns, for instance, and relative acquisition size were associated with larger returns. The hypotheses presented earlier predicted no relationship between performance and experience (H1) and competence and experience (H3), while positive relationships were expected between competence and performance (H2) and competence and experience (H4). The results in Table 2 actually indicate a negative relationship between experience and performance, a negative relationship between experience and competence, and a positive relationship between competence and performance.

These relationships were further explored in four regression models based on the entire 1997-2002 sample. Models 1 and 3 utilized the mean past performance as a proxy for acquisition competence, while Models 2 and 4 used the median past performance for their estimates of acquisition competence. Models 1 and 2 based their calculations on the unadjusted CAR, while Models 3 and 4 utilized residual CAR adjusted by the control variables.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>SD</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Past Performance</td>
<td>0.41</td>
<td>1.03</td>
<td>1.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Past Experience</td>
<td>0.86</td>
<td>0.85</td>
<td>-0.04</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>3. Acquisition competence</td>
<td>0.00</td>
<td>0.08</td>
<td>0.06</td>
<td>-0.08</td>
<td>1.00</td>
</tr>
</tbody>
</table>

N=3,510, if |r|>0.03 then p<0.05

The results (in Table 3) show that the regression coefficients were remarkably consistent across the four alternative measures of acquisition competence. All four measures were significant at the 5% level. This suggests that acquisition competence, or at the very least, prior acquisition success, may play an important role in predicting future performance (although the proportion of explained variance was relatively low). Most of the other control variables also had signs in the expected direction. Not unexpectedly, relative acquisition size had the largest effect on cumulative abnormal returns. In addition, the use of stock and third party advisors suppressed returns (Hayward, 2003), as did contested bids.
Unlike earlier studies (Haleblian and Finkelstein, 1999; Kusewitt, 1985), we failed to find a negative relationship between prior acquisition experience and performance. We also failed to find support for the significant U-shaped effect reported by Haleblian and Finkelstein (1999). This is at least partially attributable to the fact that we used a logarithmic transformation of the experience variable to normalize a rather skewed distribution. When non-normalized, squared experience was significant. Further investigation revealed this to be due to positive performance by a small group of firms with extreme levels of experience that were biasing the regression estimates. Firms with medium and high levels of experience showed no positive gains from squared experience. Moreover, experience was correlated highly with firm size ($r=0.34$, $p<0.001$). When the log of firm market capitalization was dropped from the regression, experience was significantly associated with negative returns. Interestingly, Haleblian and Finkelstein (1999) did not use firm size as a control variable in their study.

### 4.1 Effect of Target Status

The effect of target status is presented in Table 4. The table reveals a differential pattern of results that shows deviations from the aggregate results in Table 3. Acquisition competence is highly significant in Model 1 (private targets), somewhat significant for Model 3 (subsidiaries), and not significant for Model 2 (public targets). These effects are in the hypothesized direction.

As anticipated, cash deals were associated with higher performance in public bids and stock deals with lower performance. We also replicated Hayward’s (2003) result that the use of advisors is associated with lower returns in public bids. Interestingly, the use of advisors was positively associated with performance in private bids.

### 5. DISCUSSION

#### 5.1 Experience effects

Our results support the findings of a recent meta-analysis by King et al (2004) that indicate no relationship between experience and performance. Furthermore, we were unable to replicate the U-shaped relationship between experience and performance reported by Haleblian and Finkelstein (1999), although we were able to reproduce the Haleblian and Finkelstein result with non-normalized data. We also found a significant correlation between experience and firm size that may bias studies on the relationship between experience and performance that do not control for firm size in their models.

The results provide strong evidence that prior acquisition experience per se is not a strong predictor of focal acquisition performance (thus confirming hypothesis 1). One explanation is that the sample may
comprise firms with a mixture of acquisition motives, with some firms undertaking acquisitions for value creation and others for more opportunistic reasons (Berkovitch and Narayanan, 1993). The prevalence of opportunistic motives in the sample may mask the performance enhancing effects of experience in the value creation group.

Another possible explanation is that the market may not fully appreciate the value of the acquisition at the time of announcement and that long run performance indicators may be a better measure of acquisition performance. However, King et al (2004) found no relationship between experience and performance across several time periods ranging from days to months.

5.2 Competence effects

The results indicate that acquisition competence, operationalized as past acquisition success, was significantly related to acquisition performance (thus providing support for hypothesis 2). The effect was present in the total sample but differential results were found when the sample was divided by target status. The competence variable was most significant for private acquisitions, significant for subsidiaries, and not significant for public bids. These results are consistent with hypotheses 5 and 6. The difference in effect strength between private firms and subsidiaries was not anticipated but is consistent with the view that the advantage may be rooted in an information asymmetry between the acquiring firm and the market because, arguably, there is generally more information on subsidiaries of public firms than private firms.

Fuller et al. (2002) reported that acquiring firms pay less for private firms and subsidiaries than public firms. They attributed their result to the ability of the acquiring firm to capture the liquidity discount inherent in the valuation of private firms. However, this does not explain why other firms do not compete away the gains from this liquidity discount. Nor does it explain why firms with a history of successful acquisitions make higher returns when acquiring private firms and subsidiaries. The most likely explanation is that there are *ex ante* limits to competition in the market for private acquisitions that are chiefly attributable to an informational asymmetry between firms (Barney, 1986; Peteraf, 1993).

There may be a number of ways that a firm might exercise a competence in handling superior information. For instance, it may be able to act more quickly on the information before it has a chance to become general knowledge (Baum and Wally, 2003), or it may be able to protect the information better (Liebeskind, 1996). It might also choose to enter bids that have a lower probability of being contested.

Certain characteristics of public markets make informational advantages less valuable for public bids because a) more information is available on the target, b) information can diffuse more rapidly, and c) information has longer to diffuse. Mechanisms that facilitate these factors include: regularly update stock price information, SEC reporting requirements (e.g. annual and quarterly reports), mandatory waiting periods and disclosures, the presence of professional arbitrageurs, and anti-takeover laws. All of these factors combine to make any public bid highly contestable (Fuller et al., 2002).

5.3 Experience and competence

No significant interaction could be found between competence and experience in any of the models analyzed in the present study. These results provide support for hypothesis 3 and, consequently, fail to support hypothesis 4. Thus, it would appear that differences in performance are attributable to differential technique rather than differential learning.

For Chambliss (1989), superior performance is the result of dozens of small differences in organizational routines discovered by accident or by “…practice, experimentation, and discussion” (Weick, 1991, p. 121). While it may be possible that an acquisition competence may be the result of a major difference in modus operandi (such as a centralized acquisition function), we believe that the principle of ‘no general rule for riches’ (Rumelt, Schendel, and Teece, 1991) favors the Chambliss interpretation. Causal ambiguity and social complexity would also throw up barriers to the imitation of such a competence and provide a ready explanation for the sustainability of the construct over our sample period (Peteraf, 1993).

5.4 Limitations and implications for future research

Our research design attempted to escape some of the tautological issues inherent in the resource-based view (Priem and Butler, 2001) by examining the influence of performance in one period on performance in a later period. Of course, this reliance on past success as a proxy for acquisition competence is also one
of the key limitations of the current study (Ray, Barney, and Muhanna, 2004). There is an assumption on
the part of the researchers that companies that perform well do so because of an unobserved acquisition
competency. However, it is possible that some companies may be performing well in both periods while
not possessing the stated competency (Powell, 2001). It is also possible that some firms may possess a
distinctive acquisition competency but not perform well due to other deficiencies (Ray et al., 2004).

Ideally, we would have liked to open the black box to discover the specific practices and routines that
companies with an acquisition competence utilized to improve performance. In the alliance literature,
Kale et al (2002) were able to collect primary data on the existence of an ‘alliance function’, which they
defined as the ability “a position to manage or coordinate all alliance related activity in the firm” (p. 754).
They found that abnormal returns were positively related to the existence of such an alliance function.
Clearly, there is now an opportunity in acquisition research to gather primary data on the precise nature of
acquisition competence. Determining if firms possessed an ‘acquisition function’ that was positively
associated with performance would seem to be one such profitable line of inquiry.

One concern is that past performance may simply be a way of unmasking mixed acquisition motives in
the sample by enabling us to separate firms pursuing value-creating strategies from those pursuing value-
destroying strategies based on hubris or opportunism (Berkovitch and Narayanan, 1993; Seth, Song, and
Pettit, 2002). Rather than possessing any particular skill or competency, successful firms may just
possess different behavioral intentions. The fact that agency costs may be higher in private transactions
may also explain the strength of the association between competence and performance in private and
subsidiary bids. Clearly, further research is required to test between the competing hypotheses of
competency and motivation.

Finally, another issue in the current study is the limitations of the SDC database itself. Although this study
represents perhaps the largest sample of acquisitions in the strategic management literature to date,
there seems to be some gaps in the data. For instance, Hitt et al (2001) reported that General Electric
(GE) made 47 acquisitions in 1998 alone but the SDC database lists GE as the parent of the bidder only
53 times in the entire sample from 1991-2002. The concern is that we may be underestimating
experience and competence if large successful firms like GE are not fully represented in the data.
Opportunities exist to test the effects of these omissions.

5.5 Implications for theory and practice

From a practical point of view, possessing an acquisition competence may raise the return to private bids
by up to 7% when compared with average returns. In subsidiaries, the effect is around 5%. These effect
sizes are similar in magnitude to other commonly studied factors such as method of payment. This
suggests that the development of an acquisition competence has significant implications for practitioners.

From a methodological perspective, this study exposes new layers of heterogeneity in acquisition
samples. For instance, different processes seem to be operating in private and public acquisitions. Future
research on bidder returns should be prepared to control for type of acquisition. The study also further
reinforces Hayward’s (2002) observation that it is the nature of prior acquisition experience that is crucial
to subsequent performance rather than its quantity. However, Hayward’s (2002) result that small historical
losses contribute to performance is not consistent with our result that prior success lifts acquisition
performance. Further work is required to resolve this issue.

While the current study does not clearly delineate between competence-based and motivation-based
explanations for acquisition success this is not as serious as it first seems. If the primary determinant for
success is a managerial team focused on value-creating, rather than value-destroying, strategies then we
need to ask why this difference exists. For agency theorists, the answer is likely to be that value-creating
firms have superior monitoring and bonding capabilities that lower agency costs (Jensen, 1998). If this is
true, then the real question for theory (and practice) is ‘What is the most efficient resource allocation
between traditional acquisition activities (e.g. identification, negotiation, implementation) and governance
activities (e.g. monitoring and bonding)?’ In truth, we suspect that firms in our sample are effective on at
least one, if not both, of these dimensions. Value-creating firms may even be motivated to develop
acquisition capabilities.
6. CONCLUSION

The current study provides support for the view that acquisition competence or, at the very least a history of success in prior acquisitions, is more important to acquisition performance than experience. In fact, we find no support for the linear or curvilinear experience effects reported in earlier studies (Haleblian and Finkelstein, 1999; Kusewitt, 1985). This result is consistent with recent metanalytical results (King et al., 2004). While it is easy to argue that experience should produce greater competence and ‘practice makes perfect’, the results of many studies, including our own, indicate that the process is more complicated -- even historically successful performers do not seem to improve with experience.

Our primary argument is that high performers may display numerous subtle differences in acquisition technique and that qualitative differences can exist between firms at the same level of experience, largely as a result of accident and experimentation. A competing explanation, which cannot be ruled out with the current data, is that high performers are more motivated to create value and less prone to opportunism or hubris. Superior performance, then, is likely to be the result of superior governance mechanisms rather than the traditional focus on the ability to identify, negotiate, and implement deals. This represents quite a different type of acquisition competence than the one typically portrayed in the strategy literature.

We also find that the type of acquisition affects a firm’s ability to profit from their acquisition competence. Acquisition competence is most effective in private bids, less effective in subsidiaries, and seems to play no significant role in public bids. We conclude that abnormal returns are possible in private, or semi-private, bids because of sustainable information asymmetries but that the public market serves to eliminate informational advantages.

<table>
<thead>
<tr>
<th>Table 4. Regression model of bidder returns by target status (1997-2002)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>--------------------------------------------------</td>
</tr>
<tr>
<td>Firm Performance</td>
</tr>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Stock</td>
</tr>
<tr>
<td>Contested Bid</td>
</tr>
<tr>
<td>Business Similarity</td>
</tr>
<tr>
<td>Relative Acquisition Size</td>
</tr>
<tr>
<td>Use of Advisor</td>
</tr>
<tr>
<td>Bidder size</td>
</tr>
<tr>
<td>Past experience (log)</td>
</tr>
<tr>
<td>Experience squared</td>
</tr>
<tr>
<td>Acquisition competence</td>
</tr>
<tr>
<td>Competence * Experience</td>
</tr>
<tr>
<td>R²</td>
</tr>
</tbody>
</table>

Note: all coefficients x 10^3  
* - p<0.1, ** - p<.01, *** - p<.001
REFERENCES