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## **When and how previous experience affects the stock market reaction to business combinations**

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**Abstract:** In this paper, we analyse to what extent previous experience of the firms affects the investors' valuation of business combinations. We analyse two types of business combinations as alternative means to gain access to external strategic resources: strategic alliances and acquisitions. We point out that the previous experience of the companies in the management of business combinations will positively affect the abnormal returns of these operations. However, if the business combination supposes a diversification of the company, experience affects the investors' valuation of acquisitions and alliances in a different fashion. An empirical study of the investors' valuation of business combinations carried out by European telecom firms between 1990 and 2001 has confirmed these hypotheses.

**Keywords:** internationalisation; strategic alliances and joint ventures; mergers and acquisitions; experience; telecommunications industry.

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## **1 Introduction**

Both strategic alliances and acquisitions – organisational combinations – are alternative means commonly used by companies to gain access to external strategic resources and knowledge needed to compete (Chi, 1994). However, the transfer and redistribution of resources and knowledge between the companies involved are processes extremely difficult to manage in both cases, although for different reasons. Whereas in acquisitions the main problem is what Hennart and Reddy (1997) label as ‘digestibility’, that is, the integration of assets and businesses within a single hierarchy, in strategic alliances the main obstacles are the lack of trust between the partners (Hamel, 1991; Doz, 1996; Kale et al., 2000). Previous empirical research suggests that previous experience accrued by the firms in the management of organisational combinations can help them in the management of these operations. Haleblan and Finkelstein (1999) and Zollo and Singh (2004) found that prior experience in acquisitions positively affected the performance of the acquisition process. In the field of strategic alliances, Barkema et al. (1997), Anand and Khanna, (2000), Kale et al. (2002) and Kale and Singh (2007) found that previous experience in alliance management increased the performance and longevity of alliances. The main logic to explain these results is that firms develop organisational routines for dealing with each type of combination that can be exploited in subsequent alliances or acquisitions.

The stock market reaction to a business combination is a good assessment of the performance consequences of the decision to participate in it. The results of Cornett and Tehranian (1992), Healy et al. (1992) and Kaplan and Weisbach (1992), for the case of acquisitions, and those of Koh and Venkatraman (1991), Park and Kim (1997) and Kale et al. (2001), for the case of alliances, shows that abnormal returns<sup>1</sup> generated by the announcement of an organisational combination are highly correlated with other measures of the ex-post performance of each combination. In fact, previous literature on the impact of the experience in the management of business combinations on their performance has used as empirical evidence the stock market reaction to the formation of acquisitions, as Haleblan and Finkelstein (1999), or alliances, as Anand and Khanna (2000) or Kale et al. (2002). Although the impact of accrued experience in the stock market reaction to business combinations is well documented, there are not empirical studies with comparative analysis of both acquisitions and alliances that take into account the preceding experience of the companies in the management of these operations. Neither are there studies that take into account whether the operation involves diversification or not. This latter aspect is important because the implications and requirements of management and integration are different depending on whether diversification exists or not.

To fill these gaps, in this paper we present a theoretical framework that underlines the influence of the preceding experience of a company in the market reaction to the

formation of alliances and acquisitions. Besides the comparative study of alliances and acquisitions, our main contribution is the analysis of the interaction between experience and the business scope a company enters into through acquisitions or alliances. The implications of this theoretical framework will be tested using a sample of the business combinations carried out by European telecom firms.

This paper is organised as follows. First, we present a theoretical framework that analyses the impact of previous experience on the market reaction to business combinations. The implications derived from this theoretical framework will be contrasted in the third part of this paper, just before the presentation of the main results of the empirical study. After discussing the significance of these results and their implications, the paper ends with its main conclusions.

## **2 Theoretical framework**

Business combinations are processes that imply a previous negotiation between the companies and a subsequent integration either of all (in case of total acquisitions) or of part of the resources of these companies (in case of alliances). Both the negotiation and the subsequent integration are processes with a high associated complexity (Jemison and Sitkin, 1986; Haspeslagh and Jemison, 1991). Previous experience plays a very important role in these processes because it allows managers to develop a series of skills that they will be able to exploit in future business combinations (Haspeslagh and Jemison, 1991). Following literature on the learning curve, the learning and the incremental improvements in the performance of companies can be explained by the accumulation of experience in a particular activity (Yelle, 1979; Dutton and Thomas, 1984). If we apply this idea to business combinations, we can state that previous experience in the carrying out and management of this kind of processes allows companies to acquire a knowledge that will facilitate the carrying out of further operations in the future, and that the use of these mechanisms will improve as experience increases.

Nevertheless, acquisitions and alliances present different requirements for the efficient combination of resources. First, acquisitions imply the integration of more resources than alliances (Hennart and Reddy, 1997). On the one hand, acquisitions force companies to integrate people, organisational systems and different cultures, which is usually a difficult challenge for companies (Haspeslagh and Jemison, 1991). On the other hand, whereas acquisitions affect all the resources of the companies involved, alliances only affect those resources selected by each of the partners. This does not necessarily imply that alliances are easier to carry out than acquisitions, as the analysis of the high percentage of unsuccessful alliances shows. Moreover, alliances usually have problems relating to the partners' opportunistic behaviour and their contradictory objectives (Ring and Van de Ven, 1994; Doz, 1996; Madhok and Tallman, 1998; Ariño and de la Torre, 1998). Secondly, in acquisitions there only exists one single hierarchy in charge of the management of the common resources whereas in alliances all the partners share the management (Hennart, 1988; Kale et al., 2002), which increases the costs associated with the use of mechanisms to reduce the potential conflicts between partners (Geringer and Hebert, 1989). Third, while in an acquisition the acquiring company must pay for the total value of the acquired company's assets, in alliances firms do not need to pay the full value of their partners' resources and knowledge, since alliances are based on the reciprocal

access to resources by the partners (Hennart, 1988). Finally, acquisitions are operations with a higher degree of irreversibility than alliances because acquisitions are followed by a global reorganisation of resources within an integrated company or business group.

What most recent research shows is that acquisitions and alliances require specific knowledge and skills because they are different processes (Villalonga and McGahan, 2005). This knowledge and these skills can improve through experience. Zollo and Singh (2004) have found that previous experience in acquisitions positively affects the returns of an acquisition. Companies that have already carried out acquisitions have gathered experience they can use to successfully carry out future acquisitions, which increases the returns of new operations of this kind.

Regarding alliances, Kale et al. (2000) show the importance of what they name 'alliance capabilities'. These authors find that the key to achieving the highest returns from alliances is to carry out successful management practices of this kind of agreements such as those relating to conflict management or to the creation of relational capital. By developing capabilities on this kind of practices, companies can learn at the same time as they protect their own resources (see also Kale and Singh, 1999). In fact, empirical research has revealed that alliances give more results as the relationship develops (Doz, 1996). Theoretical research shows how these capabilities in the management of the alliance are acquired through experience (Westney, 1988). In addition, some evidence shows that the performance of the alliance (measured by companies' abnormal returns) is better in companies with experience in this field (Anand and Khanna, 2000; Kale et al., 2002).

From an organisational learning perspective, experience in the management and integration of the acquired companies (in acquisitions) or in the development of cooperative relations (in alliances) can be understood as a capability which is specific to the companies that carry out these processes. To this effect, Zollo and Winter (2002) present a theoretical discussion about how a company's capabilities can improve through the accumulation of experience (tacit knowledge) and its interactions with the existing company's organisational routines, which have been already codified (explicit knowledge). Moreover, the knowledge and experience of the people in each organisation in the merger is a key factor in the creation of new practices and the improvement of existing ones (Weber et al., 2012).

Based on all the previously mentioned ideas, we state the following hypotheses:

- Hypothesis 1      Previous experience of the companies in the carrying out and management of acquisitions will have a positive effect on the abnormal returns of these companies around the days of the announcement of a new acquisition.
- Hypothesis 2      Previous experience of the companies in the carrying out and management of alliances will have a positive effect on the abnormal returns of these companies around the days of the announcement of a new alliance.

As we have just seen, previous experience is a means to improve organisational routines that companies use when carrying out new business combinations. However, this new knowledge is not always equally beneficial. The positive effect will depend on the kind of operation we are analysing.

An important problem of the companies that carry out business combinations is the integration of the resources they have access to. In the case of acquisitions, the main difficulty of integration is the management of redundant resources (Capron et al., 1998), that is, those resources that the acquiring company already had before acquisition. When a company buys another one from the same industry, there exist important overlaps between areas such as marketing or sales force in both companies (Mitchell and Shaver, 2003). Therefore, although the bidder can transfer more management skills to the acquired company, integration needs to be more intense; that is, it requires bigger restructuring of the companies. In effect, when a company acquires a competitor, a great part of the value generated in the operation comes from the growing scale economies in production, marketing, distribution and administration. In order to take advantage of scale economies, the acquiring company must combine the acquired resources with those it already owns. In addition, this integration must be often carried out rapidly so as to recover the premium paid as soon as possible by means of an increase in the company efficiency. It is also common that acquiring companies have to get rid of resources – either of its own or of the acquired company – that have become obsolete or redundant (Capron et al., 2001). All this process of integration and consolidation requires an elevated skill that can be improved through experience (Mitchell and Shaver, 2003). In contrast, when a company acquires another from a different industry, the problems stemming from this integration are less important because there exists less duplicity of resources between companies than when both companies belong to the same industry. In fact, in this case the acquired company will usually continue to be autonomous (Datta and Grant, 1990). Besides, literature on the learning curve suggests that the accumulation of relatively homogeneous experiences (acquisitions in the same sector as that of the acquiring company) allows improving the efficiency in several activities (Dutton and Thomas, 1984; Yelle, 1979). The efficiency improvements will be more important in situations similar to those already experienced (March, 1991). However, if companies try to apply that acquired knowledge in different environments, they can fall into ‘competency traps’ in which “favorable performance with an inferior procedure leads an organization to accumulate more experience with it, thus keeping experience with a superior inadequate to make it rewarding to use” [Levitt and March, (1988), p.322].

Taking into account these ideas, we state the following hypothesis:

Hypothesis 3     The positive effects associated to experience in the carrying out and management of acquisitions will be lower when companies enter into industries different from their own.

In the case of alliances, however, an effective integration needs that partners overcome their unwillingness to share the assets that are necessary to obtain the required synergy. It is necessary some trust, which acts as a good governance mechanism and a guarantee for the relation (Dyer and Singh, 1998). Nevertheless, if there is not any previous relation between the companies, the key to generating this trust and obtaining adequate information to organise the cooperation is the development of what Madhok and Tallman (1998) name relation specific investments. That is to say, wasting time, energy and efforts to understand the objectives of the partner and facilitate the combined interaction. In this process, the skills of the companies to share information without falling into unnecessary risks are essential. This circumstance is what leads Kale et al. (2000) to develop the notion of alliance capabilities, which reveals that not all the companies are equally prepared to take the greatest advantage from their cooperative relations. Previous

experience in the carrying out and management of alliances will permit companies to develop some mechanisms and routines which can be exploited in the management of future alliances increasing their chances of success (Westney, 1988). As said before, some scholars suggested that a firm's experience contributes to its relational capabilities (Dyer and Singh, 1998; Gulati, 1999, 2007; Kale et al., 2002; Lorenzoni and Lipparini, 1999). In particular, such experience contributes to the development of alliance management routines that assist in partner selection, the choice of appropriate governance mechanisms, and the effective management of alliances. These relational capabilities, in turn, enhance value creation in subsequent alliances (Anand and Khanna, 2000). These ideas have received some support in prior empirical research. For example, Merchant and Schendel (2000) found that partnering experience, indicated by the overall number of prior joint ventures formed by a focal firm, produced an insignificant effect on a firm's abnormal market returns. Anand and Khanna (2000) reported similar results, but demonstrated that this effect becomes positive and significant when controlling for firm-specific factors. Finally, Hoang and Rothaermel (2005) found that in drug development projects, this experience effect is marginally diminishing and benefits biotechnology firms, and their pharmaceutical partners. Following this last result, we could say that the mechanisms to develop an alliance will not have to be different irrespective of the industry the company has entered into, since what is significant is the capability to develop a cooperative relation successfully. Consequently, we would expect that the positive effect derived from previous experience in the carrying out and management of alliances will remain regardless of the industry the company has entered into.

We, thus, state the following hypothesis:

- Hypothesis 4      The positive effects associated to the experience in the carrying out and management of alliances will remain even though the companies enter into industries different from their own.

### **3 Sample and methodology**

#### *3.1 Sample*

With the purpose of contrasting the above-mentioned hypotheses, we have used a sample on acquisitions and alliances carried out by European telecom companies between 1986 and 2001. In the last decade these companies have needed to adapt to important changes in their environment due to technological innovations and to deregulation and privatisation. This sample was obtained from the Securities Data Corporation (SDC) Database in its Platinum edition. Specifically, we have used SDC Platinum, Mergers & Acquisitions Database to obtain an initial sample of 643 operations<sup>2</sup> of this kind in the studied period. We have also used the SDC Platinum, Joint Ventures and Strategic Alliances Database, from which we have obtained 736 operations<sup>3</sup>. Therefore, our initial sample includes 1,379 business combinations completed<sup>4</sup>. We believe that this empirical setting provides an excellent opportunity to study the impact of experience on the stock market reaction to intra-industry and inter-industry business combinations. First, in this industry there have been a huge number of acquisitions and alliances through which firms

tried to gain access to external resources. Second, our sample covers a very wide time period through which we have tracked the history of the business combinations carried out by the telecom firms in our sample.

In order to measure the returns of the companies that carry out these business combinations, we have used daily price data obtained from the DataStream Database<sup>5</sup>, which reduces the initial sample to 1087 observations: 485 acquisitions and 602 alliances.

Similarly, Reuer et al. (2001) and Low (2001) have revealed that the date in the SDC database does not always coincide with the day when the news of the business combination is published. In order to rectify this error, and given that the correct measurement of this date is crucial for an adequate application of the methodology we are about to describe, we have verified every date by means of a systematic search in the Lexis-Nexis database.

Likewise, following McWilliams and Siegel (1997), we have removed from our initial sample all those operations potentially biased by confounding events. Specifically, we have removed from the original database all those observations in which there had been other news related to capital operations (capital increases, divestments or splits), dividend payments, state contracts, other acquisitions or alliances different from those studied or changes in key personnel in a  $\pm 5$  day period around the announcement day. We have made use of the Lexis-Nexis database to achieve this task.

Finally, the SDC database includes operations carried out by telecom companies that are not listed on the stock exchange but are affiliated to other listed companies. In this case, we have removed from the final database all those events in which the parent company is not a telecom operator. An example of an operation removed from our final sample would be that carried out by Thyssen Telecom AG, a telecom company that is not listed on the stock exchange and is affiliated to Thyssen Krupp AG, whose main activity is iron foundry (SIC 3322). We do consider, however, operations of telecom companies that are not listed but are affiliated to telecom companies that are listed on the stock exchange. For instance, the operations carried out by Telefónica Data, a company that is not listed but is affiliated to Telefónica de España.

Once we have removed all the above-mentioned cases, the final sample consists of 615 cases made up of 255 acquisitions and 360 strategic alliances. Table 1 shows the companies studied, grouped by nationality, and the number of acquisitions and alliances considered in our final samples for each of them.

**Table 1** Firms in our sample

<i>Country</i>	<i>Company</i>	<i>Acquisitions</i>	<i>%</i>	<i>Alliances</i>	<i>%</i>
Austria	CyberTron Austrian Dig. Tel.	1	.4	0	0
Belgium	Telindus Group	1	.4	1	.3
Denmark	Tele Danmark	15	5.7	7	1.9
Finland	Elisa Communications Oyj	5	2.0	0	0
	Sonera	6	2.4	1	.3
France	Avenir Telecom	2	.8	0	0
	France Telecom	17	6.7	6	1.7
	Genesys SA	4	1.6	0	0

**Table 1** Firms in our sample (continued)

<i>Country</i>	<i>Company</i>	<i>Acquisitions</i>	<i>%</i>	<i>Alliances</i>	<i>%</i>
Germany	Debitel AG	1	.4	0	0
	Deutsche Telekom	12	4.7	10	2.8
	Mannesmann	28	11.0	27	7.5
	MobilCom Kommunikationst.	7	2.7	1	.3
Greece	Hellenic Telecomm. Organiz.	5	2.0	0	0
Italy	Ing. C. Olivetti	10	3.9	46	12.8
	Tiscali SpA	1	.4	0	0
	Telecom Italia	21	8.2	36	10.0
	Wind Telecomunicazioni	1	.4	4	1.1
Luxembourg	Millicom Internat. Cellular SA	2	.8	0	0
Netherlands	KPN	17	6.7	17	4.7
	Libertel	1	.4	0	0
Portugal	Portugal Telecom	10	3.9	5	1.4
Spain	Telefónica	18	7.1	31	8.6
Sweden	Aspiro Information AB	1	.4	0	0
	Tele1 Europe Holding	1	.4	1	.3
UK	Atlantic Telecom Group PLC	1	.4	0	0
	British Telecom	14	5.5	94	26.1
	Cable & Wireless	28	11.0	56	15.6
	Colt Telecom	0	0	3	.8
	Energis	4	1.6	3	.8
	Kingston Communications	1	.4	2	.6
	Netcall	2	.8	1	.3
	Redstone Telecom PLC	2	.8	0	0
	Scottish Telecom	1	.4	2	.6
Telewest Communications	2	.8	5	1.4	
	Vodafone	13	5.1	1	.3
<i>Total</i>		<i>255</i>	<i>100</i>	<i>360</i>	<i>100</i>

### 3.2 *Dependent variable and method of analysis*

We run multiple linear regression models on the samples above described by means of the method of ordinary least squares with the aim of detecting what characteristics of the business combinations have a greater influence on the value creation of these processes.

As dependent variable, we use the percentage of the accumulated abnormal return in the  $\pm 3$  day period around the day the business combination is announced. We have used this period of accumulation because it is the longest gap in which we could guarantee the non-contamination of our events due to the  $\pm 5$  day period used to remove the contaminated cases. The returns obtained by the companies that carry out business



combinations have been measured by using the event study methodology, whose purpose is to determine the reaction to the announcement of some relevant facts in the price of the financial assets, following Brown and Warner (1985).

The response in the price of the shares around the day of the announcement of a business combination is analysed starting from the estimate of the abnormal return, which is defined as the difference between the returns really obtained certain day and the expected returns, which is calculated by taking as a basis some of the models of valuation of financial assets with risk<sup>6</sup>.

$$RA_{kt} = R_{kt} - ER_{kt} \quad (1)$$

being:

$RA_{kt}$  the residual returns, in excess or abnormal, of the share  $k$  the day  $t$ .

$R_{kt}$  the returns really obtained for the share  $k$  the day  $t$ .

$ER_{kt}$  the expected return of the share  $k$  the day  $t$ .

### 3.3 *Independent variables*

With the aim of testing the two first hypotheses, we have measured each company's previous experience (EXPERIENCE) as the number of similar previous operations the company has carried out to date. Thus, depending on the subsample, this variable will capture the number of previous acquisitions or alliances carried out by the company. In order to construct this variable, we have taken into account not only the operations included in the final sample but also all the operations from the initial sample (1,379).

In order to test hypotheses 3 and 4 relating to the industry the company is entering into, we have multiplied experience by a dummy (DIVERSIFICATION) valued 1 when the operation implies diversification<sup>7</sup>. This dummy has also been introduced into the regression models.

### 3.4 *Control variables*

We also include the following control variables in the regression models. Since the information for these variables could not be obtained for all the studied cases, the final size of the samples has been reduced to 202 alliances and 139 acquisitions. The variables we have used are the following:

Company dummies: they capture individual effects associated to each company, and thus, account for any unobserved heterogeneity inherent to each company that could affect the abnormal returns. Since the companies that carry out the acquisitions included in the final sample are 16, we have included 15 variables in the models estimated on this subsample. The alliances have been carried out by 15 companies, so we only use 14 dummies for those models. These dummies are not shown in the tables in order to simplify the presentations of results.

Year dummies: they capture any influence of time on the abnormal returns. In both subsamples we introduced 11 dummy variables, one for each year between 1991 and 2001. The dummy variable for 1990 is omitted in order to avoid problems of perfect multicollinearity. These dummies are not shown in the tables either, in order to simplify the presentations of results.

**INTERNATIONAL:** a dummy variable valued 1 if the operation involves the acquisition of a foreign partner or the formation of an alliance that implies activities in countries different from that of the European company that has carried out the operation. Some studies as DeLong (2001) or Eckbo and Thorburn (2000) found that international acquisitions benefit the company's shareholders. In the case of alliances, the evidence is mixed (see, for instance, Chen et al., 1991 or Lee and Wyatt, 1990). This variable was constructed with the information obtained from SDC. In the case of acquisitions, INTERNATIONAL is valued 1 when the activities of the alliance take place out the country of the studied company. In the case of alliances, INTERNATIONAL is valued 1 when the activities of the alliance are performed outside the home country of the focal firm.

**CULTURAL DISTANCE** between the companies: it has been measured using the Kogut and Singh's (1988) index and taking as an input the measurements brought up to date by Hofstede (2001). When there were more than two partners in an alliance, we followed the procedure used by Kim and Park (2002): we calculated the Kogut and Singh's (1988) index for each pair of partners and, then, we calculated the average of all these indexes. Please note that this procedure weights the different nationalities of the partners adequately since it takes into account all the possible combinations between them. We include this control variable because it is a variable often used in the literature on the market reaction to business combinations, although the empirical evidence is mixed (Very et al., 1997; Merchant and Schendel, 2000).

**CASH FLOW:** it is a variable that measures the free cash flow of the studied company. We have constructed this variable as (operative income – interests – taxes – dividends) / total assets (using the procedure followed by Chen et al., 2000). The data for the construction of this variable were obtained from DataStream.

**DEBT:** This is the debt ratio of the firm, defined as the short and long term debt over the total assets of the firm. This variable was also built using the information of DataStream. As this information is only yearly, we calculated the DEBT variable at December 31st of the year previous to the acquisition or the alliance studied.

**POLITICAL STABILITY:** the political stability in the target country of the operation is measured using the index developed by Henisz (2000). We have introduced this control variable by taking into account that the telecommunications industry is greatly affected by the decisions taken by regulators (Henisz and Zelner, 2001), and also because the country's institutional environment has been one of the aspects analysed in previous research (Chen et al., 2000; Lee and Wyatt, 1990).

**STATE PARTICIPATION:** it is the percentage of the company's capital that belongs to the State. We have constructed this variable by obtaining the data from the companies' annual reports and from direct and/or e-mail conversations with employees from these companies.

**INTANGIBLES:** this variable is an approximation to the ratio of the company's intangible assets over the total amount of assets on the 31st of December of the year before the date of the business combination. We have constructed this variable as the ratio *intangible assets / total assets*. The information on both items was taken directly from DataStream.

**TOBIN'S Q:** as Chung and Pruitt (1994) suggest, this variable is calculated as the ratio of the market value of each company's share plus the book value of debt divided by the book value of its assets<sup>8</sup>. This is a variable commonly used as a measure of the value of the companies' intangible assets (Morck et al., 1990; Morck and Young, 1992;

Delgado-Gómez et al., 2004). However, according to Hall (2001), this variable can also reflect the market power of a company. In the case of the telecommunications industry, where important (regulatory and non-regulatory) entry barriers exist, the Tobin's Q can be understood as a measurement of the strength of a company's market position. Consequently, given that we have introduced a specific variable related to the intangible assets of the companies (INTANGIBLES), we assume that the Tobin's Q allows to proxy the strength of the competitive position of the companies in our sample. This variable was calculated for the 31st of December of the year that precedes the acquisition or the alliance since the necessary data for its construction (obtained from the DataStream database) are annual.

NET SALES: this variable is used to measure the size of the telecommunications and costumers network of the company. The construction of this variable has started from the volume of net sales (in millions) obtained by each company in the 31st of December of the year that precedes the announcement of each acquisition or alliance. This measure was converted into euros using data about the exchange rate between several currencies and the euro at prices of the year in which the operation takes place. Finally, in order to discount the effect of inflation on this variable, it has been deflated using each country's consumer price index at constant prices of 1995. The measure of experience (previous acquisitions or alliances) could be also measuring the size of this network. We include this new variable in order to isolate the effect of this size on the companies' returns. Thus, our explanatory variable will show only the effect of experience in the carrying out of acquisitions and alliances. All the data necessary to construct this variable were obtained from the Thomson Financial DataStream database.

LISTED TARGET: a dummy variable valued 1 if the acquired company (at least, one partner from the alliance besides the European operator) was listed on the stock exchange at the time of the acquisition (alliance). This variable has been introduced in order to control the effect that the relative size of the companies involved in the business combination could have on the abnormal returns associated to each operation.<sup>9</sup> This relative size has been a factor commonly studied in papers that analyse the market reaction to the carrying out of both acquisitions (Asquith et al., 1983; Shelton, 1988; Jarrell and Poulsen, 1989; Seth, 1990; Walker, 2000; Fuller et al., 2002) and alliances (McConnell and Nantel, 1985; Crutchley et al., 1991; Koh and Venkatraman, 1991; Chan et al., 1997; Das et al., 1998; Kim and Park, 2002; Merchant and Schendel, 2000). We assume that, when this variable takes value 1, there exists a greater similarity between the sizes of the companies involved, given that the European operators that carry out the acquisition (or the alliance) are always listed on the stock exchange.

The following control variables were introduced only into the models with acquisitions:

GDP GROWTH<sup>10</sup>: it measures the gross domestic product of the country which the company enters, in the same year of the operation. The data for the construction of this variable have been obtained from the statistics published by the OECD and from the annual reports of the EU countries published by *Eurostat*.

TOTAL ACQUISITION: dummy variable valued 1 if the operation is a purchase of the 100% of a company without any previous presence of the acquiring company in the capital of the target.

PARTIAL ACQUISITION: dummy variable valued 1 if it is the first purchase of less than 100% of the capital of the acquired company, and takes value 0 in the rest of the

cases. This variable was omitted in the estimations in order to avoid problems of perfect multicollinearity.

ACCUMULATION: dummy variable valued 1 if the operation is not the first acquisition of a company by another one.

The following control variables were introduced only into the models with alliances:

JV: dummy variable valued 1 if the alliance has involved the creation of a joint venture.

GLOBAL ALLIANCE: dummy variable valued 1 when the alliance is global, that is, when it implies activities in more than one country. These global (Parkhe, 1991) or multicountry (Porter and Fuller, 1986) alliances are viewed as more valuable than those alliances limited to one country. Kim and Park (2002) and Vidal and García-Canal (2003) found a positive and significant effect of this kind of alliances on the abnormal returns of the partners.

R&D: dummy variable valued 1 if the content of the alliance implies R&D activities.

MANUFACTURING: dummy variable valued 1 if the content of the alliance implies manufacturing activities.

MARKETING: dummy variable valued 1 if the content of the alliance implies marketing activities. This variable, together with the two previous ones, has been introduced into the regression model of the alliances due to the fact that many earlier studies have analysed how the functional scope of the alliances, especially R&D alliances (Das et al., 1998; Merchant and Schendel, 2000), could affect the abnormal returns of a company's shareholders.

PARTICIPANTS: it is the number of partners in an alliance.

All these variables have been constructed using the information obtained from the SDC database, which contains very precise information about the geographical scope of alliances, the functional areas they include or the number of partners that participate.

Table 2 offers a summary of the control variables used and their definition.

**Table 2** Control variables

<i>Variable</i>	<i>Definition</i>
In both subsamples	
Firm dummies	Firm fixed effects
Year dummies	Year fixed effects
INTERNATIONAL	Dummy valued 1 if the operation enters a country different from the studied firm's one
CULTURAL DISTANCE	Measured using Kogut and Singh's (1988) index
CASH FLOW	Free cash-flows ((operating income– interests – taxes– dividends) / total assets)
DEBT	Debt ratio of the firm
POLITICAL STABILITY	Political stability of the host country, measured using Henisz's (2000) index
STATE PARTICIPATION	Percentage of the company's capital that belongs to the state
INTANGIBLES	Intangible assets / total assets
TOBIN'S Q	(Market value + debt) / total assets
NET SALES	Net sales (in million € of 1995)
LISTED TARGET	Dummy valued 1 if the acquired company or, at least, one partner from the alliance, besides the one studied, was listed on the stock exchange

**Table 2** Control variables (continued)

<i>Variable</i>	<i>Definition</i>
In acquisitions	
GDP GROWTH	GDP growth in the target geographical area of the acquisition
TOTAL ACQUISITION	Dummy valued 1 if the operation is a purchase of the 100% of a company without previous presence of the acquiring company in the capital of the target
PARTIAL ACQUISITION	Dummy valued 1 if it is the first purchase of less than 100% of the capital of the acquired company
ACCUMULATION	Dummy valued 1 if the operation is not the first acquisition of a company by another one
In alliances	
JV	Dummy valued 1 if the alliance has involved the creation of a joint venture
GLOBAL ALLIANCE	Dummy valued 1 when the alliance implies activities in more than one country
R&D	Dummy valued 1 if the content of the alliance implies R&D activities
MANUFACTURING	Dummy valued 1 if the content of the alliance implies manufacturing activities
MARKETING	Dummy valued 1 if the content of the alliance implies marketing activities
PARTICIPANTS	Number of partners in an alliance

Using all these variables, we estimate several multiple linear regression models for the subsample of acquisitions and that of alliances. The structure of these models is as follows:

$$\text{CAR} [-3, 3] = f(\text{EXPERIENCE}, \text{CONTROL})$$

being:

EXPERIENCE: independent variables related to our hypotheses.

CONTROL: control variables.

Specifically, due to the existence of a high correlation between the INTERNATIONAL and CULTURAL DISTANCE variables in the subsample of acquisitions, as Table 3 shows, we have estimated two models for this subsample. We have introduced these variables into these two models so that the variables never coincided. Thus, we estimated in this subsample a model into which we introduced the INTERNATIONAL variable (Model 1) and another model into which we introduced CULTURAL DISTANCE (Model 2). In the subsample of alliances, we did not find high correlations between these variables as Table 4 shows. Consequently, in this subsample we have only estimated a regression model with all the variables (Model 3).

**Table 3** Correlation matrix (acquisitions subsample)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
(1)	1.000	-0.411	-0.058	0.060	-0.087	0.052	0.051	0.084	0.048	0.154	0.035	0.115	-0.148	-0.117	-0.020
(2)		1.000	0.053	-0.169	0.003	0.088	-0.096	0.028	0.046	-0.031	0.046	-0.095	0.117	0.128	0.065
(3)			1.000	-0.257	0.565	0.053	0.097	-0.165	0.113	-0.044	0.124	-0.022	0.141	0.124	0.216
(4)				1.000	-0.200	-0.155	0.022	0.247	0.029	0.018	-0.027	0.032	-0.034	-0.222	-0.066
(5)					1.000	0.108	-0.007	-0.322	-0.011	-0.021	0.026	-0.036	-0.007	0.070	0.106
(6)						1.000	-0.137	-0.056	0.104	-0.004	-0.010	-0.250	0.183	0.079	0.218
(7)							1.000	-0.021	0.495	-0.123	0.149	-0.096	0.237	0.044	0.274
(8)								1.000	0.099	0.037	-0.082	0.008	0.039	-0.014	0.036
(9)									1.000	-0.240	-0.010	-0.084	0.410	-0.065	0.208
(10)										1.000	0.104	0.021	-0.113	-0.019	0.058
(11)											1.000	-0.051	-0.004	0.087	0.107
(12)												1.000	-0.182	-0.037	0.022
(13)													1.000	0.051	0.634
(14)														1.000	0.130
(15)															1.000

  

(1)	TOTAL ACQ.	(5)	CULTURAL DISTANCE	(9)	STATE PARTICIPATION	(13)	NET SALES
(2)	ACCUMULATION	(6)	CASH FLOW	(10)	INTANGIBLES	(14)	LISTED TARGET
(3)	INTERNATIONAL	(7)	DEBT	(11)	GDP GROWTH	(15)	EXPERIENCE
(4)	DIVERSIFICATION	(8)	POLITICAL STABILITY	(12)	TOBIN'S Q		



#### 4 Results

Table 5 shows the abnormal returns in the total sample and in each of the subsamples (acquisitions and alliances) in the day zero and in the main intervals of accumulation. In addition, it also presents the percentages of cases in which the abnormal returns are positive. We can observe how this percentage is always placed between 42% and 48%.

**Table 5** Event study – abnormal returns (%)

<i>Interval</i>	<i>AR full sample</i>	<i>% Pos.</i>	<i>AR acquisitions</i>	<i>% Pos.</i>	<i>AR alliances</i>	<i>% Pos.</i>
(-3,3)	-0.34**	45	-0.26*	43	-0.39	46
(-2,2)	-0.25***	45	-0.16**	42	-0.31*	47
(-1,1)	-0.07	48	-0.03**	47	-0.09	48
día 0	-0.07	46	-0.05	45	-0.06	46

Notes: \* $p < 0.1$ ; \*\* $p < 0.05$ ; \*\*\* $p < 0.01$

As the table shows, in the whole sample, the companies that carry out business combinations obtain, on average, negative returns that fluctuate between  $-0.07\%$  and  $-0.34\%$  and are negative in the main accumulation intervals.

If we analyse acquisitions and alliances separately, we see how the acquiring companies are damaged on average when they carry out this type of operations.

In the case of alliances, although negative returns are obtained on average in all the accumulation intervals, these abnormal returns are statistically significant only in the interval  $(-2,2)$ , in which a loss of value of  $-0.31\%$ , with a confidence level of 90%, can be observed.

Regarding the percentage of positive cases, we can notice an important heterogeneity in the abnormal returns of the cases of each sample so it seems especially relevant to investigate the factors that affect these results.

Table 6 presents the results of the two multiple linear regression models estimated in the subsample of acquisitions. This table shows the value of the coefficients of the independent variables and the level of significance of each variable. Similarly, Table 7 shows the results of the regression model estimated in the case of the sample of strategic alliances. Both tables illustrate how our results confirm the predictions.

The two first hypotheses are verified. Both in alliances and in acquisitions there exists a linear positive significant effect of the EXPERIENCE variable on the abnormal returns of the companies.

Likewise, if we analyse the results of this variable and those of the EXPERIENCE \* DIVERSIFICATION multiplicative variable jointly, the differences between alliances and acquisitions that we posed in hypotheses 3 and 4 are also confirmed. The positive effect of experience in acquisitions on the abnormal returns of new acquisitions decreases considerably when these acquisitions take place in industries different from telecommunications, given that the multiplicative variable in this subsample presents a negative and statistically significant sign. In contrast, the experience in the management of alliance seems to be applicable to operations in all types of industries, given that in this case the multiplicative variable does not present any statistically significant coefficient.

As regards control variables, although they are discussed later, a relevant result is that the geographical scope of the companies shows significant results only in acquisitions. In this subsample the internationalisation destroys value.



**Table 6** Multiple linear regression models in acquisitions (N = 139)<sup>a†</sup>

	<i>Model 1</i>	<i>Model 2</i>
Independent variable:		
Intercept	80.46	73.40
Experience variables:		
EXPERIENCE	0.50**	0.47**
EXPERIENCE * DIVERSIFICATION	-0.27***	-0.26***
Control variables:		
INTERNATIONAL	-1.64*	
DIVERSIFICATION	4.04	4.04
CULTURAL DISTANCE		-0.14
CASH FLOW	65.91	63.35
DEBT	-25.94**	-24.06**
POLITICAL STABILITY	3.63	3.49
STATE PARTICIPATION	-0.09	-0.09
INTANGIBLES	-0.68	2.51
TOBIN'S Q	1.08	1.22*
GDP GROWTH	-0.14	-0.20
NET SALES	0.28	0.30
LISTED TARGET	-1.07	-1.28
TOTAL ACQUISITION	0.91	0.97
ACCUMULATION	-1.41	-1.55
Model significance (F)	2.25***	2.16***
Adjusted R <sup>2</sup>	27.1%	25.7%

Notes: †Firm and year dummy variables have been omitted in order to simplify the presentation of the results. Estimated coefficients are robust to heteroskedasticity.

<sup>a</sup>Dependent variable: CAR (-3,3).

\*p < 0.1; \*\* p < 0.05; \*\*\* p < 0.01.

**Table 7** Multiple linear regression model in alliances (N = 202)<sup>a†</sup>

	<i>Model 3</i>
Independent variables:	
Intercept	23.10
Experience variables:	
EXPERIENCE	0.11**
EXPERIENCE * DIVERSIFICATION	-0.01

Notes: †Firm and year dummy variables have been omitted in order to simplify the presentation of the results. Estimated coefficients are robust to heteroskedasticity.

<sup>a</sup>Dependent variable: CAR (-3,3).

\*p < 0.1; \*\* p < 0.05; \*\*\* p < 0.01.

**Table 7** Multiple linear regression model in alliances (N = 202)<sup>a†</sup> (continued)

	<i>Model 3</i>
Control variables:	
INTERNATIONAL	-1.25
DIVERSIFICATION	1.25
CULTURAL DISTANCE	0.10
CASH FLOW	16.68
DEBT	-0.80
POLITICAL STABILITY	1.41
STATE PARTICIPATION	-0.01
INTANGIBLES	41.91*
TOBIN'S Q	1.71
NET SALES	0.18
LISTED TARGET	-0.34
JV	-0.05
GLOBAL ALLIANCE	2.60***
R&D	-0.95
MANUFACTURING	-1.14
MARKETING	-0.83
PARTICIPANTS	-0.18
Model significance (F)	1.57**
Adjusted R <sup>2</sup>	10.5%

Notes: †Firm and year dummy variables have been omitted in order to simplify the presentation of the results. Estimated coefficients are robust to heteroskedasticity.

<sup>a</sup>Dependent variable: CAR (-3,3).

\*p < 0.1; \*\* p < 0.05; \*\*\* p < 0.01.

## 5 Discussion

This study intends to analyse how previous experience affects the creation of value associated to two kinds of business combinations: acquisitions and alliances. Our four hypotheses have been confirmed.

In this paper we have explored hypotheses relating to the effect of the previous experience in the management of business combinations on the returns associated to each new combination of the same kind. We expected that this previous experience positively affected the returns of a company that carried out a new combination of the same kind (hypotheses 1 and 2) and that, in the case of acquisitions, the market would value this experience only when it takes place in the same industry (hypothesis 3) while, in the case of alliances, this experience could be used in every type of industry (hypothesis 4).

Results in the Tables 6 and 7 corroborate hypotheses 1 and 2, that is to say that previous experience in the carrying out and management of acquisitions (alliances) positively affects the abnormal returns of the acquiring company involved in a new acquisition (alliance). These results confirm previous evidence found by other authors

such as Zollo and Singh (2004), in the case of acquisitions, or Anand and Khanna (2000) or Kale et al. (2002) in the case of alliances.

Regarding hypotheses 3 and 4, our results also reveal an important difference between acquisitions and alliances. The experience in alliances seems directly applicable to every kind of new alliances, since differences between the effect of experience in operations in the same industry and operations in other industries cannot be appreciated. These results complement those of Barkema et al. (1997), who found that the experience accumulated in the management of domestic alliances could be exploited in the management of international alliances. In view of the fact that the key to get the most of alliances requires trust building and the development of the alliance (Buckley and Casson, 1988; Dyer and Singh, 1998), it seems that the best practices in alliance management must be the same in all cases. However, the experience in acquisitions does not seem equally useful when the company crosses the borders of its own industry. The management of the acquisition and of the subsequent integration of the target into the acquiring company is very different when the former is placed in a different industry. And this is reflected on the reduction of the importance of this experience when the said company does not belong to the acquiring company's main business.

We can also extract from the control variables results that bring forward information, which may complement previous empirical results. A result that clashes with previous empirical literature is the INTERNATIONAL variable. In effect, our results show that, when acquisitions are used to enter into a foreign country, these acquisitions destroy value, contrary to the majority of the papers that analyse this effect on acquisitions (Doukas and Travlos, 1988; Delios and Beamish, 1999; Eckbo and Thorburn, 2000 or DeLong, 2001). However, we must take into account that the greater a company's debt ratio is (measured with the DEBT variable) the less valued the acquisition is. This result would reflect the existence of some concerns by investors as regards the financing of investments abroad by the analysed companies.

Additionally, a greater volume of intangible assets in a company carrying out an acquisition (measured with the INTANGIBLE variable) does not seem to affect the abnormal returns obtained, which clashes with Morck and Yeung's (1992) results, who found that the presence of this type of assets would facilitate the value creation by means of acquisitions. Nevertheless, the coefficient of this variable in the subsample of alliances has a positive sign and is statistically significant. Therefore, the presence of intangible assets in the hands of companies carrying out strategic alliances favours a positive reaction by the market to these operations.

Finally, alliances will create more value when they are global, that is, when they are created to carry out activities in several markets simultaneously. This result confirms previous papers such as Vidal and García-Canal (2003).

## **6 Conclusions**

Our purpose in this paper is to complement the literature on the market reaction to the formation of strategic alliances and acquisitions (business combinations) by highlighting the role played by a company's experience in the management of business combinations. An analysis of the business combinations carried out by European telecom operators in the last years has allowed us to verify that the firms' experience exerts a relevant influence. In fact, the experience in the management of business combinations influences

abnormal returns positively, although this effect is only significant in acquisitions within the same industry and in all kind of alliances.

Some interesting insights emerge from this paper which may be helpful for practitioners, even outside the telecommunications industry. Our results show that investors value previous experience in acquisitions when firms acquire a direct competitor, while in the case of alliances, previous experience is valued regardless the business scope. These results are especially relevant for firms with previous experience in acquisitions and alliances, and for firms which are immersed in a process of expansion.

Nevertheless, our paper has also limitations that must be taken into account in order to value the implications of our results adequately. First, these results can be affected by the particular characteristics of our sample: all the acquisitions and alliances extracted from the database were carried out by European telecom operators. Obviously, these results are not necessarily transferable to other industries. However, they can improve the selection procedures between acquisitions and alliances in companies that belong to industries that have experienced a critical change in their environment. For instance, these results can be especially interesting in the electric industry. An interesting extension of this study could compare samples from various industries and from other continents.

Another limitation is that, despite our efforts to include all the relevant control variables, we could not include all the effects. Thus, it was impossible to use the relative size of the companies involved in business combinations in terms of their market value or of their employees as a control variable. The high number of companies acquired and of partners taking part in the alliances collected by our sample did not allow us to obtain information to construct this variable for the whole sample. However, we have included the dummy LISTED TARGET in our estimations as an approximation to the relative size. And we can observe that this variable does not affect the abnormal returns obtained by the companies that carry out business combinations.

Finally, we have not taken into account the previous experience of partners in an alliance in our analysis of the abnormal returns of companies that carry out this type of agreements. The calculation of this variable could not be accomplished because of the lack of data of the alliances carried out by all the companies involved in the operations of our sample.

Consequently, it seems necessary further research that use data from other industries and other countries in order to draw conclusions that can be generalised to all acquisitions and alliances, regardless of the investing company's industry or the country where the investment comes from.

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## Notes

- 1 Abnormal returns are the variations in the stock price of a company directly attributable to the announcement of a specific event, in this case an alliance or an acquisition.
- 2 In our sample, we only consider those acquisitions in which a European operator carries out the purchase. Acquisitions of European companies by non EU companies are not included in our database.
- 3 We consider as an event the announcement of the carrying out of an alliance by a Telecom operator from the European Union. Given that in some of the alliances more than one partner was European, these alliances have led to more than one event. Specifically, the total amount of events the 736 alliances we have found have led to is 830.
- 4 This gives rise to 1,473 events.
- 5 This database contains the prices of all the companies listed on the most important European Stock Exchanges. In our study, the most relevant data from this database is the *Total Return Index*, which reflects the variations in each company's price relating to a specific date. This



index is prepared to carry out event studies, and is corrected by dividend payments and other operations. Thus, this information is very useful to carry out an event study.

- 6 The expected daily returns were calculated starting from the market model by Sharpe (1964). The estimations of the market model was carried out using data from a 180 day interval, which started 200 days before the day of the announcement ( $t = -200$ ) and ended 21 days before that same date ( $t = -21$ ). We use as a reference index the *Global Index* included in DataStream. This is a market index for each stock exchange and is constructed using the same criteria for each of them. Thus, the index includes the main companies in each market in terms of market value (an average of 120 securities for each case) and is corrected by the payment of dividends, splits, increases of capital and/or divestments.
- 7 To be exact, DIVERSIFICATION takes value 1, in the case of acquisitions, when the acquired company is not a telecom operator and, in the case of alliances, when the activities relating the agreement are different from this kind of business.
- 8 Please note that the measurement of the Tobin's Q is an approximation since the denominator of this measurement should be the replacement cost of the company's assets.
- 9 Although the optimum procedure would have been to introduce a variable that measured the relative size of the companies involved into each acquisition or alliance depending on variables such as its market value or its number of employees, this solution would imply a drastic reduction of our initial sample. The reason is that many acquired companies from our sample are not listed on the stock exchange (more than 50%) and/or the data about their number of employees are not available in our databases. In particular, in the case of acquisitions, some estimations have been made by measuring the relative size as the ratio of the number of employees of the acquired company divided by the number of employees of the acquiring company. The information necessary for the calculation of this variable has only been obtained for 52 acquisitions. Likewise, due to the inclusion of other control variables in our models, of which we did not have complete information (DEBT, CASH FLOW or POLITICAL STABILITY), the estimations have been made on a final sample of 39 observations and have led to similar results as those in the table 6. These results are available upon request.
- 10 This variable has been introduced into the models of acquisitions, as Hennart and Park (1993) found that the propensity to enter into a foreign country through acquisitions is dependent on the growth rates of this country.