

CEO PREVENTION FOCUS AND MERGERS AND ACQUISITIONS



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General Introduction

Managers pay a greater attention to mergers and acquisitions (M&As) because of the inherent risks of valuation uncertainties, adverse selection (Akerlof, 1970), post-acquisition integration difficulties (Very & Schweiger, 2001), target firm managerial turnover (Krug *et al.*, 2014), and poor acquirer performance (King *et al.*, 2004). However, M&As do facilitate firm's growth and provide access to resources (Hitt *et al.*, 2001). Since CEO is the chief cognizer of such strategic decisions, M&A literature has paid substantial attention on CEO's role in M&A decisions (e.g., Hayward & Hambrick, 1997; Malhotra *et al.*, 2017; Roll, 1986). Among various CEO related factors, CEO's psychological attributes play a vital role in M&A decisions (Chatterjee & Hambrick, 2007; Gamache *et al.*, 2015; Meyer-Doyle *et al.*, 2019). While much of the M&A literature examines M&A decisions through CEO psychological attributes which dispose CEO to make risky choices in M&A process, a little is known about psychological attributes which could motivate CEOs to adopt risk mitigation approaches in M&A decisions. Addressing this research gap is important due to the risks encompassed in M&As and risk mitigation stance of acquiring firm CEO could offer substantial implications pertaining to M&A related decisions. To that end, in this thesis, author adopts regulatory focus theory to explicate risk reduction choices related to M&As.

Regulatory focus theory (Higgins, 1997) propounds that people have a twin regulatory focus: promotion and prevention foci. While promotion focused individuals are concerned with advancement, growth, gains (or non-gains), errors of omission, accomplishments, and aspirations, individuals with high prevention focus are concerned with vigilance, errors of commission, need for safety, and security. Further, Higgins (2000) proposes that when an individual's chronic regulatory focus is (not) in congruence with a situation, his or her regulatory focus will get accentuated (or mitigated) resulting in regulatory fit (or non-fit). The author uses regulatory focus theory to posit the baseline hypotheses, and regulatory fit (non-

fit) mechanisms to establish the contextual influences. Author believes that promotion focus does not offer explanation for the risk mitigation aspects in M&A related decisions. Also, since prevention and promotion foci are orthogonal constructs and differently related to other constructs and as this thesis attempts to investigate the risk mitigation aspects of M&A related decisions, author remains focused on the hypothesising the effects of prevention focus. This thesis comprises of below mentioned three studies:

The first study attempts to investigate the relationship between acquirer firm CEO's prevention focus and the likelihood of using risk mitigating instrument of 'earnouts'. M&As entail several ex-ante risks such as adverse selection (Akerlof, 1970), risk of higher premiums (Hayward & Hambrick, 1997), and likewise ex-post issues of post-merger integration (Very & Schweiger, 2001), turnover of target firm's managers (Krug *et al.*, 2014), poor acquisition performance (King *et al.*, 2004), and so forth. To mitigate such risks, acquirer firm may adopt 'earnout' which is a contract through which acquirer firm partially transfers risk onto the target firm by paying a part of deal consideration upfront and the rest contingent upon the pre-defined target performance metrics (Barbopoulos & Sudarsanam, 2012). Accordingly, the author submits that in M&A deals, prevention focused CEOs may perceive relatively higher risks as they are sensitive to losses (or non-losses) and incorporate the instrument of earnouts in payment consideration structure. Also, this study demonstrates the moderating impact of the acquiring firm's acquisition experience and relative size on the relationship mentioned. Author tested and found support for the hypotheses on a dataset comprising of 343 deals involving private targets firms from 2006 to 2012 in the United Kingdom.

In the second chapter, the author examines the influence of acquiring firm CEO's prevention focus on spatial separation in cross-border acquisition location choice decisions. Spatial distance impedes flow of information resulting in valuation problems and information asymmetry about true value of target. In post-acquisition phase too, spatial distance prompts

management and integration challenges leading to performance risks (Denk *et al.*, 2012). In this study, the author argues that due to their nature of being vigilant, loss-aversion, and focus on avoiding errors (Crowe & Higgins, 1997), CEOs of high prevention focus avoid geographically distant targets in cross-border acquisitions, and thus propose a negative relationship between CEO prevention focus and geographical distance. This study also demonstrates the moderating roles of acquirer's acquisition experience and industry munificence of acquiring firm on the main relationship. The author tested and found support for the baseline hypothesis and the moderating role of acquisition experience but not for the moderating role of industry munificence, in a sample of 607 cross-border acquisitions by public acquirer firms from United States and United Kingdom from 2007 to 2013.

Relatedly, the third study is an attempt to understand the timing of acquisitions in an industry-specific M&A wave through the prevention focus of CEOs. An M&A wave represents heightened M&A events in an industry (McNamara *et al.*, 2008). Early movement in a wave engenders the risks of market or demand uncertainty due to changes in customer preferences and technologies (Cho *et al.*, 1998). Since, prevention focus individuals are concerned with errors of commission and are driven by needs for safety, vigilance and protection (Crowe & Higgins, 1997), author posits that degree of acquirer firm CEO's prevention focus will positively impact the delay in the entry time in an industry-specific M&A wave. Further, the moderating roles of capital intensity and prior performance of acquiring firms is hypothesized and tested. The author finds support for all three hypotheses in a sample of 264 deals by public acquirers in 52 industry-specific M&A waves from 2005 to 2016 in United States.

This thesis hopes to make few contributions. By demonstrating the impact of acquiring firm CEO's prevention focus on the likelihood of using earnout contracts, the thesis responds to a recent call from Johnson *et al.*, 2015 to incorporate the role of regulatory focus in the contracts. The second chapter is the first study to explore the role of microfoundations in

determining spatial distance in cross-border acquisition location choice decisions. Third chapter is the first study to account for the role of microfoundations in determining the acquisition timing in an industry-specific M&A wave by demonstrating the impact acquiring firm CEO's prevention focus on acquisition timing. Overall this thesis complements recent burgeoning research on the effects of psychological attributes resulting in risk mitigation stance. The below table presents an overview of all the three chapters.

Table 1: Overview of the thesis

Literature Gap	Chapter/Study	Theory	Sample and Analytical Model	Findings	Important Contribution
Role of CEO psychological attributes in M&A consideration structure.	<u>Chapter I:</u> Earnouts in Acquisitions: The Impact of CEO's Prevention Focus	Regulatory Focus Theory	-343 M&A deals involving private targets in U.K during 2006-2012. -Binary logit regression model.	Acquiring firm CEO's prevention focus is positively related with the likelihood of using earnouts.	Establishes the role of CEO psychological attribute in M&A deal consideration structure.
How CEO psychological attributes impact location choice decisions in cross-border acquisitions?	<u>Chapter II:</u> Spatial distance in location choice of cross-border acquisitions: Impact of prevention focus of acquiring firm's CEO	Regulatory Focus Theory	-607 cross-border M&As in U.S and U.K during 2007-2013. -Ordinary least square regression model.	Acquiring firm CEO's prevention focus is negatively related with spatial distance in cross-border location choice decisions.	Incorporate the role of microfoundations in international business decisions.
How acquiring firm CEO psychological attributes determine acquisition timing in industry-specific M&A waves?	<u>Chapter III:</u> Acquisition Timing in M&A Waves: The Impact of CEO's Prevention Focus	Regulatory Focus Theory	-264 M&A deals in 52 M&A waves in 49 industries in U.S during 2005-2016. -Tobit regression model.	Acquiring firm CEO's prevention focus is positively related with the time taken to make acquisitions in industry-specific M&A waves.	First study to account for the role of CEO's psychological attribute in acquisition timing in M&A waves.

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