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4 TOP MANAGEMENT TEAM  
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6 TURNOVER IN MERGERS &  
7  
8 ACQUISITIONS  
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15 **ABSTRACT**  
16

17 *This paper reviews the evolving literature on top management team effects*  
18 *in mergers and acquisitions (M&As). Existing research has focused on*  
19 *understanding why incumbent top managers depart at higher rates than*  
20 *normal following an acquisition and why high turnover rates have negative*  
21 *postacquisition performance effects. We explore two new areas of inquiry.*  
22 *First, we discuss the role of newly hired executives – executives hired after the*  
23 *acquisition. Our research indicates that executives who join target companies*  
24 *after an acquisition also depart more quickly than executives who join*  
25 *companies not previously involved in an acquisition. Acquisitions appear*  
26 *to create long-term instability in the target firm's top management team –*  
27 *both incumbent and new-hire executives depart at higher rates than normal*  
28 *well into the future. Integration of the target firm often intensifies instability*  
29 *within the target company's top management team. This instability affects*  
30 *performance and leads to further integration efforts as the firm attempts to*  
31 *improve performance. These additional integration activities, in turn, lead to*  
32 *even higher subsequent executive turnover. Second, we examine the topic of*  
33 *director turnover and propose a theoretical framework for understanding the*  
34 *relationship between acquisitions and director retention. Future research that*  
35

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1 *considers the role of directors as well as executives may lead to deeper insight*  
2 *into the nature of turnover and integration effects in mergers and acquisitions.*

## 3 4 INTRODUCTION

5  
6 The importance and popularity of mergers and acquisitions as a means of achieving  
7 corporate growth and profit objectives is well established. The merger wave of the  
8 1980s is considered to be the fourth merger wave of the twentieth century (Golbe &  
9 White, 1988). Between 1980 and 1989, 36,622 U.S. firms were acquired, an average  
10 of 3,662 transactions each year (The Thompson Corporation, 2004). Rather than  
11 showing signs of slowing, however, merger activity intensified through the 1990s  
12 both in terms of value and number of deals. Between 1990 and 1999, 103,016 U.S.  
13 firms were acquired, an average of 10,302 transactions each year. This high level of  
14 M&A activity continues relatively unabated. Between January 2000 and July 2004,  
15 an additional 42,077 U.S. firms were acquired for a total value of \$4.8 trillion, an  
16 average of \$1.1 trillion each year. Given the U.S. gross domestic product of \$11.0  
17 trillion in 2003, the M&A market is generating transactions valued at about 10%  
18 of the U.S. economy (Bureau of Economic Analysis, 2004).

19 Despite the popularity of M&As, the evidence is that acquisitions, on average,  
20 do not improve performance of the firms they acquire. In the most recent review  
21 of M&A literature, King, Dalton, Daily and Covin (2004) conducted a meta-  
22 analysis of 93 empirical studies of M&A performance. They found that stock  
23 values for both acquiring and target firms generally increase significantly on the  
24 day of the acquisition announcement. This suggests that shareholders expect long-  
25 term synergy gains at the time of the announcement, even though one in four  
26 global acquisition announcements is later withdrawn because of conflicts arising  
27 during merger negotiations or because the acquiring firm uncovers organizational  
28 problems during the due diligence process (Aguilera, Dencker & Escandell,  
29 2004). They also found that future measures of acquiring firm market returns and  
30 accounting returns (ROA, ROE, and ROS) are generally negative. This suggests  
31 that acquiring firms generally fail to realize expected synergy gains. There is  
32 also little evidence that greater degrees of strategic relatedness between merging  
33 firms lead to greater acquisition value or postacquisition performance (Barney,  
34 1988; Lubatkin, 1987; Singh & Montgomery, 1987). Relatedness appears to be a  
35 desirable but insufficient condition for creating value in the absence of effective  
36 integration (Capron & Pistre, 2002). Integration is viewed as a critical determinant  
37 of acquisition success regardless of the degree to which potential synergies exist  
38 (Cartwright & Cooper, 1996; Galpin & Herndon, 2000; Haspeslagh & Jemison,  
39 1991; Hitt, Harrison & Ireland, 2001; Hubbard, 1999; Marks & Mirvis, 1998;  
40 Schweiger, 2002; Schweiger & Goulet, 2000).

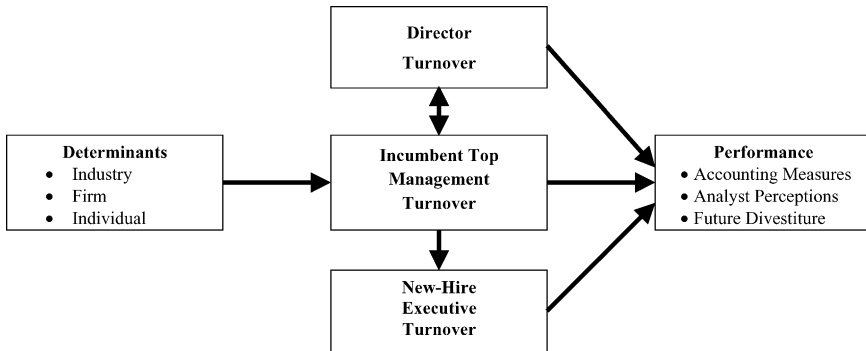


Fig. 1. Top Management Team Turnover in Mergers & Acquisitions: A Conceptual Framework.

*Corporate Governance Issues in Mergers & Acquisitions*

In this paper, we focus on the role of the target company’s top management team. We examine the existing literature and present the preliminary results of our research. Our objective is to give the reader an understanding of what has been done and where we believe the most productive future contributions to this evolving literature may be made. We examine the target firm’s top management team as a dependent variable (e.g. understanding the determinants of top management turnover) and as an independent variable (e.g. understanding the effect of top management turnover on postacquisition integration and performance). We adopt the framework in Fig. 1 as a basis for our discussion.

Most of the literature has focused on the target company’s incumbent top management team. Despite anecdotal evidence and widespread acceptance in the media through the 1980s, Walsh (1988) was the first to empirically test whether acquisitions led to higher executive turnover. Walsh is generally credited with stimulating much of the work that followed on incumbent top management team effects in mergers and acquisitions. In the ten-year period following his initial research, the literature generally focused on three primary questions:

- (1) Do target company executives depart at higher rates than normal following an acquisition?
- (2) If so, what are the determinants of this higher than normal executive turnover?
- (3) What are the performance effects of high executive turnover after an acquisition?

This literature focused exclusively on the incumbent executive team. The literature generally concluded that the turnover effects of acquisitions disappear beyond the

1 second or third year after the acquisition. That is, beyond the second or third year  
 2 following the acquisition, executives in acquired firms are no more likely to depart  
 3 than executives in firms that were not acquired two or three years prior. Our research  
 4 indicates that this conclusion was erroneous. Mergers and acquisitions have effects  
 5 that extend far beyond the incumbent top management team. Executives hired  
 6 after the acquisition are also affected. Our findings indicate that the study of top  
 7 management team effects may be an important avenue for helping us understand  
 8 where and how value is created in M&As.

9 Recent research on the long-term effects of acquisitions indicates that  
 10 acquisitions have a significant impact on executives hired after the acquisition  
 11 (Krug, 2003a, b). Two important questions arise from these findings. First, if an  
 12 executive has two job offers – one with a firm that was acquired several years  
 13 before versus one with a firm that was not – will his or her daily responsibilities,  
 14 work environment, and career prospects be any different? Second, if acquisitions  
 15 have long-term effects on the target company's top management team, how do  
 16 these effects influence integration efforts, company strategy, human resources,  
 17 and long-term performance? The following queries show promise for contributing  
 18 to our understanding of the long-term top management team effects of M&As.

19 Issues related to the target firm's top management team:

- 20  
 21 (1) Are executives who join companies after an acquisition more likely to depart  
 22 than executives who join companies not previously involved in an acquisition?  
 23 (2) If so, what are the determinants of this higher than normal turnover?  
 24 (3) What is the relationship between incumbent top management team turnover  
 25 and new-hire executive turnover?

26 Issues related to the target firm's board of directors:

- 27  
 28 (1) What is the effect of acquisitions on the target firm's board of directors?  
 29 (2) What theoretical explanations predict director retention?  
 30 (3) What are the theoretical linkages between board retention and integration  
 31 effectiveness?  
 32  
 33

## 34 **INCUMBENT TOP MANAGEMENT TEAM TURNOVER**

### 35 *Level of Turnover after the Acquisition*

36  
 37  
 38 Table 1 summarizes the results of studies that measured rates of turnover among  
 39 incumbent target company executives after an acquisition. No attempt was made to  
 40 measure the effect of the acquisition on executives who joined the target company

**Table 1.** Cumulative Top Management Turnover Rates Following Acquisition.

Study	Sample	Period	Year Following Acquisition				
			1	2	3	4	5
<b>Walsh (1988)</b>							
Acquired firms	50	1975–1979	25.0	37.0	46.0	52.0	59.0
Non-acquired firms	30	1975–1979	2.0	13.0	21.0	31.0	33.0
<b>Walsh (1989)</b>							
Acquired firms	102	1975–1979	26.1	38.6	48.9	54.9	61.1
<b>Walsh and Ellwood (1991)</b>							
Acquired firms	102	1975–1979	26.1	38.6	48.9	54.9	61.1
Non-acquired firms	75	1975–1979	7.1	15.0	24.3	29.2	33.5
<b>Hambrick and Cannella (1993)</b>							
Acquired firms	97	1980–1984	27.0	45.0	55.0	67.0	
<b>Krishnan, Miller and Judge (1997)</b>							
Acquired firms	146	1986–1988			47.0		
<b>Krug and Hegarty (1997)</b>							
Acquired firms	270	1986–1988	21.2	40.5	59.9	68.4	74.8
Non-acquired firms	120	1986–1988	8.1	16.3	23.6	31.6	36.9
<b>Lubatkin, Schweiger and Weber (1999)</b>							
Acquired firms	69	1985–1987	20.0	33.0	42.0	52.0	
Average turnover rates							
Acquired firms			23.6	39.3	50.6	60.6	68.0
Non-acquired firms			5.7	14.8	23.0	30.6	34.5

*Note:* Cumulative top management turnover rates calculated by dividing the number of executives employed at time of acquisition (incumbent top management team) leaving the firm through year being reported divided by the number of executives employed at time of acquisition.

after the acquisition. In all cases, cumulative rather than annual rates of turnover were reported. The objective was to understand the full effects of the acquisition on the acquired top management team and when those effects returned to normal. A significant number of executives leave during the first year after the acquisition, when an average of 24% of the top management team departs. This represents a postacquisition turnover rate almost three times higher than normal. By the end of the third year, more than one-half of the original top management team is gone. Sixty-eight percent are gone by the end of the fifth year.

A significant portion of the incumbent executives who depart after the acquisition leaves involuntarily. Two studies interviewed a sample of target company executives to understand the nature of the executive’s departure decision (Krug & Hegarty, 2001; Krug & Nigh, 2001). One third of the executives who

1 departed after the acquisition reported that they left voluntarily for reasons  
2 that had nothing to do with the acquisition, e.g. retirement, to take a better  
3 career opportunity, or family reasons. Another one-third reported that they were  
4 involuntarily terminated. The last one-third reported that they departed because  
5 they felt alienated from the new top management team or were made to feel that  
6 their participation in the new management team was no longer valued. In these  
7 cases, the company recorded the executive's departure as voluntary. The nature of  
8 these executives' turnover decisions, however, indicated that they would not have  
9 departed absent the acquisition. Despite the acquiring firm's reporting these latter  
10 departures as voluntary, these findings suggest that acquisitions may have negative  
11 consequences for up to two-thirds of the target company's top management team.  
12  
13

#### 14 *Situational Determinants of Incumbent Executive Turnover*

##### 15 *Merger Characteristics*

16 Early attempts to understand the causes of high postacquisition executive turnover  
17 in target firms focused on a variety of merger, industry, firm, and individual  
18 characteristics. Walsh (1989), for example, examined aspects of the merger  
19 negotiation process. His analysis included preacquisition interest in the target  
20 company, tender offer versus merger proposal, negotiations marked by numerous  
21 counteroffers, the amount of time required to negotiate the deal, buyer's public  
22 assurance that they would retain target company management, hostile versus  
23 friendly negotiations, type of payment (i.e. cash or stock), and the premium paid  
24 for the target company. Only the hostility of merger negotiations explained high  
25 turnover rates in the first year after the acquisition. When target executives opposed  
26 an acquisition, particularly in instances where an acquiring company bypassed the  
27 target company's top management team and presented a tender offer directly to  
28 shareholders, they were less likely to stay once the acquisition took place. Other  
29 merger characteristics, however, generally did not explain why so many executives  
30 left soon after the acquisition. While hostile negotiations were the most significant  
31 of the merger characteristics studied, it is noteworthy that hostile acquisitions  
32 represent an insignificant number – 5% of less – of all acquisitions transacted in  
33 any year (Krug & Nigh, 1998). Thus, merger characteristics appear to be a poor  
34 predictor of future target company turnover.  
35  
36

##### 37 *Industry Characteristics*

38 The examination of industry differences has focused primarily on the issue of  
39 relatedness. Early research tested the hypothesis that acquiring firms were more  
40 likely to view target executives as dispensable when they acquired firms that

1 operated in similar industries or product categories (Manne, 1965; Pitts, 1976).  
2 In unrelated acquisitions, acquiring firms have less knowledge of the firm they are  
3 acquiring and would, therefore, be favorably inclined toward retention of target  
4 company executives. Walsh (1988, 1989) tested the effect of relatedness using the  
5 five Federal Trade Commission categories (related = horizontal, vertical, product  
6 extension, and market extension; unrelated = conglomerate). He found no direct  
7 correlation between relatedness and turnover. Walsh's (1989) analysis of merger  
8 characteristics, however, did find indirect associations. When a target company  
9 was approached with a merger proposal by an unrelated acquiring firm after it  
10 had been subjected to significant merger interest, its executives were more likely  
11 to leave four years after the merger. Walsh, however, suggested that his analysis  
12 of merger characteristics and industry relatedness, both which were based on the  
13 examination of intercorrelations, stopped short of adequately explaining the high  
14 level of turnover, especially during the first two years after the acquisition.

15 Hambrick and Cannella (1993) also tested the effect of relatedness. They used  
16 two judges who independently placed acquisitions into categories of relatedness  
17 using business descriptions of the merging firms. Their findings, however, were  
18 contrary to existing thought. Horizontal acquisitions, which resulted in the  
19 combination of firms operating in similar product categories, experienced low  
20 levels of turnover among target firm executives during the first month after the  
21 acquisition. Unrelated acquisitions experienced higher target executive turnover  
22 rates. Relatedness was not associated with turnover beyond the first month after  
23 the acquisition. The immediate loss of executives in unrelated target companies  
24 was counter to the expectation that acquiring firms would take steps to minimize  
25 turnover given that they had fewer managers with sufficient industry knowledge  
26 to operate the unrelated target. Hambrick and Cannella (1993) argued that the  
27 lack of relatedness may generate greater cultural gaps that lead to communication  
28 problems and create incentives for executives to leave. The findings in both Walsh's  
29 (1988, 1989) and Hambrick and Cannella's (1993) research suggest that relatedness  
30 is nevertheless a weak direct predictor of turnover.

31 A more promising avenue for understanding industry effects may be found in  
32 Krug and Nigh's (1998) study of cross-border acquisitions. Using the concept of  
33 transnational integration developed by Kobrin (1991), they found that turnover in  
34 U.S. target companies was significantly higher when the merging firms operated in  
35 a global industry. This effect began immediately after the acquisition and intensified  
36 through the sixth year following the acquisition, suggesting that global industry  
37 effects are immediate and long-term. Previous studies of industry relatedness  
38 focused on whether the acquiring firm had an adequate supply of managers  
39 with sufficient industry knowledge to operate the acquired company after the  
40 acquisition. In contrast, Krug and Nigh (1998) focused on the desirability of

1 retaining target company managers given industry structure. In global industries,  
2 companies benefit by standardizing product designs, manufacturing processes,  
3 distribution channels, and marketing practices. Standardization lowers costs  
4 through scale effects and provides the firm leverage across a larger sales base.  
5 It also has two important human resource effects. First, local managers – that is  
6 target company managers – are less critical to the global firm’s integration efforts,  
7 since standardization reduces the need for local market knowledge. Second, the  
8 global firm’s existing managerial base becomes a critical resource for transferring  
9 the firm’s strategy abroad. In multi-domestic industries, in contrast, firms benefit  
10 from local adaptation rather than standardization. Local managers become a more  
11 critical resource for helping the global firm adapt its product and processes to the  
12 local market. These findings suggest that managers’ firm- versus industry-specific  
13 knowledge may be more influential in enabling the acquiring firm to successfully  
14 transfer capabilities and integrate the target firm.

#### 15 *Firm Characteristics*

16 Research on firm characteristics has concentrated primarily on target company  
17 performance prior to the acquisition and on the market for corporate control.  
18 Hambrick and Cannella (1993) found that poor accounting performance in  
19 target companies relative to the acquiring firm is associated with greater target  
20 company executive departures during the first two years after the acquisition.  
21 Poor preacquisition stock performance is also associated with significantly higher  
22 turnover when the target company is acquired by a corporate raider (Walsh &  
23 Kosnik, 1993). As we discuss later, Hambrick and Cannella (1993) suggested that  
24 poor preacquisition performance creates the perception of inferiority on the part  
25 of target company top management – they feel inferior and the acquiring company  
26 feels superior. These feelings of status, brought on by the target company’s  
27 poor performance prior to the acquisition, cause target company executives to  
28 depart more quickly. Acquiring firms may also be more inclined to replace target  
29 executives with their own when performance has been poor.

30  
31 The association between poor preacquisition performance and postacquisition  
32 turnover raises the question of whether poor performance is a primary motivating  
33 factor behind merger and acquisition activity. According to the market for corporate  
34 control, firms that perform below shareholder expectations become takeover  
35 targets. Outside firms may compete for control of underperforming firms, replacing  
36 perceived incompetent target firm executives immediately after the acquisition in  
37 an attempt to improve performance (Berle & Means, 1932; Fama, 1980; Fama &  
38 Jensen, 1983; Jensen & Meckling, 1976; Varian, 1988). In this type of acquisition,  
39 the termination of less than competent executives is a major objective of the  
40 acquisition (i.e. hubris). Theoretically, executives are motivated to pursue activities



1 that promote their self-interest even at the expenses of shareholders. They tend  
2 to pursue projects that create the perception of competence, thereby enhancing  
3 their own opportunities for promotion and increased job security. If boards fail  
4 to address such behavior, then the market for corporate control becomes an  
5 important mechanism whereby outside firms may intervene by acquiring the poorly  
6 performing firm, replacing incompetent management, and improving performance.

7 Studies of the market for corporate control, however, have found that few  
8 acquisitions are driven strictly by the desire to improve poor target firm  
9 performance (Walsh & Ellwood, 1991; Walsh & Kosnik, 1993). Nevertheless,  
10 companies that perform below their industry average do experience higher turnover  
11 rates after the acquisition, an indication that acquiring companies are less willing  
12 to retain executives when performance is poor. In practice, however, the average  
13 target company performs at or above industry standards before it is acquired.  
14 This suggests that most acquiring firms actively seek acquisition candidates that  
15 are either industry leaders or have some unique set of competences that are of  
16 value. The market for corporate control also assumes that executives entrench  
17 themselves by pursuing projects that maximize their tenure. Walsh and Kosnik  
18 (1993), however, found that target companies generally experience preacquisition  
19 turnover rates at or above turnover rates in comparable, non-acquired companies.  
20 This also implies that target companies are either good performers or willing  
21 to discipline themselves when performance falls short of expectations. Target  
22 companies are acquired for a variety of reasons (Ravenscraft, 1987; Trautwein,  
23 1990; Walter & Barney, 1990). The inefficient management hypothesis, however,  
24 while long accepted as a major incentive for acquisition activity in the media, has  
25 little theoretical support (Davis & Stout, 1992; Walsh & Ellwood, 1991).

26 Krug and Hegarty (1997) found that the effect of firm characteristics is  
27 intensified in cross-border transactions. Cross-border acquisitions are associated  
28 with higher executive turnover in target companies compared to purely domestic  
29 acquisitions. Research on domestic acquisitions concluded that the most significant  
30 turnover effects occur within three years after the acquisition. Beyond the third  
31 year, turnover rates rise at about the same rate as in non-acquired firms. In the case  
32 of cross-border acquisitions, turnover rates continue to rise at a higher rate than  
33 normal through the sixth year after the acquisition. This suggests that longer-term  
34 effects are present when the target is acquired by a foreign firm. In addition to  
35 the global industry effects already discussed, Krug and Nigh (1998) found that  
36 turnover rates are significantly higher when the foreign acquirer has made previous  
37 acquisitions in the same country. Acquisition experience enables foreign firms  
38 to develop internal capabilities and experiences that can be leveraged in future  
39 acquisitions. As the foreign firm gains experience, it becomes less dependent on the  
40 target company for local knowledge. Consequently, foreign firms are more likely

1 to use their own managers to integrate acquired firms when they have significant  
2 acquisition experience.

### 3 4 *Individual and Top Management Team Characteristics*

5 Individual characteristics are an important determinant of organizational success.  
6 They affect how top management team members interact and influence both  
7 the quality of decision making and the efficiency with which decisions are  
8 implemented (Schweiger & Sandberg, 1989). Certain types of executives are more  
9 likely to depart more quickly than others. More senior managers, for example, tend  
10 to depart sooner after the acquisition. In Walsh's (1988) study, 39% of the target  
11 company CEOs, presidents, and chairs left within five years after the acquisition.  
12 In contrast, a significantly lower number (27%) of vice presidents, controllers,  
13 secretaries, and treasurers left during the same period. The loss of more senior  
14 executives has important organizational implications because it disrupts strategic  
15 projects and degrades leadership continuity (Schweiger, Ivancevich & Power,  
16 1987). When the most senior executives depart, a leadership vacuum is created  
17 in the target company that must be filled by the acquirer. Executives from  
18 the acquiring firm, however, often lack the firm-specific knowledge needed  
19 to quickly step in and make informed strategic decisions. In many cases,  
20 however, replacing the most senior executives in the target company is viewed  
21 as having significant symbolic value. It signals that the acquiring firm is in charge  
22 (Pfeffer, 1981).

23 Krishnan, Miller and Judge (1997) examined the question of top management  
24 team complementarity, where complementarity referred to instances in which the  
25 merging top management teams had dissimilar or non-overlapping functional  
26 skills. They found that target company executives were more likely to depart  
27 when their functional backgrounds were similar to the backgrounds of acquiring  
28 firm executives. In these instances, executive skills were viewed as redundant  
29 in that they did not contribute to the acquiring firm's existing knowledge base.  
30 The existence of overlapping skills creates opportunities to achieve greater cost  
31 efficiencies by eliminating redundant positions. In contrast, executives were most  
32 likely to be retained when they had complementary skills or unique sets of  
33 managerial competencies that added value to the acquiring firm's knowledge base.  
34 In addition to these knowledge benefits, the merging of top management teams  
35 with dissimilar individual characteristics and functional skills improves problem  
36 solving by increasing the diversity of solutions proffered (Haspeslagh & Jemison,  
37 1991). Whereas the departure of older, more tenured executives might be viewed as  
38 non-efficient insofar as they deprive the firm of experience and leadership stability,  
39 top management team complementarity might be viewed as efficient in that it  
40 creates synergies in the decision making process.

1 Individual values and beliefs are strongly embedded in culture. Cultural  
2 differences often lead to conflicts and miscommunications that exacerbate turnover  
3 after an acquisition (Lubatkin, Schweiger & Weber, 1999). They cause target  
4 company executives to leave voluntarily and motivate acquiring firms to replace  
5 executives with their own as a way of reducing integration problems. The effect  
6 of culture, however, is moderated by a variety of other firm characteristics. Krug  
7 and Nigh's (1998) analysis of turnover in cross-border acquisitions, for example,  
8 showed that cultural effects are strongly influenced by other factors. The negative  
9 effect of culture is reduced when the foreign acquirer has significant international  
10 experience operating in multiple countries. International experience helps the  
11 firm build cross-cultural sensitivities that mitigate communication problems. The  
12 negative effect of culture is also reduced when the foreign acquirer has significant  
13 acquisition experience. This experience reduces integration problems that would  
14 otherwise be intensified by cultural differences.

#### 15 16 17 *Dispositional Determinants of Turnover*

##### 18 19 *Related Status and Removal of Autonomy*

20 Early studies focused on situational determinants (merger, firm, industry, and  
21 individual and top management team characteristics) to understand the nature of  
22 high executive turnover in target companies after an acquisition. The low predictive  
23 power of most situational characteristics, however, led researchers to examine  
24 dispositional characteristics such as executive perceptions of the merger process.  
25 While they did not directly measure perceptions, Hambrick and Cannella (1993)  
26 studied the concepts of relative status and autonomy removal. They found that  
27 executives were less likely to depart when they were granted greater status and au-  
28 tonomy in the newly merged company. They measured status using a dichotomous  
29 variable that identified instances where an executive's job title indicated an increase  
30 in status. They acknowledged that this measure did not embody actual managerial  
31 responsibilities. It was, however, an expectation that executive perceptions were  
32 captured – albeit imperfectly – by the simple measure of titular status.

33 Autonomy of target company executives was measured through surveys sent  
34 to security analysts and executives in the acquiring company. As with status, this  
35 measure did not directly measure executive perceptions but was thought to capture  
36 the nature of the executive's level of autonomy after the acquisition. An individual  
37 executive's feelings about his or her status and autonomy in the new firm had a direct  
38 bearing on his or her job satisfaction and ultimate decision on departure. In addition,  
39 executives were more likely to depart when other executives in the firm received  
40 greater status enhancements. Thus, acquiring companies that increase the status of

1 one or more executives as a means of motivating them to stay may nevertheless find  
2 these executives leaving if they grant greater status increases to other executives in  
3 the firm. Lubatkin et al. (1999) replicated these findings using actual perceptions of  
4 managers in firms acquired in friendly, related acquisitions. Perceptions of cultural  
5 differences and removal of autonomy were significant in explaining more than 50%  
6 of the variance in turnover in the first year after the acquisition. In the fourth year  
7 after the acquisition, removal of autonomy remained significant.

8 In a third study, Krug and Hegarty (2001) used surveys to analyze how  
9 executives' perceptions of merger events determined whether they stayed or  
10 left after the acquisition. They found that executives' perceptions of the merger  
11 announcement, interactions with executives in the acquiring firm after the merger,  
12 and executives' perceptions of the long-term personal effects of the merger had a  
13 significant impact on their decision to stay or leave. These perceptions could be  
14 used to accurately distinguish executives as stayers or leavers in 80% of the cases.  
15 When the sample was split into "stayers" and "leavers" based on whether they  
16 were "informed" or "uninformed," Krug and Hegarty (2001) found that informed  
17 stayers had the most favorable impressions. The most informed leavers had the most  
18 negative perceptions. This suggests that good communications during the merger  
19 integration process is insufficient for overcoming all executives' initial negative  
20 perceptions of the merger. Consistent with upper echelons theory, executives  
21 are driven by a complex set of motives and often develop widely divergent  
22 interpretations of the same event. This makes it difficult for researchers to make  
23 accurate predications about an executive's behavior, even when methodology is  
24 based on perceptual measurements.

### 25 26 27 *The Performance Consequences of Postacquisition Executive Turnover*

28  
29 Three studies addressed the relationship between postacquisition executive  
30 turnover and performance. Each study drew similar conclusions: the loss of  
31 target company top managers after the acquisition has negative performance  
32 consequences and should be managed accordingly. Cannella and Hambrick (1993)  
33 looked at performance in 96 acquisitions between 1980 and 1984. Surveys were  
34 mailed to twelve expert informants, including six executives from each acquiring  
35 firm and six security analysts who specialized in the acquiring firm's industry. Each  
36 informant rated the profitability of the target firm at the time of the acquisition and  
37 four years after. Results indicated that high target company executive turnover  
38 rates after the acquisition were associated with lower performance. Performance  
39 was affected most when the most senior managers left. Giving higher status to one  
40 or more target company executives in the post-merger organization was associated

1 with the greatest performance improvement. These results suggest that executives  
2 from the target firm are important resources, especially in terms of the experience  
3 they bring to the integration process. When target firms lose their top management  
4 base, organizational processes are broken and leadership discontinuity often leads  
5 to instability. Such resources are not easily replaced.

6 **Krishnan, Miller and Judge's (1997)** study found a positive relationship between  
7 top management team complementarity and performance. They used a sample of  
8 147 acquisitions between 1986 and 1988 and measured performance as return-  
9 on-assets (ROA) averaged over a three-year period immediately following the ac-  
10 quisition. Dissimilar functional backgrounds provided complementary or synergy-  
11 contributing skills that improved the integration process. In turn, executive turnover  
12 was lowest in complementary acquisitions, an indication that target company  
13 executives who had complementary skills were both easier to integrate into the new  
14 organization and provided the greatest contribution to the new company in terms  
15 of background experience and skills. Top management team complementarity  
16 was positively associated with both lower postacquisition executive turnover and  
17 higher postacquisition performance. Complementary skills are an indication of the  
18 individual executive's potential value to the integration process.

19 **Bergh (2001)** studied the association between target company executive  
20 retention and the probability that the target company would later be divested.  
21 He examined 104 of the largest U.S. publicly traded acquisitions between 1986  
22 and 1992. Fifty percent of the target companies were divested within five years  
23 of the initial acquisition. Performance was measured as return on assets (ROA)  
24 for the acquiring firm during the years the target firm was retained. Target firms  
25 had the highest probability of eventual divestiture when the least senior executives  
26 were retained (i.e. executives other than the chairman, vice chairman, president,  
27 CEO, or COO). In addition, targets that retained executives with the longest  
28 organizational tenures were the least likely to be divested. These findings indicate  
29 that retaining executives with the longest organizational tenure decreases a target  
30 firm's probability of divestiture. Consistent with the resource-based view of the  
31 firm, organizational tenure implies that the executive with greater firm-specific  
32 knowledge contributes to more effective integration of the target firm.

## **NEW-HIRE TOP MANAGEMENT TEAM TURNOVER**

### *Level of Turnover after the Acquisition*

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39 Three conclusions from the existing work on target company incumbent top  
40 management turnover following an acquisition can be drawn: (1) the greatest

1 executive turnover occurs during the first year after the acquisition; (2) turnover  
2 rates generally return to normal within three years after the acquisition; and (3) high  
3 executive turnover rates are associated with poor target company performance.  
4 Despite the insight offered by existing studies, several issues remain. First, the  
5 primary insight offered by existing studies is in explaining the high turnover that  
6 occurs in the first year after the acquisition. These studies, however, have had  
7 less success explaining turnover beyond year one. Additionally, many findings  
8 have been contradictory. Hambrick and Cannella (1993), for example, found that  
9 reduced autonomy and status are associated with higher turnover in the second  
10 year after the acquisition. This relationship, however, reverses itself by year four,  
11 when reduced autonomy and status are associated with lower turnover. Lubatkin  
12 et al. (1999) also found, consistent with Hambrick and Cannella (1993), that  
13 lower autonomy in year two is associated with higher turnover. This relationship,  
14 however, remained positive in year four rather than reversing itself as in Hambrick  
15 and Cannella's analysis.

16 These problems raise a number of questions. First, are the effects of acquisitions  
17 limited to executives in the acquired top management team? Or, do acquisitions also  
18 impact executives who join the firm after the acquisition (new-hire executives)? If  
19 total executive turnover equals incumbent plus new-hire turnover, then perhaps the  
20 inability of studies to fully explain turnover beyond the first year post-acquisition,  
21 as well as the contradictory findings of existing studies, can be explained by these  
22 studies focusing solely on incumbent executives. Second, if new-hires are also  
23 affected by the acquisition, then do turnover rates really return to normal? Third,  
24 what is the relationship between incumbent and new-hire turnover?

25 In order to better understand the long-term effects of acquisitions, Krug (2003b)  
26 analyzed rates, patterns, and the timing of executive turnover among 12,080  
27 executives in 473 target and non-acquired firms over a fifteen-year period. He  
28 analyzed data using a repeated measures longitudinal design that controlled for  
29 violations in homoscedastic error assumptions. He found no significant differences  
30 in turnover rates between merged and non-merged firms during the seven years  
31 leading up to the acquisition or point of observation. This suggested that there was  
32 no reason to believe that turnover rates between the two groups would have differed  
33 in the future had the target firms not been acquired. Nevertheless, during the nine-  
34 year period following the acquisition, the merged firms experienced average annual  
35 turnover rates of 9%, two times higher than turnover rates in the non-acquired firms.

36 These findings indicate that the conclusions of studies that the turnover effects  
37 of acquisitions disappear beyond the second or third year after the acquisition are  
38 erroneous. Acquisitions appear to create leadership instability in target companies  
39 that continues for at least nine years after the acquisition. Executives who join  
40 targets after the acquisition also appear to leave more quickly than executives who

1 join firms not previously involved in an acquisition. This suggests that much of  
2 the conflicting results of studies that only examined incumbent executive turnover  
3 might be explained by turnover among new-hire executives. Acquisitions create  
4 conditions that lead to high turnover rates among both groups. Studies that separate  
5 the turnover effects of these two groups may find more robust explanations of the  
6 effects of acquisitions.

### 9 *The Relationship between Incumbent and New-Hire Executive Turnover*

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11 Drawing on the concept of managerial discretion (Barnard, 1938; Finkelstein  
12 & Hambrick, 1990; Hambrick & Abrahamson, 1995; Hambrick & Finkelstein,  
13 1987). Krug and Michael (2004) analyzed the relationship between incumbent  
14 and new-hire executive turnover. Using a longitudinal repeated measures model,  
15 they examined the careers of more than 4,000 incumbent and new-hire executives  
16 in 89 merged and 90 non-merged firms over a fifteen-year period surrounding the  
17 acquisition. Consistent with the literature, they found that incumbent executives  
18 departed at abnormally high rates after the acquisition. In addition, they found  
19 that executives who joined target firms after the acquisition also departed at  
20 higher rates than executives who joined firms not involved in an acquisition. New-  
21 hire executives who joined the target firm one year after the acquisition were  
22 already departing at higher rates than normal one year later. New-hire turnover  
23 continued to occur at a higher rate than normal through the ninth year. Further, new-  
24 hire turnover was significantly higher when it was preceded by high incumbent  
25 executive turnover. Firms with the highest rates of turnover among incumbent  
26 executives immediately following the acquisition had the highest rates of turnover  
27 among new-hire executives several years later.

28 Based on their framework of managerial discretion, Krug and Michael (2004)  
29 argued that acquisitions create uncertainty among executives regarding their  
30 managerial discretion. Many incumbent executives depart immediately after the  
31 acquisition because the merger creates uncertainty surrounding their decision-  
32 making rights in the firm. Existing psychological contracts are broken when  
33 executives must deal with new managers and directors who have different  
34 interpretations of the terms and conditions of previously made psychological  
35 contracts (Hambrick & Finkelstein, 1987; Herman, 1981; Mizruchi, 1983). After  
36 the acquisition, executives suffer uncertainty regarding the extent of their new  
37 discretion. Managerial discretion is created by psychological contracts that depend  
38 on the identities of the individuals making them. Instead of negotiating new  
39 contracts with new managers and directors in the acquiring firm, many incumbent  
40 executives choose to exit.

1 Many new-hire executives face the same uncertainty regarding their managerial  
2 discretion, especially in the face of high incumbent executive turnover. When  
3 incumbent executives feel uncertainty regarding their managerial discretion, they  
4 have greater difficulty delegating decision-making rights to executives who join  
5 the firm after the acquisition. As a result, new-hire executives are more likely to feel  
6 greater uncertainty regarding the boundaries of their own discretion compared to  
7 executives who join firms not subjected to acquisition. When incumbent executives  
8 depart, this situation is aggravated. The new-hire executive must now renegotiate  
9 his decision-making rights with a new executive, one who may have a different  
10 understanding of the previously negotiated psychological contract. Acquisitions  
11 create uncertainty for all target executives who must renegotiate psychological  
12 contracts with new superiors. This uncertainty creates long-term instability in the  
13 target firm and causes high turnover rates well into the future.

## 14 15 **TURNOVER AMONG THE TARGET FIRM'S** 16 **BOARD OF DIRECTORS** 17 18

19 Little research has been conducted on the turnover behavior of the main governance  
20 body (board of directors) of the acquired firm. The few studies touching on director  
21 turnover focused on turnover of the CEO or chair using agency theory arguments  
22 (e.g. Walsh & Ellwood, 1991; Walsh & Seward, 1990). We respond to the research  
23 oversight pointed out by Walsh and Kosnik (1993, p. 692) more than a decade ago  
24 and discuss the patterns and consequences of target firms' director turnover. An  
25 understanding of director turnover is fundamental to the success of acquisitions,  
26 given the directors' potential decision-making role in the newly merged firm. Since  
27 acquiring firms are generally unable or unwilling to retain all target directors, we  
28 inquire into the factors that affect the likelihood that target company directors will  
29 be retained.

30 The role and importance of individual directors and the board of directors  
31 as a whole has been an area of extensive debate in the corporate governance  
32 literature (Johnson, Daily & Ellstrand, 1996). Class hegemony theory, for example,  
33 describes the director's role as one of perpetuating class power and the ruling elite  
34 (Useem, 1984). In contrast, managerial hegemony theory views directors as passive  
35 actors with little power (Mace, 1986). Increasing empirical evidence indicates that  
36 directors are of strategic importance in the firm's value creation process (Golden &  
37 Zajac, 2001; Westphal, 1999). Westphal and Frederickson (2001) teased out board  
38 effects on firm strategy from what previously had been considered to be executive  
39 effects. Other studies demonstrated direct board effects on firm strategic outcomes  
40 (Ruigrok, Peck & Keller, 2002) and how board demographics and processes affect



1 IPOs (Filatotchev & Bishop, 2002), entrepreneurship patterns (Zahra, 1996), CEO  
2 succession (Ocasio, 1994), and acquisition strategies (Davis, Diekmann & Tinsley,  
3 1994). In sum, the literature indicates that, as a corporate governance entity, the  
4 board of directors has direct effects on firm strategy and value creation.

5 In the context of M&A negotiations, the target firm's board of directors is critical  
6 because it is the body that engages in merger negotiations in the case of friendly  
7 acquisitions or that is superseded in the case of hostile takeovers. In addition,  
8 "maintaining continuity of board membership is often important in meeting the  
9 long-term objectives of the combined forces," unless the firm is significantly  
10 smaller than the acquiring firm (DePamphilis, 2001, p. 242). This is particularly  
11 true when the target operates as a subsidiary of the acquirer. As Bergh (2001) rightly  
12 questioned for executives, we ask a similar question regarding directors. Given that  
13 the newly merged firm is unable to retain all acquired directors, which directors  
14 should be retained and which should be let go? The retention of key human capital  
15 is one of the factors leading to successful implementation of an acquisition strategy  
16 (Haspeslagh & Jemison, 1991; Porter, 1987). We develop a theoretical framework  
17 of director turnover in acquired firms by examining directors' functions from three  
18 theoretical perspectives.

19 We confine our discussion to outsider directors – those with no executive  
20 responsibilities in the firm. For the study of insider directors' turnover post-  
21 acquisition, we refer to the TMT turnover studies already discussed. Agency  
22 theory is traditionally used to explain the conflict of interests between shareholders  
23 and the fiduciaries of their interests – the directors. We argue, however, that  
24 this single-focused approach is insufficient to understand director turnover in  
25 the context of acquisitions because directors fulfill multiple functions. We  
26 propose a framework that builds on agency theory but also examines the  
27 endogenous functions of directors through the resource-based view of the firm and  
28 directors' organizational boundary spanning functions through the social capital  
29 perspective.

30 These three distinct theoretical perspectives allow us to analyze directors'  
31 functions as fiduciaries of shareholder interests in the acquired firm, both as  
32 critical human capital contributing to the knowledge base of the acquiring firm  
33 and as social capital or resource linkages between the acquiring firm and external  
34 stakeholders. Whereas human capital fills the gaps in the principle agent dyad,  
35 social capital is the contextual complement to human capital (Burt, 2003, p. 150).  
36 Consequently, we argue that acquired director turnover is not only explained  
37 by classic agency arguments such as director dependence relative to the top  
38 management team of the acquired firm but also by factors such as asset specificity,  
39 asset complementarity, and directors' boundary-spanning relations with other  
40 organizations. These multiple factors have interactive effects.

*The Monitoring Function*

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2  
3 Amidst corporate scandals, the board of directors faces increasing pressure from  
4 various stakeholders and the institutional environment for increased accountability  
5 (Luoma & Goodstein, 1999). This pressure resonates well with the agency  
6 argument that directors are the fiduciaries of shareholder interests. The argument  
7 is built on the premise of management's potential self-serving behavior and the  
8 information asymmetry between management and shareholders (Arrow, 1985).  
9 The separation between ownership and management, particularly with diffuse  
10 ownership structures, may lead managers to act in their self-interest. These  
11 actions may not coincide with the interests of shareholders (Fama, 1980). One  
12 function of the board of directors is to behave as the ultimate internal monitoring  
13 mechanism to reduce such self-serving behavior (Fama & Jensen, 1983). This  
14 monitoring function is commonly recognized by the public and regarded as the  
15 most "orthodox" function of the board of directors as a governance entity.

16 As the main internal monitoring mechanism, the board of directors provides a  
17 lower-cost means of replacing underperforming top managers relative to market  
18 takeovers (Fama, 1980). Directors, however, may fail to monitor management  
19 effectively and may themselves need to be monitored. If so, the outside takeover  
20 market serves as a court of last resort, where not only inefficient management  
21 but also the ultimate internal control mechanism – the board of directors – will  
22 be culled. From an agency perspective, Walsh and Kosnik (1993) argue that if  
23 corporate takeovers are indeed motivated by the desire to increase performance  
24 by eliminating management inefficiencies, then postacquisition restructuring  
25 decisions need to address both director and management deficiencies in the  
26 acquired firm. Walsh and Kosnik (1993) suggest that turnover among directors  
27 of the acquired firm will be higher than the company's historical turnover rate and  
28 the rate of firms not engaged in acquisitions.

29 Ineffective monitoring is possible either because directors lack adequate  
30 information needed to supervise management activities or because the board of  
31 directors is subservient to the CEO, top management team, or both. Since it is  
32 difficult to ascertain any information asymmetry a priori, we focus on the case of  
33 *director dependence*. Directors are said to be dependent on top management when  
34 their personal, professional, and/or economic relationships with top management  
35 unduly influence the effectiveness of their monitoring. CEOs, for example, can  
36 significantly influence directors' interests and decision-making (Johnson et al.,  
37 1996). This is expected or anticipated and may even be considered a part of their job.  
38 It is a matter of degree and the directors' response. Some managers use any means  
39 available to pressure directors to their advantage. Directors are sometimes viewed  
40 simply as "rubber-stampers" serving top management interests (Pfeffer, 1981).

1 In sum, from an agency perspective, it is more likely that directors can effectively  
2 carry out their monitoring function when they are independent of undue influence  
3 from other directors, the CEO, or other top management members. Conversely, we  
4 expect that directors are more likely to monitor the TMT ineffectively when they  
5 are unduly attached to the top management of the acquired firm. As a result of the  
6 acquisition, they, in turn, are more likely to leave.

### 7 8 9 *The Knowledge Contribution and Capability Building Function*

10  
11 The agency argument is built on the presumed conflict of interest between  
12 shareholders and management. Despite its dominance in the corporate governance  
13 literature, shareholders may not always be subject to conflicts of interests with  
14 managers and directors. This is particularly the case when directors or managers are  
15 altruistic or are also shareholders (Aguilera & Jackson, 2003; Davis, Schoorman  
16 & Donaldson, 1997). In these cases, the monitoring function assigned to directors  
17 may not be more important than other director functions such as those of knowledge  
18 contribution and capability building. Ideally, it is to be hoped that each director  
19 will contribute to all three functions, albeit to varying degrees.

20 Drawing on the resource-based view of the firm, we identify two director  
21 functions: knowledge contribution and capability building. First, it is broadly  
22 accepted within the *content* approach of the resource-based view that firm  
23 competitive advantage and value creation are based on the possession and service  
24 of firm-specific, costly-to-imitate resources (Barney, 1991; Mahoney & Pandian,  
25 1992). Directors are critical human capital and contribute specialized knowledge  
26 and expertise to the firm. Director knowledge and expertise are specific to the  
27 firm when they are embedded in directors' experience. In particular, tenured  
28 directors develop as the firm grows and accumulate knowledge about the firm  
29 and its environment over time. Such knowledge is difficult to replicate. If directors  
30 have valuable specialized knowledge or expertise, we argue that they also have a  
31 knowledge contribution function.

32 While the knowledge contribution function relates to the firm-specific,  
33 inimitable characteristics of director knowledge and expertise, the capability  
34 building function refers to a director's role in the dynamic process of accumulating  
35 organizational capabilities. Firms not only require a collection of resources for  
36 value creation, but they must also engage in processes of deploying and developing  
37 resources, e.g. coordination, integration, reconfiguration, and the transformation  
38 of existing internal and external resources (Teece, Pisano & Shuen, 1997). As  
39 the environment changes, the firm must generate new knowledge and renovate  
40 its resource base to maintain competitiveness. Therefore, the director's process of

1 accumulating firm-specific resources matters as well. Not only the stock of existing  
2 knowledge in a firm but also effective development and deployment of resources  
3 and capabilities over time are sources of competitive advantage and value creation  
4 (Eisenhardt & Martin, 2000). As part of the firm's strategic leadership, directors  
5 have important functions in setting strategic direction, bringing together internal  
6 and external resources, and solving various problems on a sustained basis in the  
7 capability building processes. Specifically, directors have a say in the resource  
8 allocation process for strategic investments. When directors are associated with  
9 the development of critical firm capabilities such as innovation and technology,  
10 then they have a key capability building function. Such functions are particularly  
11 valuable for a firm in competitive, technology-intensive industries and in today's  
12 knowledge economy in general.

13 These two functions are related to the "resource role" and "service role" of  
14 directors as described by Johnson et al. (1996). From resource dependency theory  
15 (Pfeffer & Salancik, 1978), directors have an important resource seeking role in  
16 the sense of securing access to certain critical resources such as financial capital  
17 or legal advice. This helps reduce uncertainty from the firm's interdependence  
18 with the environment (Dalton, Daily, Johnson & Ellstrand, 1999). These roles  
19 derive fundamentally from directors' leverage within the firm as well as the firm's  
20 interdependent relationship with other firms. Therefore, the "resource role" is  
21 power-based. The resource-based view of directors, however, emphasizes the value  
22 creation aspect of directors as critical human capital of a firm. Both resource  
23 functions of directors in our discussion are efficiency-based. Directors with these  
24 two functions should help the firm gain and sustain competitive advantage. This  
25 follows directly from the basic proposition within the resource-based view of the  
26 firm, that internal resources and capabilities that are valuable, rare, insubstitutable  
27 and inimitable are critical to a firm's competitive advantage (Barney, 1991; Conner,  
28 1991; Peteraf, 1993). In addition, our discussion explicitly distinguishes between  
29 the static and dynamic director functions. The resource dependency perspective is  
30 silent on this issue.

31 We propose that how well directors fulfill the knowledge contribution and  
32 capability building functions will influence director turnover in acquisitions. First,  
33 acquisitions are motivated not only by profit-seeking goals but also by asset-  
34 seeking goals. Teece (1988) pointed out that, under certain circumstances, acqui-  
35 sition is the only means of obtaining certain valuable assets. If directors embody or  
36 are closely associated with the development of firm-specific knowledge in the target  
37 that is sought by the acquiring firm, then these directors will most likely be retained.  
38 Even when the acquisition is not motivated solely by asset-seeking incentives,  
39 directors with firm-specific knowledge that is potentially valuable to the acquiring  
40 firm have a better chance of retention than those who lack such knowledge.

1 This dynamic capabilities view focuses on a firm’s capabilities as a source of  
2 competitive advantage. Capabilities involve purposeful and collective activities  
3 by which resources are assembled in integrated clusters spanning individuals and  
4 groups so that they enable distinctive activities to be performed. Capabilities are  
5 characterized by their degree of coherence or the degree to which one element  
6 reinforces or complements others (Teece, Rumelt, Dosi & Winter, 1994). In  
7 this sense, capabilities are highly “combinatorial” and involve complementarities  
8 among multiple resources and routines. One of Sony’s capabilities, for example, is  
9 based on its core competence of miniaturization, the maintenance and enhancement  
10 of which must be supported by complementary capabilities in manufacturing  
11 (Prahalad & Hamel, 1990).

12 Following the acquisition, the acquiring firm should reconfigure complementary  
13 resources and capabilities. For example, top scientists equipped with expertise  
14 and knowledge in the acquired firm may no longer be needed either because the  
15 acquiring firm possesses similar expertise on its board or because the firm is in the  
16 process of shifting its strategic orientation, e.g. from a focus on basic research to  
17 applied research or development. Such a redefinition in the value of complementary  
18 knowledge and expertise means that these directors are less likely to contribute to  
19 the whole firm’s capability. They may even be detrimental to the acquiring firm’s  
20 capability accumulation in case of cacophony between directors and others in the  
21 acquiring firm. If directors’ abilities do not complement the acquiring board or  
22 top management team, they are more likely to depart. Such complementarity is  
23 important for top management team members of the acquiring and acquired firms.  
24 While the asset specificity of director knowledge relates to the value of individual  
25 director knowledge and expertise to the acquiring firm, complementarity relates  
26 to whether director knowledge and abilities are compatible with the rest of the  
27 acquiring firm for its capability building. These two are distinct concepts, though  
28 equally important in determining the likelihood of acquired director turnover.

29  
30

31 *Interaction between the Agency and Resource-Based Arguments*

32

33 Our claim that directors exercise multiple functions within the board adds  
34 complexity to the prediction of acquired director turnover, since we must examine  
35 the interactive effects of these different functions. From an agency perspective,  
36 director dependence is more likely to lead to ineffective monitoring and be  
37 associated with director turnover. This may, however, not always be consistent  
38 with the resource-based view argument. When acquired directors possess critical  
39 knowledge contribution and capability building functions, their asset specificity  
40 and complementarity increase the probability of their retention. Suppose, for

1 example, that a scientist is a director in a biotech firm that has professional  
2 attachment to the firm's top management team but also possesses substitutable  
3 expertise. His or her retention following the acquisition depends on two factors:  
4 (1) whether his or her attachment to top management has had negative performance  
5 effects; and (2) whether his or her specific expertise remains an important asset to  
6 and complements the existing asset base of the acquiring firm. If these two factors  
7 operate in different directions when the acquisition takes place, one will weaken  
8 the effect of the other on director turnover. When the director is attached to the  
9 top management team of the acquired firm but his knowledge remains valuable or  
10 complementary, the acquired director is less likely to depart.

### 11 12 13 *The Social Capital Function* 14

15 The social capital perspective is an excellent complement to the agency and  
16 resource-based views because it stresses different organizational issues and  
17 dynamics. While the agency perspective focuses on the function of directors in  
18 aligning incentives of management and shareholders and the resource-based view  
19 emphasizes the endogenous directors' function in knowledge contribution and  
20 capability building, the social capital perspective focuses on the social context of  
21 the firms mediated by its directors (Burt, 2003; Coleman, 1990; Lin, 2001; White,  
22 1981). Social capital is defined as "the sum of the resources, actual or virtual, that  
23 accrue to an individual or group by virtue of possessing a durable network of more  
24 or less institutionalized relationships of mutual acquaintance and recognition"  
25 (Bourdieu & Wacquant, 1992, p. 119). From this perspective, directors bring social  
26 capital to the firm through their personal inter-organizational relations as well as  
27 through their overall location in the social structure of their networks.

28 The social capital perspective conceptualizes actors as part of a broader social  
29 structure. In line with this view, directors do not operate in isolation within  
30 the firm. Instead, they are embedded in a broader social context beyond the  
31 firm. They span organizational boundaries creating an advantage for lowering  
32 the risk of cooperation and increasing the value of information and resource  
33 transfer (Granovetter, 1985). In this respect, directors hold a pivotal function  
34 in building and maintaining a firm's social capital. They serve as key linkages  
35 between the focal firm and peer organizations, suppliers, customers, government  
36 and other stakeholders. Such inter-organizational relationships are critical to the  
37 firm's competitive advantage and value creation.

38 Although directors possess internal bonding relationships with other directors  
39 on the board, their external bridging relationships are particularly important in our  
40 analysis of director's social capital and acquired director's likelihood of turnover

1 (Adler & Kwon, 2002). We now focus on the directors' function of boundary  
2 spanning relationships that was originally discussed in the management literature  
3 by Barnard (1938) and Mintzberg (1978) in describing the role of senior managers.  
4 Directors' social capital stems from boundary spanning relationships beyond their  
5 firm and industry. This director function may be fulfilled, for example, by serving  
6 on several boards or having a functional background in other firms. We analyze  
7 directors' social capital along two main dimensions: relational and structural.

8 The relational aspect refers to the characteristics of directors' social relations and  
9 the resources gained from these relationships. One of the most important features of  
10 social relations is closure. Closure refers to the permeability of social relations and  
11 their density in preserving and maintaining resources. It will determine how much  
12 information and resources are gained from these relationships as well as what type  
13 of information and resources are transferred to the firm. Coleman (1990) stresses  
14 the importance of network closure as a distinctive advantage in social capital.  
15 He states that closure – as opposed to open networks – preserves and enhances  
16 trust, norms, authority and sanctions, thereby ensuring that network resources are  
17 mobilized through social relations. Moreover, because of its role in facilitating trust  
18 and norms among social actors, closed networks also confer competitive advantage  
19 by lowering the risk of cooperation in exchanging information and resources (Burt,  
20 1993).

21 Social capital research also shows that closed social relations can serve as  
22 mechanisms for effective communications and obtaining fine-grained information.  
23 In acquisitions, acquired directors may bring with them closed networks that are  
24 valuable in helping the acquiring firm integrate the target company. Directors in  
25 closed inter-organizational networks can potentially contribute more social capital  
26 to the acquiring firm than directors in open social networks. Therefore, we expect  
27 that directors with closed networks will have a greater ability to secure social  
28 capital by virtue of their membership in such social networks and will be less  
29 likely to leave than directors with open networks.

30 Second, the structural dimension of social capital concerns the location of a focal  
31 actor in a social network and the director's utility in allowing information to flow  
32 from one social circle to another. Particularly important within this social structure  
33 is what Burt defined as structural holes or the separation between non-redundant  
34 contacts predominant in sparse networks (1992). As Lin (2001) states, "Locations  
35 that link nodes and their occupants to information and other resources unlikely  
36 to be accessible otherwise constitute valuable capital for the occupants of these  
37 'structural hole' positions, and at other locations and for other occupants accessing  
38 them" (p. 22). In their boundary spanning function, directors develop social capital  
39 by building interpersonal bridges between disconnected parts of markets and  
40 organizations where it is valuable to do so. Directors' social structure defines

1 their opportunities for brokering the flow of information across organizations as  
2 well as controlling resources.

3 Burt (1992) demonstrated that sparse networks are especially beneficial because  
4 each contact serves as a bridge to non-redundant information. Thus, directors  
5 whose networks span holes across organizations are more likely to increase  
6 the value to the firm of cooperation with outsiders and consequently their own  
7 value within the firm. Directors' advantages accrue to those whose networks are  
8 *sparse* or rich in structural holes (Burt, 2003). In the context of acquired directors,  
9 those located in sparse networks will be able to add more value to the acquiring  
10 firm because these resources are difficult to access and tend to be attached to actors.

11  
12  
13 *Interaction of Social Capital Arguments with*  
14 *Agency and Resource-Based Arguments*  
15

16 Under agency theory, we proposed that director dependence on top management  
17 will lead to higher turnover because the director's monitoring function within the  
18 acquired firm will be adversely affected. The social capital perspective suggests that  
19 directors contribute social capital to the acquiring firm through their organizational  
20 boundary spanning function, particularly in the case of those with a closed and  
21 sparse social network. Therefore, the social capital brought to the acquiring firm by  
22 directors through their external linkages may dilute the impact of direct dependence  
23 on turnover. We expect that the positive relationship between director dependence  
24 and director turnover will not be as strong as when a director does not have a  
25 closed and sparse social network or does not possess any competitive advantage  
26 over other directors as an efficient boundary-spanner.

27 Finally, according to the resource-based view, asset specificity and  
28 complementarity of director knowledge and expertise lead to lower acquired  
29 director turnover. It is reasonable to expect that directors with knowledge or  
30 expertise specific to the acquired firm and potentially valuable to the acquiring  
31 firm, or abilities complementary to those of the board or top management of the  
32 acquiring firm, will have a better chance of retention if they have also maintained  
33 a close and sparse social network.

34  
35  
36 **CONCLUSION**  
37

38 Our objective in this paper was to provide the reader with a better understanding  
39 of the theoretical and empirical literature that has examined the issue of top  
40 management turnover in target companies following acquisition. One conclusion



1 from our examination is that studies have focused too narrowly on the target  
2 company's incumbent top management team. Our own research indicates that  
3 executives who join target companies after the acquisition experience high turnover  
4 rates up to nine years after the acquisition. This suggests that acquisitions create  
5 long-term leadership instability in acquired firms. Conflicting findings in studies  
6 that focused on incumbent executive turnover might be explained by the fact that  
7 they did not consider the possibility that acquisitions also impacted executives who  
8 join the target firm several years after the acquisition. Acquisitions appear to create  
9 long periods of instability in the target company's top management team that begins  
10 with a high level of departures among incumbent executives immediately following  
11 the acquisition and continues with high levels of turnover among executives who  
12 join the target firm after the acquisition.

13 These findings have both practical and theoretical considerations. Executives  
14 with job choices may find the nature and dynamics of different job opportunities  
15 to be significantly different depending on the firm's past acquisition activities.  
16 Firms previously involved in an acquisition may provide less job security and a  
17 more dynamic, rapidly changing environment as the firm pursues restructuring  
18 activities and attempts to improve performance. From a theoretical point-of-view,  
19 future research that considers these long-term effects may be more successful in  
20 providing better explanations for the high failure rates of acquisitions. We also  
21 proposed a theoretical framework for understanding the nature of target company  
22 director turnover following acquisition. Little research has yet been done in this  
23 area. We believe the best insight into merger integration effects will be found in  
24 future research that considers the role of each of these three agents – directors,  
25 incumbent executives, and new-hire executives – in managing target firms over the  
26 long-term.

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37 [Aguilera and Li \(2003\)](#).

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