To be or not to be sustainable? Solving the dilemma during the acquisition process

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Abstract

Purpose of the paper: *This study aims at explaining heterogeneity in M&A performance in the light of companies' orientation towards sustainability.*

Methodology: *We first make use of our main independent variables by measuring the sustainability orientation of the acquiring firms and their detailed social or environmental orientation toward sustainability. Then, relying on a unique dataset of 174 acquisitions, we apply regression analysis to address our research questions.*

Findings: *Our results show how acquirers' ability to intensively and extensively commit to sustainability in relation to large environmental concerns, fosters acquisition performance. Further, we contribute to the literature by expanding our knowledge on the effects of a sustainability-oriented strategy on acquisition performance.*

Research limits: *Despite building on previous research, our study is not exempt of limits, suffering precisely from common limitations associated with the use of scores as measures of strategic orientation.*

Practical implications: *Our findings highlight the relevance of companies' ability to combine different strategic perspectives related to the value-generation process of M&A. Accordingly, our study has relevant implications for companies and practitioners that are involved in acquisition processes.*

Originality of the paper: *This study overcomes the profit-oriented perspective of the acquisition process while offering a more extensive picture of the factors affecting the success of M&A. Further, we disentangle the construct of sustainability orientation by distinguishing between social and environmental orientation and then investigating its effects on post-acquisition performance.*

Key words: acquisition performance; corporate sustainability; strategic orientation

1. Introduction

Despite the large number of failures (Young, 1981; Schweiger and Lippert, 2005; Christensen *et al.*, 2011), for more than one century, mergers and acquisitions (M&As) have offered rich opportunities for external growth, progressively taking hold in the strategic management toolbox (Cartwright and Schoenberg, 2006). Given the "the general recognition of the importance and relevance of the M&A phenomenon" (Gomes *et al.*, 2013, p. 15), research has thriven dramatically profiting from various approaches stemming from the disparate theoretical lenses of disciplines ranging from finance, management, and industrial economics to human resources and organizational theory (Zollo and Singh, 2004; Stahl *et al.*, 2005). In any case, when inquiring into the antecedents of value creation, scholars mostly consider M&A, thus opting for a shareholders' outlook while overlooking perspectives on stakeholders and their relationship with involved corporations (Parvinen and Tikkanen, 2007). When addressing stakeholders is at the core of creating effective corporate strategy (Freeman, 1984), as Corporate Sustainability (CS) lies in engaging and managing the web of companies' stakeholders in order to broaden its responsibility beyond the sole paradigm of "profit maximization" (Jamali, 2008), then no clear-cut dichotomy can exist between CS and corporate strategy (Ahen and Zettinig, 2015). Social environment definitely plays a significant role in companies' survival (Husted, 2000), pushing organizations to a "broad strategy-making perspective that incorporates the needs and demands of multiple stakeholders group" Harrison *et al.,* 2010, p. 149). Therefore, a new "polyphonic" form of organization is required to deliver key social outcomes exceeding the capacity of the shareholder primacy model (Hazen, 1993; Banerjee, 2014). Similarly, M&A need to reconcile different standpoints on companies' orientation towards sustainability, which is crucial for successful corporate renewal (Haspeslagh and Jemison, 1991). Indeed, while many stakeholders, from investment banks to advisors and from employees to customers, play a role in the acquisition process (Meglio, 2016; Russo and Perrini, 2006), increased regulation, stakeholder activism, and the progressive alignment of social and consumption needs still act as a prod to ponder a wider set of objectives when dealing with the critical task of merging with a new corporate heritage.

As CS is founded on a stakeholder model (Russo and Perrini, 2010), our paper relies on CS theory to overcome the lack of previous investigation on the role of companies' orientation towards CS in their ability to successfully extract value from acquisitions. We refer to *sustainability orientation* as firms' ability to carry out a sustainability-oriented strategy consisting of the exploitation of tools and the implementation of activities related to social and environmental outcomes (Ferrell *et al.,* 2010). Then, our contribution aims at advancing such theory by surpassing the current outlook on a profit-oriented perspective in M&A and going for a more sustainability-oriented one. Therefore, we provide new insights on the role of companies' alignment in M&A performance by assessing their fit in *sustainability orientation*.

We have tested our hypotheses by means of a unique sample of 174 M&As involving worldwide companies across several industries and covering the years from 2010 to 2014. Our results show evidence of a significant effect of *sustainability orientation* over post-acquisition performance.

The remainder of the paper continues as follows. In the next section, we build on present literature on CS and M&A to develop our hypotheses. Next, we introduce data and methodology. Then we present our results, which we comment in the discussion section and finally provide our conclusions while advancing relevant implications for both academia and practitioners.

2. Theoretical Background and Hypotheses Formulation

2.1 Sustainability orientation and M&A

Whereas "turbo capitalism" continues to find expression in never-ending M&A activity (Karitzki and Brink, 2003), frantic motion and recurring waves of corporate acquisitions still end up wasting value. Un coincidentally, more optimistic views claim that "a merger has no better than a 50-50 chance of creating value" (Adams and Neely, 2000, p. 19) whilst more severe estimates pose failure between 70 and 90 percent (Christensen *et al.,* 2011). As many deals fail to generate economic sense because they lack a proper consideration of "soft" intangible aspects referring to the social and environmental spheres of the involved companies (Knecht and Calenbuhr, 2007), in the same way, extant academic production has yet to explain variation in post-acquisition performance when focusing on classical strategic and financial perspectives (King *et al.,* 2004).

A new standpoint is therefore necessary to reconcile the disruptive nature of M&A with the broad dimensions of its influence in relation to its capacity to affect the complex set of interacting expectations of society and the natural environment. Based on such a triple bottom line perspective, the success or failure of the entire process, covering all stages from pre-acquisition to actual integration, can be influenced by companies' ability to monitor and manage different stakes to balance the numerous interests involved (Haspeslagh and Jemison, 1991). Indeed, the whole group of employees, shareholders, customers, financial partners, suppliers, surrounding communities and national and local authorities, as well as the voiceless environment need to be incorporated into governance processes of acquisitions. Screening, monitoring, and listening to sustainability-oriented concerns is therefore a precondition to not affect acquisition outcomes.

In this sense, the involved firms' briefing with a strategic orientation toward sustainability during the acquisition process can result in smoother transitions, avoiding the feeling of breaking formal as well as "psychological contracts" when dealing with the changes that are brought by the merger (Konstantopoulos *et al.,* 2009). In particular, by focusing on social issues, the integration itself can be regarded as "an issue of social responsibility" (Borglund, 2012, p. 36). Organizational commitment to support the acquisition is definitely carried by companies' obligation towards justice, caring practices and job security which then allow the avoidance of "voluntary resignations, low morale, reduced productivity, and even resentment of the acquired employees" (Lin and Wei, 2006, p. 97). While companies' positive virtues of organizational empathy, warmth and conscientiousness can be accompanied by loyalty, emotional attachment and job security during the merger (Chun, 2009), *sustainability orientation* can help companies to face the increased anxiety accompanying the change process. More precisely, as reconfiguration implies growing anxiety unless organizations are familiar with change (Teece, 2007), companies embedding sustainability into their organization possess greater flexibility and develop the ability to quickly configure and reconfigure resources by pursuing the constant evolution of the stakeholder environment (Cui and Jiao, 2011).

As a result, companies need to assess the complete spectrum of risks associated with social and environmental issues that potentially affect the acquisition. Indeed, coherently with the growing demand of social responsibility in corporate transactions (Ciambotti *et al.,* 2009), the reputation of involved companies is reinforced by a sustainability-oriented strategy that is recognized within their competitive arena and can facilitate or hinder processes of negotiation and consequent implementation (Russo and Mariani, 2013). Furthermore, by moving beyond due diligence (Hendricks, 2000), sustainability-oriented companies can more easily assess and manage risks associated to the natural environment, which can definitely affect the value of the acquisition consisting in the incurred costs for the acquiring company that are associated with environmental clean-up (Stanwick and Stanwick, 2002).

At the same time, while acting within social contexts made of changing, reciprocal expectations, companies face social and political pressure to act in ways that are socially desirable (Abbott and Monsen, 1979). In this sense, *sustainability orientation* functions as a legitimacy device, highlighting accomplishments in critical areas, justifying intentions, acts and omissions (Patten, 2002). In other words, a strategic approach to sustainability allows firms to watch for potential legitimacy threats, thus improving M&A performance by means of its favorable impact on society and the natural environment. On the other hand, an appropriate sustainability-oriented approach contributes to making actors involved in and affected by the acquisition process while being aware that corporate procedures are fair. Therefore, a strategic approach to sustainability will also favor the acquisition process, especially in the post-acquisition stage.

In light of these considerations, we expect the *sustainability orientation* of companies involved in such transaction to positively enhance post-acquisition performance. More specifically, we expect a strategic approach to sustainability to increase the value creation process of M&As and a social and/or environmental orientation toward sustainability to positively influence post-acquisition performance. Therefore, a set of hypotheses are proposed as follows.

Hypothesis 1: The *sustainability orientation* of companies involved in the transaction will positively impact post-acquisition performance.

Hypothesis 2: The social orientation of companies involved in the transaction will positively impact post-acquisition performance.

Hypothesis 3: The environmental orientation of companies involved in the transaction will positively impact post-acquisition performance.

3. Methods

3.1 Sample

The presented hypotheses were tested using a sample of worldwide M&As covering a period between 2010 to 2014. We obtained such a sample from the Thomson Reuters Datastream Database, from which we also gathered information about the deals at first, and then both financial and sustainability-related data to calculate the dependent and control variables used in the analysis. Our sample is unique because the special purpose of the study implied identifying transactions where information on the *sustainability orientation* of involved companies could be assessed. Therefore, our sampling approach drew on the use of Asset4ESG, a sustainability-related section of the Thomson Reuters Datastream Database to identify companies with a background on sustainability practices. Then we looked for transactions that involved those companies in a time span going from one year before the acquisition to one after it. We considered 2010 the starting year to avoid the period of the well-known global economic and financial crisis, while 2014 was chosen as the final year to observe the effects of the acquisitions along a broader timeframe. Finally, after eliminating transactions missing either a target or acquirer financial data, we ended up with sample of 174 M&As about which we had complete information.

3.2 Measures

3.2.1 Dependent variable

In accordance with an extensive steam of literature on M&A (Thanos and Papadakis, 2012), we measured post-acquisition performance as the difference between acquirer return on assets (henceforth, ROA) three years after the acquisition and the same measure one year before the acquisition (Zollo and Singh, 2004). We did not consider the targets' post-acquisition performance given the occurrence of consolidation after the deal's completion. Furthermore, we opted for a three-year time span following the acquisition because it gives enough time to "realize most of the effects associated with synergy while at the same time reducing the probability of extraneous influences such as other strategic actions by the firm" (Krishnan *et al.,* 1997, p. 368).

3.2.2 Independent variables

We built our measures of *sustainability orientation* by making use of the companies' sustainability scores that were provided by Asset4ESG in the Thomson Reuters Datastream Database. These scores indicate the social and environmental grade of the companies, and we considered the three-year period surrounding the focal acquisition. This had the aim of drawing a more detailed picture of the companies' orientation towards sustainability within a crucial period for the success of the acquisition capable of covering the pre- and post-acquisition phases. In particular, the *sustainability orientation* variable was built as an average score between the social and environmental scores provided by Asset4ESG for each acquiring firm in our sample. On the other hand, while dealing with the specific social orientation and environmental orientation, we relied on the scores provided by Asset4ESG.

3.2.3 Control variables

We included several control variables in relation to the acquirer, target, deal and year levels that could influence post-acquisition performance on the basis of previous literature. In particular, we checked for acquirer *acquisition experience* as to account for the firms' acquisition capability, measured as the number of acquisitions carried out in a window period of five years before the focal acquisition (e.g. Laamanen and Keil, 2008). Then, we considered the *relatedness* of the deal through the traditional relatedness operationalization on the SIC Codes of Haleblian and Finkelstein (1999). As greater complexity is associated with different national backgrounds, we included a dummy variable with value 1 for *cross-border* and 0 for domestic acquisitions (Gaur *et al.*, 2013). As for the bidder, we looked at the *debt-to-equity* ratio by means of financial leverage, computed as the ratio between acquirer total liabilities and equity capital. Also, to find greater chances of collaboration we include the measure of the *percentage acquired* (McCarthy and Aalbers, 2016). We also checked for the *relative size* of the deal through the ration between the acquirer and the target size, expressed as their total asset. Lastly, we controlled for both *period* and *industry effects*. In both cases, the control variable was built as a dummy variable, measured as 1, if the deal was completed in a given year, 0 otherwise; and measured 1 if the acquirer or the target pursued its activity in a given industry, 0 otherwise.

4. Results

The hypotheses were tested using Ordinary Least Squares (OLS) estimates with year-fixed effects regression models. We computed Durbin-Watson statistics for all regression equations in the study, thus finding that no autocorrelation biased the parameter estimates. Similarly, we checked for the absence of any issue of multicollinearity by looking at variance inflation factors (VIF), which have been found consistently below the rule-of-thumb cut-off of ten (Neter, Wasserman and Kutner, 1990). Accordingly, Table 1 presents correlations and descriptive statistics. No relevant correlations between our dependent variable, post-acquisition performance, and main independent variables of *sustainability orientation* were found. Moreover, Table 2 presents the regression models, whereas Model 1 represents the baseline model and only includes the control variables to seek their effect over post-acquisition performance. Instead, Model 2 provides tests for our hypotheses regarding the effect of *sustainability orientation* on acquisition performance.

Tab. 1: Correlation and descriptive statisticsa

		Mean	St.Dev	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1	Post-acquisition performance	-0.14	0.06																			
2	Acquirer SOD	49.22	3.60	0.10†																		
3	Target SOD	20.91	2.14	0.10†	0.19**																	
4	Acquirer SOB	2.31	0.12	0.13*	0.80**	-0.01																
5	Target SOB	1.19	0.10	-0.11†	0.14*	0.90**	-0.06															
6	Distance Depth	53.45	3.40	0.01	0.76**	0.13*	0.57**	0.12*														
7	Distance Breadth	2.48	0.12	0.00	0.30**	-0.13*	0.46**	-0.12*	0.63**													
8	Acquisition Experience	8.71	0.61	0.13*	0.25**	-0.16**	0.33**	-0.19**	0.20**	0.22**												
9	Corss Border	0.47	0.03	0.17**	-0.18**	0.13*	-0.23**	0.14*	-0.21**	-0.25**	-0.19**											
10	Business Relatedness	2.63	0.10	-0.01	0.16**	0.02	0.17**	0.06	0.12*	0.04	0.03	-0.06										
11	Acquirer Slack	2.01	0.39	0.00	-0.07	0.17**	-0.10†	0.14*	0.04	0.06	-0.07	0.09	-0.10									
12	Structural Integration	0.22	0.03	-0.06	-0.02	-0.13*	-0.03	-0.13*	0.03	0.03	0.16**	0.00	0.14*	-0.04								
13	Target Pub Status	0.38	0.29	-0.05	0.04	0.32**	-0.15**	0.34**	0.09	-0.15**	-0.29**	0.15**	0.02	0.07	-0.19**							
14	Target Age	36.06	2.44	0.03	-0.03	0.20**	-0.15**	0.23**	-0.04	-0.14*	-0.16**	0.12*	-0.09	-0.02	-0.02	0.20**						
15	Percent Acquired	61.82	2.53	0.13**	-0.14*	-0.40**	0.03	-0.47**	-0.13*	0.11†	0.20**	-0.08	0.00	-0.08	0.17**	-0.44**	-0.26**					
16	Acquirer Size	9.93	0.15	0.15**	0.31**	0.01	0.28**	-0.02	0.21**	0.10†	0.36**	-0.19**	0.03	-0.06	0.00	-0.14*	0.01	-0.08				
17	Target Size	6.93	0.18	0.02	0.16**	0.34**	0.03	0.38**	0.13*	-0.02	-0.03	0.20**	0.12*	0.02	-0.10†	0.34**	0.34**	-0.41**	0.41**			
18	Acquirer SOC	0.28	0.01	0.03	0.01	-0.01	0.00	0.00	-0.04	-0.03	0.05	-0.04	0.08	0.06	-0.08†	0.04	-0.06	0.07	0.04	-0.04		
19	Target SOC	0.15	0.01	-0.07	-0.03	0.03	0.00	0.02	-0.05	-0.02	0.02	0.07	-0.03	-0.07	-0.08	0.03	0.04	0.00	0.00	0.04	-0.13	-0.13

an=174
† $p < .10$
* $p < .05$
** $p < .01$

Source: our elaboration

Tab. 2: Coefficients for the dependent variablea

	Model 1	Model2	Model 2
Relatedness	1.31	1.04	1.03
Relative Size	-2.64**	-2.80**	-2.80**
Previous Acquisition Experience	-0.28	-1.18	-1.14
Cross-border	0.45	1.36	1.04
Period Effect	-1.37	-0.85	-0.86
Acquirer Industry	0.73	0.91	0.68
Target industry	1.32	1.60†	1.58†
Deal Type Percentage	2.42**	2.25**	2.28*
Debt-to-equity ratio	0.46	0.14	-0.07
Sustainability orientation		3.20**	
Social orientation			1.08
Environmental orientation			2.53**
R2	0.10	0.14	0.14
Adjusted R2	0.03	0.07	0.07
P <	0.071	0.008	0.001

an=276
† p < .10
* p < .05
** p < .01

Source: our elaboration

As a result, our first hypothesis finds partial support in the results. More precisely, Table 2 reports a positive and strongly significant coefficient ($\beta = 3.20$, $p < 0.01$) for *sustainability orientation* (Hypothesis 1), while, as opposed to what we predicted, no significant effect for the intensity of *social orientation* over the acquisition performance is captured (Hypothesis 2). Greater commitment towards sustainability is associated to better post-acquisition performance when carried out by acquiring companies with a higher environmental orientation since the variable has significant influence ($\beta = 2.53$, $p < 0.01$) over our dependent variable (Hypothesis 3).

Other control variables have been included to observe supplementary aspects affecting post-acquisition performance. In particular , we recorded a negative and highly significant effect ($p < 0.01$) of deal-type percentage, suggesting the greater complexity associated with a value creation process involving a higher stake acquired with a deal. In contrast, the results presented a negative effect of the relative size of the deal ($p < 0.1$), which relates to the lower complexity associated with smaller deals where the acquirer is a larger firm compared to the target.

5. Discussion

In accordance with the intention of strategic management to explain why some companies outperform others (Harrison *et al.*, 2010), our paper aimed at explaining heterogeneity in M&A performance by surpassing a schismatic focus on a profit-oriented perspective of the acquisition process.

Indeed, as results in extant literature suggest focusing more on the non-financial aspects associated with M&A (King *et al.,* 2004), differences in post-acquisition performance can be explained in the light of companies' ability to manage the complexity associated with an effective strategic orientation toward sustainability. In this sense, the proposed hypotheses find support in our findings, showing that *sustainability orientation* has a significant role in enhancing the value of an acquisition. Accordingly, our analysis supports the idea that corporate phenomena, and particularly M&A, should not be considered "aseptically", thus overlooking the indissoluble bonds connecting business and society.

In more detail, our findings show that a more intensive commitment towards a sustainability-oriented strategy by firms involved in the acquisition process, especially by the acquiring company, entailing greater knowledge, stronger ties and punctual actions, enhances the post-acquisition performance. Indeed, the greater respectability of the acquiring company can translate into less resistance from the acquired company, as the promise of ethical and respectful relationships can provide the necessary legitimacy to operate in the new operating context. For instance, government and local authorities may be more easily willing to support the acquisition when acquirers respect and/or take due care of social and environmental concerns, such as ties with their territory (Ciambotti *et al.,* 2009). Similarly, a more intense commitment to sustainability encourages corporate ability to communicate with stakeholders, which is particularly critical within the occurrence of an acquisition due to the necessity to clarify plans and goals to obtain stakeholders' support during the transition (Peltokorpi *et al.,* 2008), as well as gather relevant information on their expectations. The acquirer and target firms' ability to merge two different strategic views is essential in order to protect the acquisition, as provides acquirers with better chances of reaching fruitful negotiation and effective tools to reduce negative feelings of anxiety and fear while fostering a supportive environment for the sake of knowledge transfer and cooperation among different actors (Bresman *et al.,* 1999; Russo, 2012).

In accordance with our first finding, the results highlight the importance for acquirers to embrace broader sustainability-oriented issues to cope with the variety of prospects and claims associated with the acquisition. A consistent strategic orientation toward sustainability, aiming at extending the scope of its reach, is certainly more likely to be effective rather "than a strategy that "pick and chooses" the stakeholders it wants to treat well" (Harrison *et al.,* 2010, p. 164). Consequently, acquirers capable of drawing a more complete picture of societal and environmental concerns will be more likely able to effectively govern the entire acquisition process. As the multiplicity of actors involved in the acquisition process present legitimate and powerful claims (Meglio, 2016), acquirers lacking the ability to monitor and manage often contrasting stakes may undermine much of the value of the acquisition by exposing themselves to risks as well as losing profitable opportunities.

Analysing more in depth , despite our initial speculation, no significant effect of *social orientation* is found. The lack of any direct effect of a specific social orientation can be best explained in light of companies' different roles in the transaction and the absence of a direct interest in social issues related to an acquisition, as design and management of the acquisition process normally lies in the acquirer's domain and responsibility. Therefore, our results provide evidence of a lack of attention and interest in social issues when dealing with an acquisition.

In contrast, the present analysis points out how more detailed environmental concerns affect companies' capacity to extract value from the acquisition. Considering *environmental orientation* as a cultural and strategic orientation profoundly shaping the ontology of the firm, greater environmental orientation by the firms involved in the acquisition process can help companies in establishing a common route for future work. In fact, companies would share a similar strategic attitude defining the extent and scope of environmental-related issues in decision making processes, which in turn would facilitate the process of integration. Similarly, comparable levels and coverage of environmental impact would facilitate communication and mutual understanding, fostering the transfer of competences between acquirer and target. Overall, when dealing with environmental concerns, the entire acquisition process could find support in the common dominant logic defining the role and purpose of firms capable of coherently steering the development of the newly merged entity.

Going beyond the empirical claims that *sustainability orientation* is a univocal construct, our findings provide a preliminary answer to the question of how *sustainability orientation* should be organized to improve M&A performance.

Our findings support theoretical claims that CS cannot be separated from dependence relationships between companies and their social context (Post *et al.*, 2002). The detection and scanning of - and response to - social demand has become fundamental in achieving social legitimacy, greater social acceptance, and prestige while managing a deal, which in turn impacts on several actors who are involved in the acquisition process. In this sense, active company involvement in CS has to go beyond a generic responsiveness toward society at large, focusing rather on the importance of identifying an effective strategic orientation and related areas of either social and environmental oriented responsibility, which might influence post-acquisition performance. If so, regardless of the level of *sustainability orientation*, the more firms are able to extend their CS-related programs, the stronger their ability to achieve superior performance will be, especially if accompanied by the determination to maintain an appropriate balance between different, often contrasting interests related to integration after the M&A (Ogden and Watson, 1999). In other words, in order to have a direct impact on the ability to manage multiple relationships throughout the acquisition process, enlightened companies seem to be aware of the importance of communicating information that is relevant for sustainability-related topics in their efforts to make coherent decisions according to expectations concerning the deal.

6. Conclusions

This paper explores the role of companies' orientation towards sustainability in affecting the value generated by an acquisition. Our investigation moved from the intention of surpassing the leading "profit-oriented perspective" found in the extant literature on M&A by recomposing the complexity associated with the interrelated nature of firms and their strategic orientation, which could potentially affect the result of an acquisition. In this sense, our study confirms the advisability of planning a more effective strategic orientation toward sustainability by providing evidence of the significant effects of companies' commitment towards sustainability on post-acquisition performance. We found that acquirers' intensity of commitment as well as their ability to focus on sustainability-related concerns increases profitability following the acquisition. Still, our analysis shows that a company's greater alignment with the extent and latitude of sustainability-related topics translates into a better M&A performance. We therefore contribute to M&A literature by further promoting the profit-oriented perspective while offering new insights on the difference between a social or environmental strategic orientation as a necessary condition for the success of the acquisition.

Nevertheless, our study is not exempt from limitations. It suffers from usual limitations associated with the use of scores that have been highlighted by previous studies (Garegnani *et al.,* 2015). While no study has insisted on the cross-field of M&A and sustainability yet, it would be of interest for further research to investigate how different stakeholders affect the acquisition process (Bettinazzi and Zollo, 2017). Another important matter consists in the strategic distance that can exist between acquirer and target firms that lean toward sustainability, as they can influence the probability of an acquisition, as well as choices among different forms of collaboration such as alliances and joint-ventures.

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