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# The Antecedents of Acquisition Performance based on the Organizational Learning Theory

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**Abstract:** With a regression model, this paper studied the influence of acquisition experience and business relatedness on acquisition performance based on an empirical analysis of Chinese firms and found that both acquisition experience and business relatedness have significantly positive effect on acquisition performance of the acquiring firm. Moreover, this paper introduced legitimacy from the perspective of institutional theory and found that both acquisition experience and business relatedness have positive influence on acquisition legitimacy. It is proved that acquisition legitimacy has partial mediation effect both on the relationship between acquisition experience and acquisition performance and on the relationship between business relatedness and acquisition performance, which means acquisition experience and business relatedness can increase acquisition performance not only by integration effect of acquisition but also by gaining more support with getting high legitimacy.

Keywords: multiple regression analysis; acquisition experience; business relatedness; acquisition performance

## 1. INTRODUCTION

For a long time, as one of the most important ways of business expansion, acquisition has been given a lot of attention in the field of business and academy. It also has been argued a lot about whether acquisition is positive to business performance. The studies of acquisitions show that whether acquisitions can gain success is influenced by a number of factors, of which acquisition experience and business relatedness can have significant effect on acquisition performance. However, there are not consistent research results among different studies by different scholars. Bruton, Oviatt, and White (1994) found that the acquisition experience of the buyer can increase the possibility of acquisition success, while Kusewitt(1985) found that with the times of acquisition increased, the buyer's performance would be harmed. Besides, Lahey and Conn(1990) found that there was no significant relationship between the buyer's acquisition experience and acquisition performance. Because of the complicated and ambiguous relationship between acquisition experience and acquisition performance, Hitt and his colleagues(2001) emphasized that the importance of corporate experience in acquisition can not be under-estimated at any time, especially the significant role of the executive's acquisition experience.

Similarly, business relatedness between the buyer and the target has been considered to have obvious effect on corporate performance of both firms. The majority of the current literature on acquisitions argued that the acquisition of a company with related business can improve the level of financial performance and market performance <sup>[2, 4]</sup>. However, the empirical study of Datta and Puia (1995) found that there is not a clear relationship between mergers and acquisitions of both business and acquisition value creation <sup>[5,6]</sup>.

It can be seen from the existing studies, scholars explore mostly from the perspective of resource-based theory, transaction cost theory, organizational learning theory or mainly focus the research on the characteristics of the firms, or the characteristics of the relationship between the buyer and the target, without sufficient attention to the external environment, especially the impact of institutional factors. Strategic management scholars believe that the system has an important impact in China's context. Hoskisson (2000) believed that institution theory can provide more insights in emerging markets <sup>[7]</sup>. Therefore, this study attempts

to introduce the concept of merger legitimacy from the perspective of institutional theory to explain acquisition experience, business relatedness and acquisition performance, on the basis of traditional strategic management theory, such as the resource-based view and transaction cost theory.

## 2. THEORY AND HYPOTHESIS DEVELOPMENT

### 2.1 Acquisition experience, legitimacy, and acquisition performance

Acquisition has been popular but also controversial, because the complexity of mergers and acquisitions will lead to failure due to various factors. For example, during acquisition, the buyer may choose an inappropriate acquisition targets, make a higher payment, or carry out an unsatisfactory post-merger integration<sup>[8]</sup>. These factors help explain why many mergers and acquisitions are difficult to get a good income. Therefore, in order to avoid problems caused by the complexity of mergers and acquisitions, personal and organizational experience are needed<sup>[8]</sup>.

In reality, firms with frequent mergers and acquisitions often succeed in gaining the reallocation of resources<sup>[9]</sup>, the new technology and knowledge and the improvement of market position through the acquisition. According to Hayward (1997), firms to implement mergers and acquisitions, in theory, has enormous potential to learn from the acquisition experience, but often fail resulted from the difficulty of realizing or achieving this potential<sup>[10]</sup>. An interpretation of such failure is that experience gained from mergers and acquisitions lies in the quality of learning rather than quantity. Scholars of organizational learning theory believed learning is a problem-solving process to ensure that the main amendment of their own behavior. But the learning process doesn't always have a positive impact. On the one hand, the experience allows companies to learn to solve the problem more effectively under certain conditions. On the other hand, there are quite a few cases, where the positive role of the experience cannot apply, because the knowledge gained may be forgotten or be hindered. Moreover, firms may make false inferences or wrong application of knowledge in the learning process. Therefore, if the firm gets a satisfactory performance or income from mergers and acquisitions, current or upcoming, it will naturally learn. Firms acquire a wide range of knowledge from the acquisition process, including how to select the right acquisition. This skill is dependent on many factors, including corporate pricing, finance and the ability to integrate<sup>[8, 10]</sup>. However, given that previous acquisition experience are derived from the acquisition of a business-related enterprise, both firms may be incapable of seizing the opportunity when facing different important opportunities. Another possibility is that the theory gained from the experience will be more effective only when used during appropriate interval. The short interval between two acquisitions can cause the imperfectness of experience, conversely, the long interval will result in indistinct experience and less strong relatedness.

Relatively speaking, the acquisition market in China is still imperfect, mergers and acquisitions experience and acquisition capabilities are lacked, compared to foreign developed market companies. After several rounds of domestic acquisition wave, the Chinese enterprises have begun to gradually contact with and understand scientific acquisition process and regulations. Therefore, to the managers of Chinese enterprises, the richer mergers and acquisitions experience is, the higher acquisition skills they will acquire, including the selection of suitable acquisition targets, the right way to negotiations and the effectiveness of promoting the post-merger resource integration and restructure. Therefore, this study proposes the following hypothesis:

Hypothesis 1-1: There is a positive correlation between the acquisition experience of the acquiring firm and its acquisition performance.

System theorists emphasize that the enterprise is in the environment with system, and the decision of the corporate will affect various stakeholders, thus having an impact on the legality of the enterprises<sup>[11]</sup>. Legitimacy is a core concept of institutional theory, with both institutional and strategic importance<sup>[12, 13]</sup>. When

mergers and acquisitions occur, the stakeholders will be affected and thus make their respective response and the corresponding decision-making behavior. Referring to Chan and Makino (2007), the legitimacy of an acquisition activity can be reflected by the support of the government of the acquiring firm locates, upstream and downstream enterprises, customers, social institutions and the general public, as well as the reaction of competitors<sup>[11-13]</sup>.

According to the perspective of the institutional theory, the sufficient acquisition experience of the acquiring firm has an impact on whether the acquisition can gain legitimacy or not. First of all, for local governments in China, if an enterprise, with rich mergers and acquisitions experience, acquires a local firm, it is expected to produce positive economic effect, of which driving the economy is the most intuitive benefit, including the increase of financial taxation and the expansion of the scale of employment. Meanwhile, acquisition-experienced companies can better deal with acquisition conflicts during post-acquisition integration process, thereby reducing the potential internal contradictions, to maintain the stability of the staff as well as the society. Therefore, when the buyer firm is more experience, it can get more potential support from the government departments. Secondly, for the acquired company's existing upstream and downstream enterprises, it is more confident of the future stable cooperation and income when acquired by an acquisition experts rather than a firm without any acquisitions. Because multiple acquisition experiences can push forward the post-merger integration more skillfully and steadily, avoid management and cooperation stagnation or bad communication caused by mergers and acquisitions. In addition, social institutions such as trade associations welcome an acquisition-experienced enterprise, because mergers and acquisitions within the industry is an important way of healthy development of the whole industry, and successful acquisition case of experienced companies can help to promote the industry's competitive environment, as well as improve the capital markets. Therefore, this study proposes the following hypothesis:

Hypothesis 1-2: acquisitions experience of the acquiring firms and the legitimacy of mergers and acquisitions are positively correlated.

Further analysis shows that when companies merger with greater legitimacy, it often means that companies can get resource support and preferential policies from the government, thus reducing the corresponding cost of government relations<sup>[14]</sup>; obtain more support from the upstream and downstream enterprises, reduce relationship cost, have access to more learning opportunities<sup>[15]</sup>; get more support from social institutions and the public, increase market reputation and brand<sup>[16]</sup>. Any of the above three aspects enhanced, it helps the companies to achieve the expected acquisition target better. Therefore, this study proposes the following hypothesis:

Hypothesis 1-3: The legitimacy of mergers and acquisitions plays an intermediary role between the acquisition experience and acquisition performance.

## **2.2 Business relatedness, legitimacy and acquisition performance**

There's a well-accepted view that, there is a diversification trap in the process of mergers and acquisitions expansion, that is to say the lower the business relatedness is, the more unfavorable the acquisition performance is to the acquiring firm. Concerning this, scholars provide explanations from a variety of theoretical perspectives. In accordance with the view of the resource-based theory, after the mergers and acquisitions of two firms with complementary resources, the sharing during value chain activities can generate more synergy effects, for example, the sharing in product lines, brands, channels and purchases will accomplish greater scale economy and scope economy effects, thereby reduce cost and promote efficiency. If the degree of strategic complementarity is higher, the buyer and acquisition target can form a more perfect business portfolio after the merger, thereby improving the cost structure and providing better service choice<sup>[17]</sup>. Further, after the merger, a

wider business portfolio resulted from product complementation helps to improve market position and enhance reputation. Better market reputation and wider business portfolio combine further to help corporate access new market opportunities more effectively, thereby increasing income<sup>[18]</sup>.

In addition, according to organizational learning theory, the business relatedness is considered to urge the managers of the acquiring firm to introduce the dominant logic or conventional understanding of the requirements needed to succeed into the acquired company. Industry similarity can eliminate or significantly reduce the buyer managers' needs of learning their business, and contribute to learning from the acquisition process<sup>[3]</sup>. In mergers and acquisitions that require a high degree of involvement of management personnel, the market relatedness with the the acquired company is often the key to the post-merger integration of acquired business. And related mergers and acquisitions produce more value by effectively allocating the original resources of the buyer to more relevant place during new business. But a high relatedness doesn't mean no risk. A noteworthy point is resource utilization rate after the acquisition, that knowledge and ability of the buyer managers will have an impact on the reasonable utilization of resources. But the higher the business relatedness is, the better the buyer understands the acquired firm's business scope, and the better management and control are carried out, thereby enhancing performance after mergers. Therefore, this study proposes the following hypothesis: Hypothesis 2-1: there is a positive correlation between business relatedness and acquisition performance;

Further, Scott (2001) and other system theorists emphasize the impact, the legitimacy of corporate behavior will also be affected because the anticipated benefits of the company's external stakeholders that the corporate strategic behavior could cause. In terms of the government, a higher the business relatedness indicates a more likely post-merger integration effect, the effect of economies of scale and scope economies, thus creating more tax revenue for the government. In terms of upstream and downstream enterprises, a higher business relatedness means more possibility to maintain existing partnerships and channels, and helps to better learn from each other. In terms of social institutions or public, related mergers help to get familiar with industry standards (industry associations or financial institutions); In general, the failure rate of completely unrelated acquisition is quite high, so with a high degree of business success during business-related acquisition, it brings economic and social benefits where the acquired firm locates. Therefore, this study proposes the following hypothesis: Hypothesis 2-2: business relatedness and mergers and acquisitions legitimacy are of positive correlation.

Based on the above analysis, external stakeholders often holds such expectations, namely a higher business relatedness of the buyer and acquisition target will be more conducive to the performance improvement of post-merger integration, thus contributing to the acquisition of the interests of all parties. Therefore, when business-relatedness is higher, in addition to direct synergy effect and integration effect, more legitimacy can be accessed from the external system environment, which often means more resources support, benefiting the implementation of corporate strategic objectives. Therefore, this study proposes the following hypothesis: Hypothesis 2-3: legitimacy plays an intermediary role between business relatedness and acquisition performance.

### **3. RESEARCH DESIGN**

#### **3.1 Sample**

This study uses questionnaire methods to obtain first-hand data for empirical analysis. The object samples are the enterprises which implement acquisitions. An acquisition event forms an acquisition sample. Survey interviewees were top management or directly responsible for the acquisition of relevant personnel. A total of 282 questionnaires were returned 133, of which 75 valid questionnaires, the effective response rate of 26.6%. It should be pointed out that, only when the buyer has more than 50% percent of the ownership of the target firm,

the acquisition can be taken into account as a sample in this research. Nearly 80% in the sample of 123 valid questionnaires are senior management in enterprises (mainly including chairman, president or vice president and heads of department), so the questionnaires were filled in well. The occurrence time of acquisition (refers to the formal signing of the contract time) is close to 80% in the last five years' sample. And the vast majority of people who fill the questionnaire have a good memory of the acquisition, further enhancing the credibility of the result.

### 3.2 Variables

#### 3.2.1 Acquisition Experience(AE)

This variable is measured by acquisition experience of the buyers before this acquisition. Likert five-point measurement is used.

#### 3.2.2 Business Relatedness(BR)

This variable is measured by the level of relevance of business between both firms in this acquisition. Likert five-point measurement is used.

#### 3.2.3 Acquisition Performance(AP)

According to the study of Hunt, Datta, Capron and Hulland, the research measure the post-acquisition performance(AP) in the aspect of market share, sales revenues, profits, profitability, cash flow, etc.[12] Through the relevant topic options sett in the questionnaire, the degree of achieving the expected target in all respects of the buyer after the acquisition, judged by the interviewees, compared with the target of the acquisition, can be measured by the use of Likert five-point measurement.

#### 3.2.4 Acquisition Legitimacy(AL)

In reference to the studies of Chan, Makino (2007) and Dacin et al (2007) to design the measurement of acquisition legitimacy. There are six items of acquisition legitimacy(AL), that is, the measurement of the support degree from the local government of both buyer and target firm, suppliers, customers, important social organization and the public to the acquisition<sup>[10]</sup>. All can be measured with Likert five-point, the support degree can reach the maximum value of 5, the minimum value of 1.

#### 3.2.5 Control variables:

We set some control variables as shown in Table 1.

**Table 1. Descriptions and measurements of control variables**

Variables	Descriptions of variables	Measurements of variables
BO	Buyer's ownership	Ownership of target enterprise received by buyer through the acquisition
TM	Transaction methods	0-1dummy variables. Cash payment marked as 1; others marked as 0
RS	Relative size	Size of target enterprise relative to that of buyer. Likert five-point measurement
TP	Target firm's performance	The level of performance of target enterprise relative to industrial average. Likert five-point measurement

## 4. RESULTS AND ANALYSIS

Table 1 shows the mean of each variable, standard deviation and the Pearson correlation coefficient matrix. It can be seen that there is a significant positive correlation between acquisition experience, business relatedness, legitimacy and acquisition performance; at the same time, acquisition experience and business relatedness were also demonstrated a significant positive correlation with the legitimacy. In Chen Xiaoping's opinion, during the study of organization and management, the most used and most traditional method to examine is divided into three basic procedures: Firstly, examine whether the argument affects dependent variable; Secondly, examine whether the variable affects intermediary variable; Lastly, examine variable's impact on dependent

variable disappear of reduce significant when the intermediary variable is controlled.<sup>[23]</sup> This study refers to this method of testing the legitimacy of an intermediary role between the structure set-up and acquisition performance. The model regression results are shown in Table 2.

In this study, refer to this method of testing the legality of an intermediary role between the structure set up and acquisition performance model regression results are shown in Table 3 and 4.

Seen from the results of model 2, the regression coefficient of acquisition experience was 0.303 ( $p < 0.001$ ), revealing a significant positive correlation between acquisition experience significant and acquisition performance. Thus, the H1-1 is supported. In Model 4, the regression coefficient of the acquisition experience and legitimacy was 0.213 ( $p < 0.001$ ), showing that acquisition experience has a significant positive impact on the legality of mergers and acquisitions, and that H1-2 is supported. In Model 6, the coefficient of acquisition experience was 0.274 ( $p < 0.001$ ). It can be seen that taking legitimacy into account, acquisitions experience positive's impact on the acquisition performance is significantly reduced, indicating that the legitimacy plays an intermediary role in the acquisition experience and acquisition performance. H1-3 is supported. In Model 3, the regression coefficient of business relatedness was 0.235 ( $p < 0.01$ ), that is to say business relatedness can significantly explain changes in acquisition performance. Therefore, H2-1 is supported. In Model 5, the regression coefficient between business relatedness and legitimacy was 0.212 ( $p < 0.1$ ), showing that business relatedness has a significant positive impact on legitimacy. Thus, H2-2 is supported. In Model 7, the coefficient of business-related was 0.200 ( $p < 0.01$ ). It can be seen, taking legitimacy into account, business relatedness's positive impact on the acquisition performance is significantly reduced, indicating that legitimacy plays a partially intermediary role in business relatedness and acquisition performance. H2-3 is also supported.

**Table 2. Means, standard deviation and correlation analysis of all variables**

Variables	Means	St.D.	AP	AE	BR	AL	BO	TM	RS
AP	3.785	0.958							
AE	2.894	1.137	.539***						
BR	3.593	1.041	.228*	.303**					
AL	3.890	0.891	.238**	.256**	.250**				
BO	0.633	0.339	-.276**	-.225*	.338***	.050			
TM	0.846	0.363	.012	.000	.049	-.074	.021		
RS	2.309	1.202	-.116	.012	-.013	.037	-.161*	-.172*	
TP	2.935	1.371	.512***	.385***	.182*	.113	-.169*	.078	.142

\* $p < 0.1$ ; \*\* $p < 0.01$ ; \*\*\* $p < 0.001$

**Table 3. The regression results of Model 1 to Model 3**

	Model 1		Model 2		Model 3	
	AP		AP		AP	
	Coefficient	T-value	Coefficient	T-value	Coefficient	T-value
BO	-.639**	-2.974	-.463*	-2.302	-.915***	-4.096
TM	-.169	-.845	-.133	-.721	-.186	-.968
RS	-.188**	-3.072	-.167***	-2.954	-.192**	-3.257
TP	.358***	6.724	.265***	5.044	.315***	5.952
AL						
AE			.303***	4.769		
BR					.235**	3.258
R	.351		.457		.405	
R2	.329		.434		.380	
F	15.967***	.000	19.677***	.000	15.938***	.000

\* $p < 0.1$ ; \*\* $p < 0.01$ ; \*\*\* $p < 0.001$

**Table 4. The regression results of Model 4 to Model 7**

	Model 4		Model 5		Model 6		Model 7	
	AL		AL		AP		AP	
	Coefficient	T-value	Coefficient	T-value	Coefficient	T-value	Coefficient	T-value
BO	.326	1.345	-.046	-.180	-.507*	-2.527	-.907***	-4.121
TM	-.178	-.803	-.219	-.983	-.108	-.593	-.150	-.786
RS	.028	.404	.009	.134	-.171**	-3.046	-.194**	-3.331
TP	.019	.302	.045	.740	.263***	5.039	.307***	5.881
AL					.136*	1.793	.167*	2.122
AE	.213**	2.783			.274***	4.216		
BR			.212*	2.533			.200**	2.736
R	.086		.076		.471		.427	
R2	.047		.036		.444		.398	
F	2.194*	.059	1.922*	.096	17.243***	.000	14.430***	.000

\*p&lt;0.1; \*\*p&lt;0.01; \*\*\*p&lt;0.001

## 5. CONCLUSION

Acquisition Performance is affected by many factors. This study focuses on the impact of the buyer's acquisition experience and business relatedness on acquisition performance. On the basis of the resource-based view and transaction cost theory, the results of this empirical analysis support the conclusion that acquisition experience and business relatedness have a significant positive impact on acquisition performance, indicating that in the China's context, richer acquisition experience is conducive for the corporate to achieve business strategic goals; a high business relatedness will also contribute to the improvement of acquisition performance. In addition, this study introduces the concept of acquisition legitimacy from the perspective of institutional theory and proves that acquisition experience and business relatedness have significant positive impacts on acquisition legitimacy, that is the richer acquisition experience the buyer has, and the higher business relatedness is, the better acquisition performance can be achieved. Further, this study reveals legitimacy plays an intermediary role in the process where acquisition experience and business relatedness affects acquisition performance. In other words, acquisition experience and business relatedness get more support from external stakeholders, as well as generate acquisition synergy effect and other economic benefits, thus contributing to the implementation of the acquisition's anticipated objectives.

The results of this study provide some practical inspiration for Chinese corporate strategy managers to make acquisition decisions. First, select a high business-related company to implement mergers and acquisitions, and this can generate a greater economies of scale and economies of scope after the merger and reduce transaction costs. Secondly, the increase of acquisition experience will be beneficial to the success of future mergers and acquisitions. Whether the mergers and acquisitions fail or succeed both experiences contribute to the absorption of the acquisition skills and knowledge. In addition, business relatedness and acquisitions experience help to get more external legitimacy and more external support after the merger, including the government's resources policy support and cooperation of the upstream and downstream enterprises. This external legitimacy has a positive impact on the success of the mergers and acquisitions. Therefore, corporate decision-making and behavior should try to gain more legitimacy support, before acquisition, during acquisition or post-merger integration.

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