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The Effect of Director Experience on Acquisition Performance

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Abstract

Purpose: This study was conducted to examine the impact of the director's experience on the acquisition performance. *This research also focuses on how the experience of director in making future acquisitions.* The authors used. *The object of this research is the company that made acquisitions in 2013-2017*.

Design/methodology/approach: *The purposive sampling method is used to select the research sample. The descriptive statistical test, outlier test and hypothesis test is used to analyzed the data using SPSS program.* Assuming cumulative abnormal return (CAR) are the performance to measure a success acquisition, and the factors that have an impact on acquisition performance are performance are taken *number of prior acquisitions with positive CAR, number of prior acquisitions, average number of acquisitions, number of acquisitions with same industry, percentage number of acquisitions with positive CAR, board independent, board size, managerial ownership, firm size, free cash flow, CEO tenure and leverage as independent variable. The purposive sampling method is used to select the research sample. The descriptive statistical test, outlier test and hypothesis test is used to analyzed the data using SPSS program.*

Findings: *The results from this study show that the number of acquisition with positive CAR can improve acquisitions performance in the future, but the number of prior acquisitions can be reduce the acquisitions performance.*

Practical implications: This finding will be very helpful for management as a condition in choosing a new CEO. By adding acquisition experience as one of the conditions in choosing a CEO. This will increase the level of successful acquisition of the company.

Originality/value: This article present the empirical study of how CEO Experience in Acquisition can increase the success rate of acquisition in Indonesia.

1. Introduction and Background

In the era of globalization, many companies compete with each other to gain market share. Most of the companies will do various ways to make their company a pioneer company or the best company, having a broad market share and competing with competitors is by internal expansion and external expansion. Internal expansion is the normal growth in the company in accordance of the company. Conversely, external expansion can occur by doing a business combination.

Business combination can be made by mergers and acquisitions of target companies (Walters, Kroll, & Wright, 2007). Acquisitions is the fastest corporate tool in the growth of the company and to increase the size of the company in the face of domestic or global competition (Mallikarjunappa & Nayak, 2013). In addition to increasing company size, acquisitions are also widely used by managers as a strategy expansion tool (Benson & Ziedonis, 2010), increasing efficiency and direct access to external resources (Chao, 2017).

In the acquisitions process, not all went well and succeeded. One of the successes of the acquisitions is influenced by the acquirer's experience in the process of acquiring a target company (Cho & Arthurs, 2018). Experience in prior acquiring can improve performance on subsequent acquisitions (Kim, Haleblian, & Finkelstein, 2011).

Famous subjects in today's business world are mergers and acquisitions. based on information from the Institute of Mergers, Acquisition, and Alliances, it shows that more than 50,600 mergers with estimates of absolute exchange of up to US $ 2.9 trillion EUR (US $ 3.5 trillion / 2.5 trillion GBP) in 2017. These results are different with 2016, where there was an increase in the number of M & A exchanges by 2.9% (IMAA, 2017). This shows that M & A is a system that is considered to provide maximum results in accelerating development.

In April 2017, M & A activities in Indonesia reached Rp. 27.93 trillion, equivalent to 2.1 billion US $, with an exchange rate of Rp. 13,300 per 1 US dollar. M & A activities this year increased by 2.1% from the previous year. The number of understandings reached 56 agreements, with a total of 1 billion US $ status proposed, 707.5 US $ status pending and 2.1 billion US $ status completed. (Databoks, 2017).

2. Literature Review and Hypothesis Development

2.1. Acquisitions Performance

Acquisition performance is a way to measure returns on assets and capital from the acquisition process that is carried out in a certain period of time (Field & Mkrtchyan, 2017). In conducting this research, measurement of acquisition performance uses the short-term window event method. This method is used because it can evaluate the short-term effects of new information on company returns. The effect of new information on a company's return can be interpreted as a change in the distribution of company returns over a period, which in a short-term study lasts a maximum of several days (Zollo & Meier, 2008).

The short-term window event method in which there is an estimate of the cumulative abnormal return (CAR) of the company's shares for the day before the acquisition announcement and after the announcement of the acquisition. Because it is important to consider the cumulative abnormal return (CAR) of stock returns when the acquisition announcement. In this study the distance of time used is 1 day before and 1 day after the announcement of the acquisition. The formula for calculating cumulative abnormal return (CAR) as follows.

$ARit = Rit - Rmt.$(1)

where:

$ARit$ = *Abnornal Return of Company i at time t*

Rit = *Actual Return of Company i at time t*

Rmt = *Return of the Reference Market on day t*

Source: (Field & Mkrtchyan, 2017)

2.2. Number of Prior Acquisitions

The number of prior acquisitions is the number of other company takeovers that have been carried out, which involved independent directors in the process of taking over the company. The more companies make acquisitions, the more companies will face things that affect the success of the acquisition (Field & Mkrtchyan, 2017). That way, companies with a large number of acquisitions will be better prepared to deal with various issues related to acquisitions and have a higher chance of successful acquisitions than companies that have fewer acquisitions(Haleblian & Rajagopalan, 2011).

The company's experience in acquiring more and more, will make the company have extensive knowledge about how to organize knowledge efficiently (Haleblian & Rajagopalan, 2011). Can help companies in making decisions, including excessive information, tight time challenges and the potential of the company's focus and the need to formulate long-term strategy implications (Cusumano, Kahl, & Suarez, 2008).

H_1 = Number of prior acquisitions have a significant effect on acquisitions performance.

2.3. Number of Prior Acquisitions with Positive CAR

Cumulative Abnormal Return (CAR) is a return generated by a company after a cumulative acquisition (Field & Mkrtchyan, 2017). This CAR can be positive if the real return is greater than the return expected by the company (Woo, 2018). While it will be negative if the return expected by the company is greater than the return that occurs (Walters et al., 2007).

The number of prior acquisitions with positive CAR will be a benchmark for the company in making acquisitions in the future. Because with the data of previous acquisitions with a positive CAR value, it can give the company a picture of any industry that can provide a positive return to the acquiring company. This is very useful for acquiring companies, because the data can facilitate management in further analyzing the actions and things that must be prepared in subsequent acquisitions.

H_2 = Number of prior acquisitions with positive CAR have a significant effect on acquisitions performance.

2.4. Average Number of Prior Acquisitions

The average number of previous acquisitions is the overall acquisition that the company has made in a period (Field & Mkrtchyan, 2017). The average number of acquisitions can provide a description of the company how many companies have been acquired in the previous period and can be used as a reference in future acquisitions of the average number of previous acquisitions. That way the company can estimate the acquisition that will be carried out in the next period by considering various things that aim to improve the acquisition performance in the company through increasing returns generated later (Field & Mkrtchyan, 2017).

The average number of acquisitions in its nature is not used as a unit of measurement in determining whether or not the acquisition is good (Hamroush, 2018). But the average number of acquisitions can be a basic benchmark for the company to have good experience in making acquisitions (Field & Mkrtchyan, 2017). This can be proven by looking back on how much the company made acquisitions with the criteria of success. That way the achievements of the company will be seen as a whole.

H_3 = Average number of prior acquisitions have a significant effect on acquisitions performance.

2.5. Percentage Number of Prior Acquisitions with Positive CAR

Positive CAR is a return generated by a company with a greater value in fact than the return expected by the company (Field & Mkrtchyan, 2017). This CAR percentage can help companies determine what industry sectors can provide positive return companies, so companies can have a focal point of companies with a background like what can give a positive return after making an acquisition.

The percentage of previous acquisitions is the cumulative amount of the previous acquisition board in a simple and intuitive manner. This shows that the acquisition experience is spread among several directors and councils where acquisition experience is concentrated only in a number of directors (Mkrtchyan, 2013).

The percentage of previous acquisitions correlates significantly with size, albeit at a lower level. The positive correlation between the percentage of the number of acquisitions and the size of the acquisition can be explained by the fact that directors with greater experience will be asked to serve more councils to make acquisitions (Mkrtchyan, 2013). Therefore, it is estimated that there is an influence between the percentage of the number of acquisitions and the positive CAR with the acquisition performance.

H_4 = Percentage number of prior acquisitions with positive CAR have a significant effect on acquisitions performance.

2.6. Number of Prior Acquisitions with Same Industry

Acquisitions with companies that have the same industrial sector as acquiring companies will be easier to do than target companies that have different industrial fields. The same industry will facilitate the acquirer in terms of formulating the objectives and strategies to be carried out, besides facilitating the acquirer in terms of controlling all the activities of the target company due to knowing most of the work processes carried out (Mkrtchyan, 2013).

If the company acquires another business with the same industry classification at the same time it is often referred to as "the same industry merger", otherwise it will be called "a different industry of merging" (Hamroush, 2018). Acquisitions with similar industries occur when two companies belonging to the same industry group join into one unit in terms of ownership (Mkrtchyan, 2013). The type of acquisition can occur if a company makes a decision to acquire another company with a similar line of bussiness with the aim of increasing efficiency and reducing costs . This kind of thing is called vertical integration (Hamroush, 2018).

H_5 = Number of prior acquisitions with same industry have a significant effect on acquisitions performance.

2.7. Firm Size

Firm size has a negative correlation with acquisition performance (Chu, Teng, & Lee, 2016; Masulis, Wang, & Xie, 2007). Large company size is an effective means of takeover defense, because more resources are needed to acquire larger targets (Masulis et al., 2007).

The results of the study explain that the average acquirer who has a larger size tends to pay premiums higher than they should so that the acquisition results in a negative synergy (Moeller, Schlingemann, & Stulz, 2004). This proves managerial arrogance in making decisions so that it tends to benefit from the acquisition of increasing company size but the increase reduces the company's market value (Chu et al., 2016).

H_6 = Firm size have a insignificant effect on acquisitions performance.

2.8. Free Cash Flow

Free cash flow can see a negative relationship between free cash flow and abnormal cumulative free acquisition (Jensen, 1986). However, the amount of available cash flow can prove a positive performance that correlates with managerial quality, and because of this, the results of the acquisition are better (Masulis et al., 2007). Therefore it is the result of a different study in the study of free cash flow and acquisition quality.

H_7 = Free cash flow have a significant effect on acquisitions performance.

2.9. Leverage

The level of debt in financing a company's activities increases monitoring of the decision making of managers or CEOs (Teti, Acqua, Etro, & Volpe, 2017). Managers will try to maintain a low level of debt in order to have flexibility in making their investment decisions (Berger, Eli, & Yermack, 1997). Leverage has a positive effect on the performance of the company, this is due to the existence of a strict monitor by creditors towards management in terms of avoiding financial difficulties.

H_8 = Leverage have a significant effect on acquisitions performance.

2.10. CEO Tenure

The CEO becomes the controller of internal monitoring along with a long tenure. CEOs who have long tenure have more and more convincing experience than other CEOs (Hermalin & Weisbach, 2003;Jensen, 1993). CEOs with short or long tenure will make suboptimal acquisition decisions (Limbach, Schmid, & Scholz, 2015).

For CEOs with a short period of time, making them likely to choose a bad acquisition target due to lack of knowledge. In addition, short-term CEOs are also likely to make bad negotiations in the takeover of the company (Custódio & Metzger, 2014). Therefore, it is estimated that there is a positive influence between CEO tenure and acquisition performance.

H_9 = CEO tenure have a significant effect on acquisitions performance.

2.11. Board Size

The role of the board is to monitor managerial policies and the board of directors (Fama & Jensen, 1983). The large council places greater emphasis on "Politeness and Courtesy" and thus it is easier for a CEO to control. Monitoring is more efficient if the size of the board is smaller than the size of the larger board (Eisenberg, Sundgren, & Wells, 1998).

Larger board sizes can produce bureaucratic decisions, therefore they are less effective in carrying out surveillance actions against executives. The poor quality of corporate governance with a large company size allows executives to make acquisitions with personal goals. So that a small board size can make the acquisition performance increase.

H_{10} = Board size have a significant effect on acquisitions performance.

2.12. Board Independence

An independence board is tasked with overseeing the quality of the company's financial statements, as delegated directly by shareholders (Fama & Jensen, 1983). Financial statements are monitored because they have material influences. This must be done with the aim of avoiding managers from committing misuse that can lead to errors in decision making (Fields & Keys, 2003).

One important mechanism that should be possible is to choose independent directors in the company. The Independent Director will not coordinate with managers regarding the value of ownership of independent directors who support their accountability (Fama, 1980;Fama & Jensen, 1983). External stakeholders will ask independent external board members to monitor financial reporting and internal transactions, with adequate levels of external oversight, and in accordance with established estimates (Lynall, Golden, & Hillman, 2003). Therefore, as a management monitor, independent directors play an important role in supervision and monitoring in corporate governance.

H_{11} = Board independence have a significant effect on acquisitions performance.

2.13. Managerial Ownership

Far reaching administrative proprietorship motivating forces, including share capital and investment opportunities, can lessen office issues identified with acquisitions. The nature of the portfolio's wealth of an executive influences his attitude towards the company's strategy (Wright, Kroll, Lado, & Van Ness, 2002). The higher amount of investment the executive has in the company, the more he will be involved in “worthy” acquisitions that increase risk (Cornett, Hovakimian, Palia, & Tehranian, 2003).

In short, because stock prices generally increase with the size of the company so executives are more likely to make better acquisitions to build their empire or enrich themselves. When more executive compensation is associated with stock options or stock-based compensation, the acquiring company has a lower risk of making a bad acquisition.

H_{12} = Managerial ownership have a significant effect on acquisitions performance.

3. Research Methodology

This research is a quantitative study where the research data uses fiscal data in financial statements for 5 years. The financial statements used in sampling are companies listed on the IDX and conduct M & A activities from 2013 - 2017. Companies that carry out M & A activities must be accompanied by an M & A decree on the KPPU website. The method of selecting samples used was purposive sampling. descriptive statistical test, outlier test and hypothesis test will be used to test the data.

4. Research Finding

Table 1: Descriptive Statistics Result

	N	Minimum	Maximum	Mean
CAR	101	-0,0642	0,0849	0,008071
NUM_ OF_ PRI_ACQ	101	0,0000	3,0000	0,683168
NUM_ OF_ PRI_ACQ_WITH_POS_CAR	101	0,0000	2,0000	0,356436
AVE_NUM_OF_PRI_ACQ	101	0,0000	2,0000	0,534653
PERC_NUM_OF_ACQ_WITH_POS_CAR	101	0,0000	3,0000	0,673267
NUM_OF_PRI_ACQ_SAM_IND	101	0,0000	2,0000	0,445545
FRM_SIZE (in million)	101	923.169	733.099.762	82.439.859
FRE_CSH_FLW	101	-0.1504	0.3673	0.038443
LEV	101	0.0638	0.8823	0.522484
CEO_TEN	101	0,0000	16,0000	4,326733
BRD_SIZE	101	3.0000	11.0000	6.356436
BRD_IND	101	0.0000	16.0000	4.326733
MAN_OWN	101	0.0000	0.0020	0.000238

Table 2: t – test Result and Summary of Hypothesis

	B	Sig	Hypothesis
NUM_ OF_ PRI_ACQ	0.012	0.115	Insignificant
NUM_ OF_ PRI_ACQ_WITH_POS_CAR	0.032	0.000	Significant
AVE_NUM_OF_PRI_ACQ	-0.020	0.077	Insignificant
PERC_NUM_OF_ACQ_WITH_POS_CAR	0.014	0.003	Significant
NUM_OF_PRI_ACQ_SAM_IND	0.023	0.001	Significant
FRM_SIZE	-0.013	0.080	Insignificant
FRE_CSH_FLW	-0.062	0.105	Insignificant
LEV	0.027	0.170	Insignificant
CEO_TEN	0.003	0.001	Significant
BRD_SIZE	0.003	0.209	Insignificant
BRD_IND	-0.038	0.333	Insignificant
MAN_OWN	0.033	0.997	Insignificant

The result of this research clarified that almost all variables have insignificant effect on acquisitions performance. Variables that have significant result are variable number of prior acquisitions with positive CAR, percentage number of acquisitions with positive CAR, number of prior acquisitions same industry and CEO tenure so H2, H4, H5 and H9 are accepted. The test results of variables number of prior acquisitions, average number of prior acquisitions, board size, board independent, managerial ownership, firm size, leverage and free cash flow show insignificant result so that H6 is accepted and H1, H3, H7, H8, H10, H11 and H12 are rejected.

5. Conclusion

The Board of Directors has a fiduciary obligation to participate in all important company decisions and is seen as an important managerial in monitoring and giving advice. This study provides empirical results about how acquisition experience of directors can increase the value of the company through acquisitions. The results of this study indicate the fact that the acquisition is better than the obtained from the results of more gains. The CEO experience has a significant relationship to cumulative abnormal returns. This study also shows that previous acquisition experience allows directors to better monitor and advise management in future acquisitions. This finding will be very helpful for management as a condition in choosing a new CEO. By adding acquisition experience as one of the conditions in choosing a CEO. This will increase the level of successful acquisition of the company. Further analysis identifies two advantages of the company if it has an experienced director. First, experienced directors can choose the target company to be selectively acquired and allow acquiring companies that have high synergies and prevent management involvement in transactions that can damage the results of the acquisition returns. Second, the director's previous acquisition experience allows companies to negotiate agreements more effectively, as measured by an increase in the relative share of acquisition. However, this study also identified the weaknesses of companies that have experienced directors, namely the impact of overconfidence in acquisition decisions. Overconfident directors are clearly more likely to make lower quality acquisition when the company has abundant internal resources. Overconfidence makes the director think making an unconditional acquisition that will affect the results of the CAR becomes less good.

Based on the research conducted, it is known that the calculation of the acquisition performance is carried out using a market adjusted model that might be less accurate to estimate the actual results of abnormal returns. This model assumes that the best estimator in estimating a company's return is the market return. By using market returns, it is not necessary to use the estimation period to form the estimation model, because this model considers the estimated company return equal to the market return. In addition, the acquisition performance calculation is also only using the cumulative abnormal return (CAR) with a time of one day before trading days and one day after trading days. The time contained in this calculation is fairly short so that it can only reflect returns in a short time. The weakness of this short term window event method is that the analysis that can be done only revolves around a short period of time and is likely to produce an analysis that cannot describe the results of the study in the long term.

The recommendation that can be given is trying to make different measurements of the results of acquisition performance is to use the mean adjusted model or market model to get more accurate abnormal return results. The market model method has the advantage of having the ability to detect abnormal returns from all three methods. Market models have the potential to produce simple statistical tests. The market model can also estimate returns to reflect the characteristics of each security. The calculation of return in this model uses two stages, (1) forming the expectation model using realization data during the estimation period and (2) using this expectation model to estimate the expected return in the current period. Measurements with different models are expected to produce more varied research data and show more accurate results.

The next recommendation is to use the long term window event method in determining the event study abnormal return. The use of the long term window event can produce longer data to retrieve the results of abnormal returns. The advantages of this method are that it can produce data with quality that is more accurate because it combines the value of abnormal returns with quite a long time.

Appendix A. Variable Definitions and Measurements.

Variable	Definition
Panel A : Independent Variables	
Number of Prior Acquisitions	Cummulative number of other company acquisitions carried out with the involvement independent directors.
Number of Prior Acquisitions with Positive CAR	Cummulative number of other company acquisitions carried out with the involvement independent directors which generated positive CAR.
Average Number of Prior Acquisitions	Cummulative number of other company acquisitions carried out with the involvement independent directors scaled by the number of independent directors.
Percentage of Prior Acquisitions with Positive CAR	Cummulative number of other company acquisitions carried out with the involvement independent directors which generated positive CAR scaled by the number of independent directors.
Number of Prior Acquisitions with Same Industry	Cummulative number of other company acquisitions in the same industry.
Panel B : Dependent Variables	
CAR [-1 :1]	Three days cummulative abnormal return calculated using standard market adjusted model, where abnormal return is calculated as the difference between a firm return and the market return.
Panel C : Control Variables	
Firm Size	Natural logarithms of total asset.
Free Cash Flow	Operating income before depreciation minus income taxes, interest expense and capital expenditures, scaled by the book value of total asset.
Leverage	Book value of debt divided by book value of total assets.
CEO Tenure	Number of years in the position of CEO.
Board Size	Number of directors on the board.
Board Independence	Number of independence directors divided by number of directors on the board.
Managerial Ownership	Percentage of total shares directors, commisioners or management divided by total outstanding shares.

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