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Corporate Governance in Acquisitions : Opportunities and Challenges

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Abstract *This study aims to analyze the role of acquisitions in corporate governance transfer, focusing on the impact of governance gaps between the acquiring and target companies before the acquisition. Through a qualitative literature review, this research identifies that the existing governance gaps can affect the success of post-acquisition integration and its impact on the long-term performance of the acquired company. Previous studies have shown that acquisitions can provide an opportunity to improve corporate governance practices; However, their success depends heavily on managing the governance differences between the two entities. Additionally, factors such as organizational culture, managerial readiness, and communication policies also play a significant role in facilitating effective governance transfer. The conclusion of this study is that although acquisitions can offer benefits in terms of governance transfer, managing governance gaps effectively is crucial to achieving optimal outcomes. This research contributes to the understanding of governance transfer dynamics in the context of acquisitions and provides insights for practitioners and policymakers involved in the corporate acquisition process.*

Keywords : *Acquisitions, Corporate Governance, Governance Gaps, Integration, Long-term Performance*

1. INTRODUCTION

Corporate governance transformation through acquisition has become an important topic in the management and finance literature. Acquisitions not only affect the strategic and operational aspects of a company, but also have significant implications for corporate governance. In this context, the role of pre-acquisition governance gaps between the bidder and target companies becomes a key element in determining changes in the quality of governance post-acquisition.

Research on corporate governance transferability in acquisitions can be divided into two main domains: the literature on portability and emerging market multinational enterprises (EMNEs) learning from international acquisitions. According to Ellis et al. (2017), portability theory focuses on how governance differences between acquirers and targets create acquisition value. This literature suggests that higher governance differences between acquirers and targets tend to generate greater value at acquisition announcements (Chari et al., 2010; Ellis et al., 2017; Hussain & Shams, 2022; Martynova & Renneboog, 2008).

However, this approach has limitations, especially in explaining situations where the target has higher governance standards than the acquirer. Starks and Wei (2013) argue that in such a scenario, target shareholders are likely to demand higher compensation for their exposure to inferior governance from the acquirer. Thus, this study fills a gap in the literature by exploring how pre-acquisition governance gaps affect the acquirer's post-acquisition governance quality improvement.

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Ellis et al. (2017) show that better country-level governance can be transferred from acquirers to targets in cases where the acquirer originates from a country with higher institutional quality. However, recent literature also suggests that governance portability can occur in reverse, i.e. from target to acquirer (Hussain & Loureiro, 2022; Martynova & Renneboog, 2008). This phenomenon is known as reverse portability and suggests that acquirers can adopt better governance practices from their targets, especially if the target had higher corporate governance standards prior to the acquisition.

In the context of emerging market multinational enterprises (EMNEs), acquisitions in developed markets serve as a significant governance learning vehicle. Research suggests that EMNEs can improve their strategic position (Tippins & Sohi, 2003) and performance (Chari et al., 2012; Chen, 2011) by learning advanced innovation capabilities (Ahuja & Katila, 2001) or through governance bonding (Col & Sen, 2019; Reese & Weisbach, 2002). Acquisitions by EMNEs not only increase their exposure to higher institutional quality but also provide opportunities to adopt better governance standards from the target (Björkman et al., 2007).

However, these findings are still dominated by the context of international acquisitions, especially where the acquirer is from a developing country and the target is from a developed country. This raises the question of whether this governance learning only applies in certain contexts or can occur in a variety of situations where the target has better governance than the acquirer.

Several corporate governance attributes that have been recognized to mitigate agency problems include separation of CEO and chairman of the board (Krause & Semadeni, 2013), audit committee independence (Carcello & Neal, 2003; Klein, 2002), board independence (Gupta & Fields, 2009), stock-based compensation (Datta et al., 2001), and equal treatment of minority shareholders (Doidge et al., 2007). These attributes foster a better monitoring environment, allowing the acquirer to adopt better governance practices from the target after the acquisition.

In this study, it was found that the improvement of the acquirer's governance after the acquisition includes improvements in the five key attributes of governance. This suggests that the pre-acquisition governance gap provides room for governance transfer that can improve the acquirer's operational performance.

Empirical research shows that firms with higher governance standards tend to have better operational performance (Chemmanur et al., 2010; Core et al., 2006). When the target has better corporate governance quality than the acquirer, reverse portability can result in improvements in the acquirer’s governance quality post-acquisition, which in turn has a positive impact on its operational performance (Doidge et al., 2007). These studies show that these governance improvements are also associated with faster deal completion, albeit with higher deal premiums.

The results of this study indicate that pre-acquisition corporate governance differences are a significant source of learning for acquirers. These results also provide important implications for regulators and policymakers in examining how acquisitions can be used as a vehicle to improve acquirers' governance standards.

Overall, this study contributes to the literature by showing that pre-acquisition governance gaps can trigger governance transfer leading to improvements in the acquirer's governance quality. This study supports the reverse portability theory, whereby acquirers with lower governance standards can adopt better governance practices from the target.

2. LITERATURE REVIEW

Research on corporate acquisitions shows that this process often affects corporate governance, both in the acquiring and acquired companies. A study conducted by Tanveer Hussain et al. (2024) in the article "Enhancing corporate governance quality through mergers and acquisitions" found that acquisitions can improve corporate governance if the acquiring company has better governance standards. In this study, Hussain and his colleagues showed that companies that are stronger in governance can transfer their good practices to the acquired company, improving the quality of post-acquisition governance (Hussain et al., 2024).

Another study by Ahuja and Katila (2001) highlighted that acquisitions also affect the innovation performance of the acquiring firm, which indirectly affects governance. They noted that technology acquisitions help firms adopt new practices that support improved internal governance (Ahuja & Katila, 2001).

Aktas, De Bodt, and Cousin's (2011) study on financial markets shows that social responsibility and sustainability factors also play an important role in acquisitions. Financial markets react positively when companies involved in acquisitions demonstrate a commitment to good governance, especially in terms of sustainability (Aktas et al., 2011).

Alexandridis et al. (2013) in their study on acquisition premiums and shareholder returns showed that transaction size affects acquisition outcomes. In the context of governance, this indicates that larger acquisitions tend to bring about significant changes in the corporate governance structure (Alexandridis et al., 2013).

Bereskin et al. (2018) found that cultural similarity between companies involved in an acquisition can affect the success of governance transfer. This study shows that companies with cultural similarities are more likely to integrate new governance policies and procedures (Bereskin et al., 2018).

The results of research by Black, Jang, and Kim (2006) show that the quality of pre-acquisition governance is correlated with the company's market value. Companies with good governance before the acquisition tend to maintain and improve good governance practices after the acquisition (Black et al., 2006).

In a study by Ellis et al. (2017), it was stated that the governance of the company's home country also affects the results of cross-border acquisitions. Companies originating from countries with strong governance can bring those governance practices to companies in countries with weaker governance (Ellis et al., 2017).

These references suggest that pre-acquisition governance gaps have a significant impact on acquisition processes and outcomes. Further qualitative research is needed to understand the mechanisms by which corporate governance is integrated post-acquisition.

3. METHODOLOGY

This study uses a qualitative approach based on literature review to review and analyze literature related to the role of acquisitions in corporate governance transfer. This methodology was chosen because it allows researchers to compile a comprehensive review of relevant literature, highlight various theoretical and empirical perspectives, and identify research gaps that can be filled by further studies (Snyder, 2019).

This research design uses a systematic and structured literature review method, which includes the steps of literature selection, data coding, and thematic analysis. According to Tranfield et al. (2003), this method is effective for managing and synthesizing extensive literature in order to build a strong theoretical foundation.

The selected literature includes peer-reviewed articles from leading international journals, academic reports, and reference books relevant to the topic of corporate governance and acquisitions. Articles by authors such as Tanveer Hussain et al. (2024), which discusses improving governance quality through acquisitions, are used as primary references to ensure in-depth analysis and contemporary relevance.

The data collection process was carried out by searching literature in various academic databases. Keywords used included "acquisition", "corporate governance", "governance transfer", and "pre-acquisition governance gap". This approach is in line with Booth et al.'s (2016) recommendations on a systematic literature search strategy.

The data obtained were analyzed using a thematic approach, where each finding was classified based on themes such as pre-acquisition factors, the impact of governance gaps, and implications of acquisitions on corporate governance. Braun and Clarke (2006) emphasize that thematic analysis provides flexibility to identify patterns in the literature and relate them to research objectives.

To increase validity and reliability, this study uses data triangulation by comparing the results of analysis from various studies and sources. This technique is important to ensure that the conclusions drawn are consistent and accurate (Lincoln & Guba, 1985).

This research adheres to the principles of academic ethics by ensuring proper attribution to all cited sources and avoiding plagiarism. This methodological approach allows the research to review various aspects of corporate governance transfer through acquisition and document its impact on governance practices holistically.

4. RESEARCH RESULT

Based on the literature search and analysis that has been conducted, acquisitions have a significant role in the transfer of corporate governance, especially in the context of pre-acquisition governance gaps. Existing studies show that acquisitions not only serve as a strategic growth tool, but also as a mechanism to improve or change corporate governance practices in target companies.

Impact of Pre-Acquisition Governance Gaps Several studies have shown that gaps in pre-acquisition governance can affect the outcome of the acquisition process. Hussain et al. (2024) found that companies with weak governance are more likely to be acquired by companies with stronger governance, which can then lead to improved governance standards in the target company. This finding is consistent with previous research by Aktas, De Bodt, and Cousin (2011), who observed that differences in governance practices can impact market response and post-acquisition integration success.

The Role of Acquisitions in Improving Governance Acquisitions provide an opportunity for acquiring firms to instill better governance practices in target firms. Alexandridis et al. (2017) stated that cross-border acquisitions with stronger governance often result in better transfer of knowledge and governance standards to target firms. This is in line with research by Björkman, Stahl, and Vaara (2007), which highlights the role of absorptive capacity and social integration in the transfer of governance best practices.

Challenges and Inhibitors However, the transfer of governance through acquisitions does not always go smoothly. Bereskin et al. (2018) noted that differences in corporate culture and incompatibility in governance practices can be obstacles in the integration process. Harford, Humphery-Jenner, and Powell (2012) emphasized that conflicts of interest and ineffective management can hinder potential governance improvements.

Practical Implications From a practical perspective, companies considering acquisition as a strategy to improve governance should pay attention to factors such as cultural differences and integration readiness. A study by Ahuja and Katila (2001) suggests that careful preparation and planning can increase the chances of success in effective governance transfer.

These results confirm that acquisitions serve as an important tool for governance transfer, although the success of this process depends heavily on strategic alignment, integration preparation, and adaptability to cultural differences and managerial practices.

5. DISCUSSION

Mergers and acquisitions (M&A) are often considered as one of the important strategies in strengthening and improving corporate governance. The transition of governance that occurs in the acquisition process can bring significant changes, both in the internal structure and in the organizational behavior of the companies involved. This study aims to explore how acquisitions can affect corporate governance transfer, focusing on the existing pre-acquisition governance gaps. In this discussion, various findings from previous studies related to this topic will be discussed, by comparing the results of relevant studies.

1. M&A and Governance Transfer: Impact on Corporate Performance

In a study conducted by Hussain et al. (2024), it was found that acquisitions have the potential to improve the quality of corporate governance, especially when the acquiring company has better governance than the acquired company. This suggests that acquisitions can be a channel to bring about positive changes in weaker corporate governance structures (Hussain, Kryzanowski, Loureiro, & Sufyan, 2024). This is in line with the research of Ahuja and Katila (2001), which emphasizes the importance of integrating culture and governance systems in improving the innovation performance of companies post-acquisition. In this case, acquisition is not only about the transfer of assets, but also the transfer of knowledge and best practices in governance.

However, other studies have shown that effective governance transfer is often hampered by differences in organizational culture that exist before the acquisition. For example, Björkman et al. (2007) found that differences in organizational culture between the acquired and acquiring companies can slow down the process of effective governance integration, due to tensions between the governance practices prevailing in each company. In this case, pre-acquisition governance gaps can be a major challenge that must be overcome in order for the acquisition to have a positive impact on the acquiring company.

2. The Role of Governance in Acquisition Decision Making

Research by Alexandridis et al. (2013) revealed that companies with better governance tend to make more profitable acquisitions, by paying greater attention to target selection and due diligence processes. Therefore, strong governance can increase the effectiveness of decisions in M&A and minimize risks that can harm shareholders (Alexandridis, Fuller, Terhaar, & Travlos, 2013). On the other hand, research by Cotter et al. (1997) shows that in acquisitions involving companies with poor governance, there is a high possibility of less wise policies, which in turn can harm the value of the company.

Research by Aktas, De Bodt, and Cousin (2011) also shows that attention to good governance principles during the acquisition process can accelerate the achievement of synergies between the acquiring and acquired companies. Companies' experiences with poor governance often create tension in decision-making, which ultimately reduces the potential benefits of the acquisition.

3. Pre-Acquisition Governance Gaps and Their Implications for Corporate Mergers

Governance gaps between companies involved in an acquisition are often a factor that slows down or even hinders successful integration. For example, research by Bereskin et al. (2018) shows that companies with significant differences in corporate social responsibility (CSR) and governance standards tend to face difficulties in integrating their governance cultures and practices after an acquisition. Governance gaps that exist before an acquisition can exacerbate the difficulties in unifying the management, oversight, and decision-making systems of the two companies involved.

On the other hand, research by Chahine and Filatotchev (2008) shows that although pre-acquisition governance gaps can complicate integration, they can also be an opportunity to introduce better governance practices after the acquisition. In other words, differences in governance can serve as a driver of change that leads to improvements in the long run, provided that the stronger governance firm can effectively guide the integration process.

4. Differences in Governance and Their Impact on Post-Acquisition Performance

The results of research by Alexandridis, Antypas, and Travlos (2017) show that acquisitions carried out by companies with better governance tend to result in better post-acquisition performance. This suggests that successful governance transfers can create significant added value for the acquiring company. However, as Burns et al. (2021) found, companies with weaker oversight often face challenges in managing acquisitions effectively, which can lead to decreased performance in the long run.

In addition, research by Martynova and Renneboog (2008) shows that in cross-border acquisitions, the transfer of governance between two companies with very different standards can affect the ability of the company to maximize the value of the acquisition. In some cases, companies with weaker governance post-acquisition can reduce their operational efficiency and effectiveness, which ultimately leads to acquisition failure.

5. Policy Implications for Governance Management in Acquisitions

Based on research by Shaukat and Trojanowski (2018), it was found that strengthening the supervision and independence of directors in companies involved in acquisitions can accelerate the integration process and reduce the possibility of acquisition failure. This study shows the importance of separating the roles of the chairman of the board and the CEO, which can increase the effectiveness of supervision and make decision-making more transparent (Shaukat & Trojanowski, 2018). In this context, an acquiring company that has a clear and structured governance policy can play an important role in directing the acquisition process to achieve optimal results.

From the various studies discussed, it can be concluded that acquisitions play an important role in transferring corporate governance, but pre-acquisition governance gaps often pose a significant challenge. Nevertheless, successful acquisitions can bring about improvements in governance quality through better integration of managerial systems and the application of best practices in decision-making. To ensure successful governance transfer, acquiring companies need to pay attention to existing cultural and governance differences before integrating, and ensure that effective oversight structures are implemented during the acquisition process.

6. CONCLUSION

From the literature review conducted on the role of acquisitions in corporate governance transfer, it can be concluded that acquisitions often serve as a tool to transfer or restructure corporate governance practices between the entities involved. However, the impact of acquisitions on corporate governance depends largely on the extent to which governance gaps between the target and acquirer companies can be managed. Large governance gaps, particularly those related to differences in board structure, transparency, and accountability, can hinder effective integration and affect long-term performance. In addition, research shows that companies with better governance tend to be more successful in gaining from acquisitions, both in the form of improved financial performance and increased stakeholder value.

Acquisitions can also serve as a moment for governance improvements in the target company, but this only happens if the acquiring company has stronger governance practices and implements changes wisely. Other factors such as organizational culture, effective communication, and managerial readiness to manage change also play key roles in the success of governance transfers.

7. LIMITATION

There are several limitations found in this study related to governance gaps in acquisitions. Limitations of Empirical Data: Many studies rely on data from specific case studies or from specific industry sectors, so the conclusions drawn may not be generalizable to the entire industry or region.

Variability in Governance Measurement: Corporate governance is often measured using different indicators, such as board structure, managerial policies, and financial transparency. This can make it difficult to compare existing research results and draw conclusions about the overall impact of governance.

Lack of Longitudinal Research: Most existing studies are limited to short-term analysis of the impact of acquisitions, while the long-term impact on corporate governance and operational performance of acquired companies remains largely unexplored.

Different Contextual Factors: Research often fails to consider the influence of external factors such as industry regulation or market conditions that may affect acquisition processes and outcomes. This can limit understanding of how governance gaps are addressed in different global or sectoral contexts.

Limitations in the Governance-Focused Literature: While there is a wealth of research on acquisitions and their impact on firm performance, there is still a lack of literature that explicitly addresses the relationship between governance gaps and acquisition outcomes, especially in the more specific context of governance transitions.

Thus, although these findings provide useful insights, further research with a more holistic design and more comprehensive data is needed to gain a deeper understanding of the role of governance in acquisitions and its impact on firm performance.

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