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Corporate entrepreneurship and financial performance: The case of management leveraged buyouts

Shaker A. Zahra [1]

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Executive Summary

Leveraged buyouts (LBOs) have created much controversy in the literature, centering on their potential effect on a company's ability to innovate, engage in new ventures, and support entrepreneurial projects. Some believe that post-LBO debt reduces the financial resources available for entrepreneurial activities. Conversely, others argue that, despite the burden of debt, some LBOs provide executives with an opportunity to innovate and take risks (Malone 1989). However, past studies have focused primarily on changes in R&D spending and ignored other corporate entrepreneurship (CE) activities a firm might pursue. Additionally, these studies have not documented the changes in CE after a management-led LBO. Thus, past studies offer only a snapshot of the effect of LBOs on CE. Finally, earlier studies did not directly examine the association between changes in entrepreneurial activities after the LBO and changes in performance.

To address these shortcomings, this study adds to the literature in three ways. First, it compares a company's pre- and post-LBO commitment to corporate entrepreneurship (CE), measured along two dimensions: innovation and venturing. Second, the study compares pre- and post-company performance levels. Third, the study shows how changes in a company's entrepreneurial activities impact performance. Therefore, the following hypotheses were tested:

> *H1:* A company's commitment to CE activities increases after an LBO.
>
> *H2a:* Company performance will be higher after an LBO than before the transaction.
>
> *H2b:* Post-LBO company performance will surpass that of the firm's industry average.
>
> *H3:* Changes in post-LBO CE activities (venturing and innovations) are positively associated with company financial performance.

Data were collected from 47 LBO companies. Data were gathered from secondary sources to augment and validate interview data. Data collected from two executives per firm were averaged and the mean was then used in all analyses. Data covered the three years immediately before and three years immediately after the LBO. Companies in the sample were selected based on three criteria. First, at least 25% of the value of the LBO should have been paid by the firm's senior executives (vice presidents and higher). Second, the firm must have gone through a single LBO and must have remained private through the period of the study that eliminated reverse LBOs from consideration. Finally, the firm must have undergone its LBO at least three years before data collection. This provided an opportunity to observe changes in a company's CE and performance.

Multivariate analysis of covariance (MANCOVA), analysis of covariance (ANCOVA), and multiple regression were used to test the study's hypotheses. The results supported H1, showing that LBO companies increased their commitment to developing new products; placed greater emphasis on commercializing their technology; enhanced the quality and size of their R&D function; and intensified their new venture efforts. However, R&D spending did not change significantly after the LBO. The results also showed that post-LBO company performance was significantly higher than pre-LBO levels and the industry's average, thus supporting H2a and H2b. Finally, as stated in H3, changes in a company's CE activities were significantly associated with changes in postchanges in a company's CE activities were significantly associated with changes in post-LBO company performance.

Leveraged buyouts (LBOs) have created considerable controversy among scholars, executives and public policy-makers. Concern centers on the potential impact of an LBO on a company's willingness to innovate and engage in entrepreneurial ventures. To date, little empirical research has been devoted to documenting the changes that occur in a company's entrepreneurial behavior after an LBO and to linking these changes to company performance. Using data from 47 LBOs, this study's results lead to three conclusions. First, companies reported increases in their product development, technology-related alliances, R&D staff size and capabilities, and new business creation activities. Moreover, these firms did not change their R&D spending or the focus of R&D projects. Second, post-LBO company performance was higher than pre-LBO levels. Third, changes in corporate entrepreneurship activities after LBOs were significantly and positively associated with changes in company performance.

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