STRATEGIC ALLIANCES

The theory’s central management insight is that strategic alliances can facilitate effective cooperation between firms to achieve mutually compatible objectives by combining needed resources.

Over recent decades, strategic alliances have become a widely accepted competitive tool in business. Broadly defined, strategic alliances refer to interfirm cooperative arrangements aimed at pursuing mutual strategic objectives of the partner firms. The two or more partners forming such alliances remain competitors. Examples of strategic alliances include joint ventures, research and development (R&D) agreements, research consortia, joint manufacturing and marketing agreements, buyer-supplier relationships, licensing, franchising, and so on. Strategic alliances seem to be proliferating with increasing competition and globalization. The rationale for entering into alliances typically include market access, scale economies, risk and cost sharing, and learning. However, notwithstanding this popularity, strategic alliances have inherent instabilities and quite often end up as failures. We should note, though, that alliance failures refer to major changes (such as a merger/acquisition not originally intended) or dissolutions of alliances that are unplanned from the perspective of one or more partners. Planned terminations of alliances, with time-bound agreements, should not be considered as
failures. Estimates of instabilities have ranged between 40 and 70 percent within a period of a few years of the formation of alliances. Overall, given the relatively high likelihood of failure, strategic alliances must be considered as a high-risk strategy, and alliance managers would need to develop a facility beyond handling single-firm strategies in order to judiciously cope with the unique complexities and risks in alliances. This entry will discuss the basic types of strategic alliances, their developmental stages, and the complexities relating to their management, such as those concerning resources, risks, trust, control, and internal tensions.

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**FUNDAMENTALS**  

Strategic alliances can be divided into two groups, equity and nonequity. Equity alliances are generally in the form of equity joint ventures, which are separately incorporated entities jointly owned by the partners. Equity joint ventures are created to substantially integrate the joint efforts of partners, and are the most instrumental among various alliance forms in the transfer of tacit knowledge between the partners, because of the significant extent to which partners are exposed to each other. In minority equity alliances, one or more partners take an equity position in others.

Nonequity alliances may be differentiated between unilateral contract-based alliances and bilateral contract-based alliances. Alliances are unilateral contract-based when there are well-defined transfer of property rights, such as in R&D and licensing agreements. Such
unilateral alliances are based on contracts that tend to be complete and specific, and partners carry out their obligations independently of each other, without much coordination or collaboration. Bilateral contract-based alliances, however, require partners to work together on a constant basis, as in joint R&D, joint production, and joint marketing and promotion. These alliances involve the sustained joint creation of property and knowledge for the partners. Bilateral contracts are usually incomplete and more open-ended than the unilateral type, and the partners generally have to let their cooperative relationship unfold with experience.

For managing alliances effectively, it may be useful to keep in mind the three developmental stages of alliance formation, operation, and outcome. The formation stage comprises the formulation of an alliance strategy, selection of partners, negotiation of contractual provisions, and setting-up of the alliance. An alliance is a viable option only if it is substantially beneficial after the partial integration with another firm; otherwise, it should be avoided because of its managerial complexity. In selecting the alliance partner, the ideal would be to seek one with strategic compatibility, complementary resources, worthy of a certain level of interfirm trust, and a mutual understanding of value creation and value appropriation. A tentative partner selection would be followed by the negotiation of the alliance agreement. Here, the choice of an appropriate governance structure is a key feature. The next step is of course setting up the alliance. The partners should not pursue predominant managerial control in the alliance; rather, more attention should be given to committing the best personnel, keeping alliance personnel for a long term, and the blending of their cultures. The second of the three stages is that of
operation, in which the negotiated agreement is implemented and the partners begin working together. Here, the partners should always regard cooperation and competition as dual roles in a strategic alliance. Cooperation should be emphasized in operational areas, while competition should mostly be capitalized through interfirm learning. The third stage is that of outcome, where the alliance performance is evaluated, resulting in either some degree of stabilization or a decision to modify arrangements. A comprehensive evaluation of an alliance’s performance should use various kinds of measures, such as financial indicators as well as the state of the alliance (e.g., harmony, morale, productivity, and learning).

* IMPORTANCE

The complexities of managing alliances are well known and can be appreciated from the roles, discussed below, of such critical factors as resources, risks, trust, control, and internal tensions.

Resources

Alliances enable partners to gain access to each other’s resources temporarily and with more flexibility than mergers and acquisitions. The two related but distinct motives for a firm to consider forming a strategic alliance are to obtain resources of others and to retain and develop its own resources by combining them with others’ resources. Resources are
sometimes classified as property-based resources, which have clear property rights and in which a firm’s ownership is absolute and protected by law, and knowledge-based resources, which cover tacit skills and knowledge involved in technological, managerial, and organizational resources. The management of resources includes optimally using one’s existing resources, developing new resources, protecting one’s resources, and gaining access to other firms’ resources. Hence, the key challenge for firms in strategic alliances is effectively protecting themselves from losing critical resources at the same time as they attempt the fullest use of their contributed resources.

**Risks**

There are many types of risk in strategic alliances, arising not only from external sources such as competition, economic fluctuations, environmental factors, and government policy, but also internal sources such as lack of competence and the deceitful behavior of the partners. The concept of risk in alliances can be separated into two types, relational risk and performance risk. Relational risk is the probability that a partner firm does not commit itself to the alliance in a cooperative manner, leaving open the possibility that the partner may behave opportunistically, thereby undermining alliance performance. Perceived relational risk is high when it is difficult to protect one’s proprietary know-how, the pay-off inequity expected by partners is high, and the number of previous alliances is small. Performance risk is the probability that the objectives of the alliance may not be achieved, given full interpartner cooperation. In other words, performance risk is the probability that an alliance may fail even when partner firms commit
themselves fully to the alliance. Perceived performance risk is high when it there is a shared R&D component, cross border alliances are involved, and the non-recoverable investments are high. Whereas relational risk is the risk of unsatisfactory interfirm cooperation, performance risk is all other factors that impact adversely upon alliance performance.

**Trust**

The concept of trust has special significance in the dynamics of alliance management because of the central role of a cooperative relationship between the partners. Trust has been defined in terms of being vulnerable to the actions of trusted others in situations that involve risk. According to a popular formulation, trust has two dimensions, namely, goodwill trust and competence trust. Goodwill trust refers to the good faith, good intentions, integrity, and reputation for fair dealing of the partner. It reduces the perceived likelihood of opportunistic behavior occurring, which in turn contributes to low transaction costs. Competence trust refers to the expectation of competent performance. Competence is based on the various resources and capabilities of a firm. Firms that have been successful in previous alliances tend to build a reputation for competence.

Interpartner trust can be developed in alliances in several ways, including from risk taking, equity preservation, communication, and interfirm adaptation. Trust and risk taking are believed to form a reciprocal relationship: trust leads to risk taking, and risk taking, in turn, buttresses a sense of trust, given that the expected behavior materializes.
Trust can also be developed from equity preservation as a high level of trust tends to encourage partners to tolerate short-term inequity and exercise mutual forbearance. Given a certain trust level among partners, extended periods of inequity will create tension and strain existing trust. Communication can generate trust by ironing out the potential kinks in daily operations, to make for a satisfactory working relationship. Lastly, trust may be fostered by interfirm adaptation. Being flexible enough to respond positively to the changing needs of a partnership demonstrates that the firm not only values the alliance but is also willing to make considerable efforts towards a desirable accommodation.

**Control**

Control is generally viewed as a process of regulation and monitoring for the achievement of organizational goals. The more critical control mechanisms in strategic alliances are goal setting, structural specifications, and cultural blending. Establishing specific and challenging goals in organizations ensures discipline of both partners to strive cooperatively in operations. Structural specifications, including rules and regulations, consist of both ex ante and ex post deterrents designed to minimize partners’ incentives for opportunism, deceit, and misbehavior. As to cultural blending, it is generally accepted that managing alliance culture is a challenging task because it is about blending and harmonizing two different organizational cultures.

**Internal Tensions**
One of the reasons for the high failure rates of strategic alliances is the difficulty of managing the unique complexities of alliances. An explanation of this inordinate instability lies in the tricky problem of having to balance, on a continuing basis, the interactions among the partners in terms of the dialectical forces or internal tensions within an alliance. These opposing force-pairs are cooperation vs. competition, rigidity vs. flexibility, and short-term vs. long-term orientation. Cooperation refers to the pursuit of mutual interests and common benefits in the alliance, whereas competition is the pursuit of one’s own interest at the expense of others and private benefits in the alliance. Rigidity is the degree of connectedness of partner firms with each other in the alliance, and flexibility is the degree to which partner firms are able to modify the structural arrangements in the alliance in order to adapt to changing conditions. A short-term orientation is evident when alliances are viewed as transitional in nature, with a demand for quick and tangible results, whereas a long-term orientation is manifest when alliances are considered as at least semi-permanent entities, so that more patience and commitment are exercised.

When, in the course of managing an alliance, there is a movement toward the dominance of competition, flexibility, and a short-term orientation, the likelihood increases that the alliance will tend toward dissolution, because these forces mimic the attributes of market transactions. In this case, the internal transactions of alliances are effectively transferred to the marketplace. In the reverse situation, if the dominance encompasses cooperation, rigidity, and a long-term orientation, all associated with hierarchies, an alliance will tend
toward a merger or acquisition. Alliance transactions, then, would in effect be transferred to a hierarchy or single organization. The continuing challenge in managing alliances is to reasonably preserve a balance among the internal tensions while carrying out the usual transactions.

-- T. K. Das

See also:

Interorganizational Networks, Resource Based View of Firm, Theory of Cooperation and Competition, and Trust

Further Readings:


