

Literature review on a strategic alliance management essay



**ASSIGN
BUSTER**

A strategic alliance is a business arrangement in which two or more firms cooperate for their mutual benefit. Firms may combine their efforts for a variety of purposes including, but not limited to, sharing knowledge, expertise, and expenses as well as to gain entry to new markets or to gain a competitive advantage in one. Further, creation of a strategic alliance may turn actual or potential competitors into partners working toward a common goal. Use of strategic alliances has become a major tool for businesses that are internationalizing their operations. Therefore, use of strategic alliances has expanded dramatically over the past decade, and their use will continue to increase as we enter the 21st century.

A strategic alliance is often, but not always, in the form of a joint venture. A joint venture is created when two or more firms work together to form a new business entity that is separate from its “ parents.” (Not all joint ventures fit this definition, joint ventures by acquisitions are exceptions. Ownership may be in equal or unequal shares, and may provide for changes in ownership of shares.

The most common kind is the joint venture through a subsidiary. In such an instance, two entities create a third separate entity with its own legal existence.

Another is the joint venture by acquisition. It is created when one business purchases all or part of the shares of another.

A third is the joint venture by merger. This is created when two or more companies are dissolved and incorporated into one surviving entity. It should

be noted, however, that this legal mechanism is seldom used for international joint ventures.

In general, a strategic alliance that is not in the form of a joint venture is formed for a limited purpose and is more narrow in its operations than the joint venture. Non-joint venture strategic alliances tend to be less stable and last for shorter terms than joint ventures.

It is important to note that not all linkages between national or international businesses are strategic alliances. Examples of arrangements that do not create strategic alliances include licensing, exporting, franchising, and foreign direct investment agreements.

The Internet, advances in telecommunications, and improved transportation systems have helped firms enter foreign markets and have contributed to the globalization of business. Simultaneously, they have facilitated the creation of strategic alliances.

The decision to form a strategic alliance depends on the needs and goals of the companies involved and on the laws of the countries in which the companies are doing business.

A strategic alliance can ease entry into a foreign market. First, the local firm can provide knowledge of markets, customer preferences, distribution networks, and suppliers.

Sometimes, foreign countries require that a certain percentage of ownership remain in the hands of its citizens. Foreign firms cannot enter such markets alone; a joint venture is required.

<https://assignbuster.com/literature-review-on-a-strategic-alliance-management-essay/>

A strategic alliance can help a firm gain knowledge and expertise. Further, when partners contribute skills, brands, market knowledge, and assets, there is a synergistic effect. The result is a set of resources that is more valuable than if the firms had kept them separate.

Similarly, a strategic alliance can help a firm gain a competitive advantage. For example, a strategic alliance can be used to take advantage of a favorable brand image that has been established by one of the partners. (Establishing a brand image is a lengthy, expensive process.) It can also be used to gain shelf space for products.

After the decision is made to enter a strategic alliance, a firm faces many choices. Some of them relate to management and others relate to the law.

The first step is to select the right partner. A firm must consider many factors as it selects a partner. First, it must select a firm with a compatible management style.

Second, it is important to consider the partner's products and services. A strategic alliance will probably work best if the firms involved complement but do not compete directly with each other.

Third, the potential risks of the alliance should be considered. To do so, the two potential parties must gather as much information about each other as possible before entering an agreement. For example, has the potential partner entered other strategic alliances? Did they succeed or fail? Why? Is the potential partner financially stable? Do the potential partners share common strategic goals (a common vision) for the alliance?

Finally, it should be noted that there are situations in which a privately owned firm may form a joint venture with a government as its partner. This has occurred in Latin America in lumbering and in the discovery, exploration, and development of oil fields. The government controls the resource, but it wants the expertise of a firm that has experience in developing that resource. Similarly, with the collapse of communism in Central and Eastern Europe, in 1989 and the early 1990s, privately owned firms from Europe and the Western Hemisphere formed joint ventures with state-owned firms in the formerly communist countries.

In strategic alliances based on joint ventures, division of management must be carefully planned. There are various mechanisms through which management of such a strategic alliance can be shared. One involves shared management in which each party participates fully in management. This requires a high degree of cooperation.

A second mechanism is through assignment of management to one party. In such arrangements, the responsibility is usually assigned to the partner that owns the majority of the stock in the joint venture.

A third mechanism is through delegation to executive managers of the joint venture. In such an arrangement, executives are hired to run the joint venture. They may be hired from the outside or transferred from the firms that own the joint venture. The executive managers are responsible for day-to-day operations and decisions. The firms that own the joint venture do not get involved in day-to-day operations.

In the case of a strategic alliance based on a joint venture, a form for doing business must be chosen. Usually the joint venture is created as a corporation, but the laws of each country vary as to types of corporations that are available and the legal requirements imposed on each. Usually, a joint venture is created under the corporate laws of the country in which it will be doing business. But this is not always true. For example, sometimes, a different country may be selected because it offers tax or other legal advantages. Countries that are sometimes selected for tax reasons include, for example, the Bahamas, Lichtenstein, and Monaco. It should also be noted that not all joint ventures involve a corporation. Occasionally, there may be legal reasons to create a joint venture under a form such as the limited partnership.

A lawyer or lawyers must be consulted with regard to the choice of business organization and its formation. And, in the case of an international strategic alliance, lawyers licensed to practice in each of the nations involved should be involved.

In addition to specifying a form for the business organization, the agreement on which the strategic alliance is based covers topics such as management responsibilities, financial matters, and decision making. Other clauses depend on the needs of the individual parties.

There are some special concerns that must be faced by firms entering international strategic alliances, especially if a joint venture is involved. One area relates to intellectual property rights (IPR). IPR includes technology transfer as well as patent, trademark, and copyright protection. IPR rights

are often transferred or shared in the context of an international joint venture.

A second area of concern relates to finance. At least three sets of concerns should be addressed with respect to currency and exchange rates. First, exchange rates may fluctuate dramatically. the form of currency to be used in payments between companies from two countries must be addressed. Second, the potential for inflation must be considered. Third, interest rates can be affected by financial instability.

Exchange rates, payment (in whose currency?), the potential for varying rates of inflation in the two (or more) countries involved, and sources of loans are important considerations when an international strategic alliance is created.

A third area of concern relates to the potential for political instability. Specially, for countries like Pakistan, the growing number of political instability and current economic unpredictable scenarios result in international companies being wary of forming a strategic alliance with a country such as Pakistan.

Political risks are not taken lightly when forming a strategic alliance. Investors carefully study potential international trade partners, and the political climate under which they do business. Most international traders cannot afford to risk their investments in countries without political stability to protect their investment. Despite the political risks of international trade, healthy profits for stockholders always seem to offset the risk.

As managers evaluate a country as a potential place to do business and as they struggle to succeed once they have committed resources, they need to be aware of political risk. Political risk is when international companies fear that the political climate in a foreign country will change in such a way that their operating position will deteriorate.

Strategic alliances have become increasingly popular in international business. They provide businesses with various benefits including access to markets, sharing of risks and expenses, synergistic effects of shared knowledge and expertise, and competitive advantages in the marketplace. There are risks to be considered and cautions to be exercised as a firm enters a strategic alliance. But, as businesses continue to globalize, strategic alliances will continue to be a major tool for the firms involved.

Risk, risk perception, and risk management are acknowledged as critical in management and strategy research. Risk is also a particularly important aspect of managing strategic alliances because alliances are an inherently risky strategy. The failure rate of alliances is significantly higher than that of the single firm (Bleeke and Ernst 1991; Das and Teng 2000). One key difference between single-firm strategies and strategic alliances is the uncertainty attending the cooperation among partners. When firms pursue market opportunities on their own, there is little need to be concerned about the opportunistic behavior of other firms because they are involved only in market transactions. In alliances, however, there is the risk of the partner not cooperating in good faith (namely, relational risk) in addition to the usual risk of unsatisfactory business performance (called performance risk).

In strategic alliances, relational risk is defined as the probability and consequences of not having satisfactory cooperation (Das and Teng 1996). This risk arises because of the potential for opportunistic behaviour on the part of both firms. Opportunistic behaviour is exemplified in shirking, cheating, distorting information, appropriating resources, and so on. Conflicts arise because firms have their own individual interests that are not necessarily congruent with those of their partners. The benefits that accrue to only one partner firm have been called private benefits, in contrast to common benefits that accrue to all partners (Khanna et al. 1998). Private benefits can be a source of interest conflicts. Furthermore, partner firms often have hidden agendas in the alliance — e. g., secretly learning valuable know-how and eventually taking over a target firm — which may subsequently create serious problems in cooperative interactions. All this suggests the possibility of low commitment to the cause of producing common benefits.

The distinction between relational risk and performance risk is a crucial one (Das and Teng 1998b). For instance, depending on which risk is more of a threat, partner firms may decide on the strategy that is best for acquiring others' valuable resources while protecting their own. Also, the two types of risk affect alliance structuring, in which partner firms form their own structural preferences based on their estimation of relational risk and performance risk (Das and Teng 1996, 2001).

Perceived risk is determined by two separate factors — trust and control.

Both trust and control reduce the perceived probability and impact of undesirable outcomes — which, by definition, is risk. Trust entails a positive

<https://assignbuster.com/literature-review-on-a-strategic-alliance-management-essay/>

expectation about the partner, suggesting that unpleasant outcomes are less likely (Lane and Bachmann 1996). At the same time, control is about influencing the behavior of the partner, so that undesirable outcomes are also less likely. We maintain that there is no third determinant that is of comparable importance. Trust leads to low risk perception without doing anything about the partner. In contrast, control is a more proactive and interventionist approach and leads to a low risk perception through affecting the behavior of the partner. It is in this sense that we suggest that trust and control determines the perceived risk level.

Trust is a multilevel phenomenon that exists at the personal, organizational, interorganizational, and even international levels. At the interfirm level, researchers believe that trust is a key element in cooperative relationships (Ring and Van de Ven 1992; Sydow 1998). It is effective in lessening concerns about opportunistic behaviour, better integrating the partners, and reducing formal contracting. Therefore, although interfirm trust is difficult to come by, scholars have paid particular attention to the development of such trust (Kanter 1994; Larson 1992).

Despite the importance of trust, the issue of defining trust remains largely unresolved (as is clear from the articles included in the 1998 special research forum on trust in and between organizations appearing in the *Academy of Management Review*). Although numerous definitions of trust have been offered in the literature, we suggest that trust is about positive expectations regarding the other in a risky situation (Boon and Holmes 1991; Gambetta 1988). Some researchers, we should note, emphasize the behavioural implications of trust, thereby defining it as a reliance on the

<https://assignbuster.com/literature-review-on-a-strategic-alliance-management-essay/>

other in a risky situation (Hosmer 1995; Moorman et al. 1992). A similar differentiation has been made between trusting beliefs and trusting intentions (McKnight et al. 1998). The difference is one of trust and trusting — the latter denoting the behavioural consequences of trust.

Researchers have also identified a number of antecedents of trust –including personal characteristics (Rotter 1967, 1980), institutional arrangements (Sitkin and Roth 1993), and situational factors (Scott 1980; Kee and Knox 1970). It is while categorizing various sources of trust that it becomes clear that trust is not a unidimensional construct.

Barber (1983) and Gabarro (1978) stress the importance of competence in trust. Competence trust refers to ‘ the expectation of technically competent role performance’ (Barber 1983: 14). Other terms that have been used to denote this competence include ‘ ability’ and ‘ expertise’ (Mayer et al. 1995). In contrast to competence, the other dimension has been called goodwill (Ring and Van de Ven 1992), responsibility (Barber 1983), dependability (Rempel et al. 1985), and integrity (Mayer et al. 1995). This dimension of goodwill refers to ‘ the expectation that some others in our social relationships have moral obligations and responsibility to demonstrate a special concern for other’s interests above their own’ (Barber 1983: 14).

Based on these two broad notions, Nooteboom notes that ‘[t]rust may concern a partner’s ability to perform according to agreements (competence trust), or his intentions to do so (goodwill trust)’ (1996: 990, emphasis in original).

Risk plays an important role in our understanding of trust, but their relationship is far from clear in the literature. Many definitions of trust incorporate the element of risk. For example, Boon and Holmes define trust as ‘ positive expectations about another’s motives with respect to oneself in situations entailing risk’ (1991: 194). The idea is that trust is a relevant factor only in risky situations (Coleman 1990; Deutsch 1958). Without uncertainty in the outcome, trust has no role of any consequence.

Accordingly, strategic alliances have also been characterized as “ relational” contracting. Relational contracting is a very flexible arrangement emphasizing mutual collaboration in response to changes in business circumstances. It usually involves a fluid situation that emphasizes receptiveness to modification over time rather than to the detailed and inflexible front-end documentation of expectations. These alliances possess the common feature of ongoing mutual interdependence, a condition in which one party is vulnerable to another whose behavior is not under the control of the first. The overarching theme that seems to unite alliances is that “ each needs the other’s abilities to advance their respective interests.”

In general, to create successful alliances, a company must understand when alliances make strategic sense and how to manage them for a business results. Alliances can be extremely useful in situations of great uncertainty and in markets with growth opportunities that a company either cannot or does not want to pursue on its own. More specifically, the most common reasons for forming strategic alliances and achieve competitive advantages are as follows:

Setting new global standards. Entering into an alliance can be the best way to establish standards of technology in the sector.

Confronting competition. When a high-volume producer decides to attack a new geographic market, defense is difficult if it does not have comparable size. Alliance between companies is a response which has often led to positive results. It is equally valid to attempt an attack on a leader that has consolidated its own positions.

Overcoming protectionist barriers. Alliances can allow companies to avoid controls on importation and overcome barriers to commercial penetration. Alliances can also be a way to respect the bonds posted by the “ host” country regarding valueadded local content and participation in the capital of local businesses.

Dividing risks. For certain projects, risks of failure are high, and even higher when investments are elevated.

Economy of scale. There are many alliances designed to divide fixed costs of production and distribution, seeking to improve volume.

Access to a market segment. In mature segments, a company often wants to develop in a market segment where it is not present through an agreement with another company.

Access to a geographic market. A strategic alliance is often a way to enter a market that is protected by (national) tariff and other barriers, or dominated by another company with particular competitive advantages.

Access to technology. Convergence among technologies is the origin of many alliances. It is increasingly more frequent that companies need to appeal to their competition in different sectors if they want to realize a product line.

Uniting forces. Some projects are too complex, with costs that are too high, to be managed by a single company (military supplier contracts, civil infrastructure construction).

Bridging a gap. If a company does not have the resources or capabilities necessary to develop a particular strategy, an alliance with one or more companies is the most logical solution. Making an alliance to gain access to resources and capabilities that are lacking internally is perhaps the most frequent motive leading a company to seek partners.

“ Anticipating a play”. The advantages and risks of pioneering are significant. In many sectors, the first company to enter the market with a new product achieves advantages that are difficult for the competition to overcome. The company is the first along the experience curve. It gets the best positions for distribution. It invests initial profit margins in the production process, distancing itself further from the competition. The strategic alliance can have the scope of utilizing the pioneering experience of one of the partners. If this experience is brought to the alliance, it confers the advantages on the other partners as well.

Besides competitive advantages, strategic alliances can have some disadvantages.

Alliances are costly, not only due to cash leaving the company's hands, but rather due to returns from which it could be denied. First, they involve the investment of managerial time resources in establishing the alliance, managing it, and resolving possible conflicts of interest between the partners over the functioning of the alliance.

Moreover, alliances can create indirect costs by blocking the possibility of cooperating with competing companies, thus possibly even denying the company various financing options. For instance, an alliance with Ericsson in the area of cellular communications could reduce the likelihood of contracts with Nokia, thereby putting the company at risk that if Ericsson is weakened, so will be all the companies that depend upon it.

Alliances also expose the company to its partners, and the unique technologies that it has are sometimes revealed to its partner company, which could later become a competitor or could utilize the fruits of the venture or the know-how better than the startup itself. In addition, strategic partners may often lead the company in directions that serve the partner company better than they do the company itself.

Although a material part of the costs of alliances such as joint ventures may be forecasted during the negotiations for its establishment, in many cases the balance of power between the parties changes during the course of the venture's life, and the parties to it may have a change of mind. For instance, many joint ventures that were signed before the stock market crises of 2001-2002 between public companies and startups never materialized due to the drop in the stock prices of some such public companies. The fact that some

of the private companies had meanwhile raised capital and actually had become stronger than the public companies utterly changed the balance of power. Likewise, the non-raising of capital by the startup could motivate the public company to try to renegotiate the terms of the venture, while taking advantage of the startup's weakness. A change in the competitive environment in the field could also affect the alternative cost of the venture.

A study of alliances indicated that out of every one hundred alliance negotiations, ninety will fail to even produce an agreement. Of the remaining ten that do result in agreements, five will fail to meet the partners' expectations for the venture. Of the five that produce acceptable results, only three will survive for more than four years.