IBUS3101

INTERNATIONAL BUSINESS ALLIANCES

LECTURE 1: INTRODUCTION

- A key issue for organisations is **corporate growth**
    - "*Most CEOs will tell you that growing their business is the greatest challenge they face*" – Richard Gayder, CEO, Wesfarmers, 2010
- The biggest challenges facing Fortune 500 Companies (2016):
    - Increased regulation – 69%
    - Rapid pace of technological change = 65%
    - Cybersecurity – 58%
    - Management diversity – 21%
    - Shareholder activism – 15%
    - Competition from China – 13%
    - Competition from a start-up – 8%
- The 10 biggest challenges for CEOs in 2017:
    - New political administration
    - Costly health insurance
    - Rising cyber security threats
    - Finding capital
    - New hiring
    - The economy
    - Consumer expectations
    - Marketplace competition
    - The virtual workspace
    - Market oversaturation

WHAT ARE STRATEGIC ALLIANCES?

- **Outsourcing**: arm's length transaction, contract exists
- **Traditional M&A**: two firms coming together with similar strength / power OR one is more powerful and buys another
- **Corporate alliances**: middle of spectrum

HOW POPULAR ARE 'ALLIANCES' AS A FORM OF GROWTH

- Number of SA's increased more than 20x since 1989
- 1990-2013: more than 200,000 alliances formed worldwide
    - 60%+ were b/w firms from different national economies
        - i.e. International Strategic Alliances (ISAs)
- 40%+ revenue generated from top 2000 US + European companies comes from alliances (OECD / UNCTAD)
- Developed economies > $1 billion
- Many firms from developed countries begin exporting, then JV / licensing arrangement overseas, then open subsidiaries with more investment
- E.g. Toyota – GM (Nummi JV), 1984-2010
    - Toyota was outselling their US counterparts → US Gov wanted to impose quotas on foreign manufactured vehicles b/c hurting US car manufacturing industry
    - GM had a plant in California, Nummi, shut in the 1970s
        - Toyota had to enter US market in way other than exporting = JOINT VENTURE until 2010
    - Why would GM collaborate with a competitor?
        - Agreed b/c GM wanted to learn from Toyota → efficiency, quality management etc.
    - NOW: Toyota has a JV with Tesla
- E.g. Hero – Honda in India, 1984-2010
    - Honda wanted to enter the Indian market
    - Indian Gov had had regulations which meant foreign companies had to have JV to enter
    - Why did this JV break up?
        - Early 2000s – Gov allowed wholly owned subsidiary structures
        - Honda was well known in the market, didn't need Hero anymore
- E.g. Microsoft – Facebook, 2007 + 2011 + 2018
    - Facebook established 2004
    - Agreement to use Microsoft's search engine technology for Facebook
    - 2011 = extended agreement for further technologies
    - 2018 = extend to VR and AI technology

- E.g. Nine-MSN, 1997 AND Yahoo7, 2006
  - Nine Network + Microsoft (MSN)
  - Channel 7 made JV with Yahoo to compete with ^^
    - 7 stepped away and set up their own technology
- E.g. Apple (iPhone) and various carriers (Optus, Vodafone, Telstra)
  - Exclusivity agreements
- E.g. Cisco
  - Alliance based business model
  - E.g. construction of commercial office towers, hospitals

TWO SIDES TO ALLIANCES

1. **Proliferation of (IB) alliances**
   - Alliances are accounting for significant portions of firm value
2. **Alliances appear to have high failure rates**
   - Bleeke & Ernst – 50% failure rates
   - General estimates – 30-70%
   - Vantage Partners, 2015 – 19% generally failed, further 41% only partially achieved objectives
   - *Why is failure a problem?*
     - Alliances generally take up a large portion of resources
     - What percentage of alliances have:
       - Fully achieved their objectives → 41%
       - Partially achieved their objectives → 40%
       - Generally failed to achieve their objectives → 19%

- *"It is no longer an era in which a single company can dominate any technology or business by itself. The technology has become so advanced, and the markets so complex, that you simply can't expect to be the best at the whole process any longer"* – Fumio Sato, CEO, Toshiba Electronics Co.

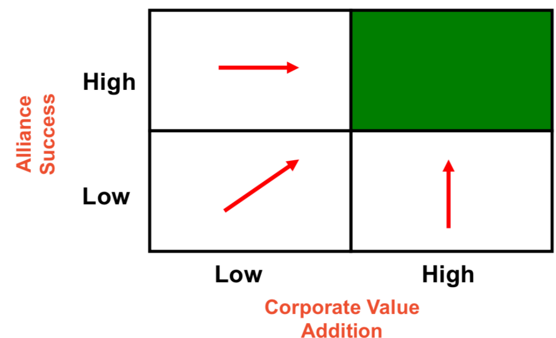
WHAT ARE ALLIANCES?

- **Three essential characteristics:**
  1. **Two or more separate firms**
  2. **"Incomplete contract," continuing relationship**
     a. Complete contract = end date = outsourcing arrangement
  3. **Joint decision-making**
- E.g. Philips
  - 2007: bought Colour Kinetics → used as market penetration and to acquire technology
  - 2012: introduced Philips HUE → built on the acquired technologies ^^
  - 2014: partnered with IBA Group → a more commercial-oriented opportunity
    - Colour of theatres can have an impact on cancer recovery patients

WHY DO ALLIANCES MATTER?

- **Globalisation:** process by which regional economies, societies and cultures have become integrated through a global network of communication, transportation and trade
  - Liberalisation, deregulation of markets
  - Rise of China as the world's largest economy (2030)
  - Lack of regulatory forces
  - Interconnectedness of companies (e.g. crisis)

- **ICT revolution:** consists of all technical means used to handle information and aid communication, including computer and network hardware as software
    - ICT transforms business models
        - E.g. Dell → Began selling PCs built to order via mail → today still built 'to order'
    - Internet penetrates companies in every possible way
    - Information across permeable boundaries
        - E.g. Zara → Changes product lines every few weeks → disrupted the fashion industry which was typically seasonal
- **Knowledge** + **sustainability**: challenge companies to create permeable organisational boundaries
    - Open innovation requires new capabilities
    - Corporate social responsibility imposes pressure to change (image improvement)
    - Increased focus on bundling of goods + services
    - Customers no longer seek specific G+S, but rather demand solutions
        - E.g. Apple – compatibility between iPhone, Mac, iPad etc.
- **Alliances function as competitive weapons**, b/c companies:
    - Unable to survive autonomously
    - Become increasingly dependent on external environment
    - Need to become more flexible and adaptive
    - Cannot depend on purchase relations alone
- Alliances are thus increasingly important to companies' survival, viability and competitive advantage (but they are instruments)
- **Value creation and success**
    - Matrix →



- QUESTION: *how can we create and manage successful and value-adding business alliances?*

LECTURES 2 AND 3: THEORETICAL PERSPECTIVES ON ALLIANCE RESEARCH

INTRODUCTION TO THEORY

WHAT ARE ALLIANCES?

- Three essential characteristics:
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ALLIANCE FORMATION:

- **Parent-level:**
  - *Are particular kinds of firms more alliance prone?*
    - Evaluate industries firms operate in, individual organisations
    - Attributes of time (context), age, CEOs etc.
  - *Is the distribution of alliance formation skewed?*
    - Are there common variables between firms with alliances?
  - *Potential answers*: firms' social, technology, commercial capital, market power, excess capacity etc.
- **Dyad-level (couple):** undergoing negotiations
  - *With whom do firms partner?*
  - *Of all possible dyads, which ones result in alliance formation?*
  - *Potential answers*: relation-specific investments (prior ties)
- LEFT IMAGE: Alliance formation = Based off the question: *who is likely to marry?*
- RIGHT IMAGE:
  - Formation @ alliance level = negotiation of scope, terms, conditions of work and financial matters etc.
  - Formation @ parent level = evaluating industries, firms, situations
  - Governance @ alliance = which structure
  - Performance @ alliance = productivity, ROI, financial returns → i.e. outcome
  - Performance @ parent = returns remitted to parent company, overall success of alliance

THE ROLE OF THEORY

- Theory serves as **filters** to help organise information for it to be used for predicting and explaining events
  - Prediction vs. explanation focus
- Complexity of strategic decision making necessitates use of theory to help explain subjective observations so reliable predictions / expectations are generated
  - Guide our practical actions + reduce biases introduced by the researcher / manager

THEORETICAL PERSPECTIVES

1 – RELATIONAL PERSPECTIVE

- **Relationship-centric organisations:**
  - Firms are embedded in relationships / inter-organisational ties
  - Boundaries of firm are porous + less clearly defined = increased communication
  - Long-term ties NOT spot transactions
- **In contrast: Neo-classical economics**
  - Focus on 'spot transactions' → at what price will markets clear?
  - Firm = independent actor, engage in transactions with stakeholders
  - Firms respond to market mechanisms, constantly renegotiating contracts to maximise utility

- *"For a person who grows up in a high-crime neighbourhood, the choice between making a career stealing and getting a job has often less to do with the comparative utility of these two alternatives than with the structure of peer groups and gangs in the neighbourhood"* – Smelser & Swedberg, 2005
- **Firms are not independent actors, their actions and performance are contingent on the relationships they are embedded in**
- Polaris + GE Capital
  - Industry value chain components for Polaris → Niche market, seasonal, volatile demand
  - GE Capital role → To provide funding to distributors for them to stock Polaris products
  - 26-year relationship, deeper than just money BUT is profitable
    - *"At GE Capital, loaning money is the start of a relationship. Not the end…I've been working with Polaris for 26 years…"*
- Valio + Tetra Pak → Tetra Pak developed 100% recyclable packaging for Valio
- Harley Davidson → Advertise HD Owners Group → lifestyle advertised rather than product

2 – SOCIAL NETWORK THEORY

- **Economic activity is always *embedded* in a social context**
  - Importance of social network lies in **<u>access</u> to info**
  - Creates a sense of legitimacy and status for firms
  - Resource flows
- Underlying logic: strategic needs and social opportunities
- Social networks:
  - Enlarge circle of potential trustworthy partners
  - Identify new opportunities for alliances
  - Create confidence, trust
  - Form natural deterrent for opportunism (damages reputation)
- Positive prior experiences with alliances create a favourable environment for establishment of new and maintenance of continuing relationships
- **Downsides of relationship-centric business model:**
  - Blindness to environment → over-dependence
  - Open for exploitation
  - Complacency to innovate
- E.g. Glasgow ship-building companies → every tie reduced a shipbuilder's risk of failure by 10%
- E.g. ties w/ competitors b/w Sydney hotels dramatically increased performance → i.e. revenue per available room
  - E.g. relationships with travel agents

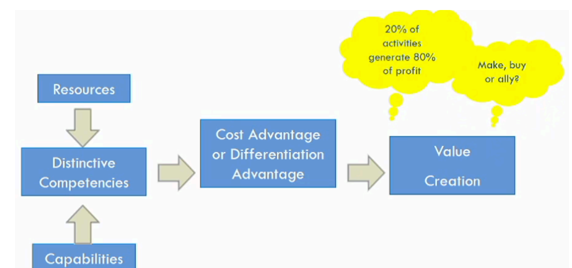
3 – TRANSACTION COST ECONOMICS THEORY (TCE)

- Coase (1937): *why does the market not govern all transactions* → i.e. why do firms exist?
  - **Sometimes costs of transacting can be reduced by bringing activities inside the firm to be governed not by relative prices but by internal management** (i.e. hierarchy)
    - Make vs. buy vs. ally decision (MBA)
- Internalisation increases production costs BUT should be outweighed by reduction in transaction costs
  - ***Transaction costs***: cost of searching, contracting, negotiation and monitoring
    - *Opportunism:* actors are inclined to act out of self interest
- *Bounded Rationality*: actors ability to plan, predict and anticipate unforeseen circumstances are limited by knowledge held at that point in time
- ***Asset specificity:***
  - Higher specificity = more expensive = JV
  - Low specificity = purchase in market
  - Relationship-specific investments lock partners in relationships = chance for opportunistic behaviour
    - Buying firms eventually internalise function
  - Sometimes firms coordinate beyond simple market transactions BUT fall short of vertical integration
    - CREATES alliances / networks + other hybrid governance forms

- **Uncertainty:**
  - High *behavioural* uncertainty = more likely to bring in-house
  - Low *technological* uncertainty = safe bet = internalise → risky decision if constantly shifting tech
- **Frequency:** highly frequent use = cost effective to bring in house
- Performance Implication:
  - Aligned governance form improves performance BUT misaligned form increases likelihood of structural change
- **TCE critiques:**
  - Not all actors are opportunistic → Stewardship View
  - Takes an atomistic view on transactions
  - Transactions take place within a social context that might influence transaction costs
  - Assumes relatively stable environments
  - "Negative view" on reducing risks/costs as opposed to positive view on increasing learning + creating synergies

4 – RESOURCE BASED VIEW

- **RBV**: a firm's strategy, competitive advantage and performance is defined by the resources they possess
  - Alliances are used to gain access to other firms' valuable resources
  - *Core competencies* = VRIO resources
    - Valuable, rare, not easily imitable, org structure
  - *Non-core competencies:* outsource to save $$
- ***Resource heterogeneity (VR):*** resources are unequally dispersed across firms
- ***Resource immobility (IO):*** resources cannot be transferred easily b/w firms
- **Alliance motives:**
  - Creation of value – minimizing costs OR maximising revenue
  - Expansion of (idle) resource usage
  - Diversification of resource usage → expand portfolio
  - Imitation – open or secret?
  - Disposal of resources → e.g. changing industries = joint venture, eventually move away from one part of business
- IMAGE:
  - R+C are two separate things → require both to create a distinctive competency
  - To create a new product, do you make it internally, purchase, or create an alliance?



RBV AND STRATEGIC ALLIANCES

- Focuses on pooling and using valuable resources
- Form of alliance depends on nature of resources held + sought by each partner
- Key element is symmetry of resource exchange process
  - Firms must have resources to get resources → complementary
- **Critiques:**
  - Neglects cost minimisation theory
  - Neglects social embeddedness of economic transactions
  - Unclear about nature of resources (exception: Das & Teng, 2000)
  - Boundary conditions relatively unknown
    - Stable vs. dynamic elements
    - Role of power and learning
- Governance structure: choice between equity and non-equity alliances

5 – INSTITUTIONAL THEORY

- ***Informal institutions:*** constraints on socially sanctioned norms of behaviour, unwritten rules of the game
- ***Formal institutions:*** legal and regulatory framework fostering rule-based transactions
- **Economic perspective (North, 1990):** Formal and informal institutions regulate behaviour
  - Regulatory institutions may limit options
  - Informal norms + social pressures influence MBA decision
  - Informal cognitive beliefs in the (intrinsic) value of collaboration
- **Sociological perspective (Scott, 1995):** Rationale is to obtain (external) legitimacy
  - *Bandwagon effect:* MBA decision based on mimetic isomorphism (imitation)
  - Status-driven imitations:
    - Mimic prestigious firms
    - Public-private partnerships (CSR)
- Firms w/ reputation for ethical behaviour in alliances are likely to have more opportunities to form cooperative strategies than those who haven't earned it
  - Firms gain reliability, trust, recommendations and legitimacy through alliances

6 – ORGANISATIONAL LEARNING PERSPECTIVE

- **1 – Learning by experience and alliance behaviour – i.e. experiential learning**
  - Firms learn from their <u>own</u> past actions
    - Momentum → likelihood of firm to engage in further alliances
    - Experience enhances alliance performance → at alliance and partner level (value capturing)
  - Uncertainty reduction
  - Firms learn from their <u>others'</u> actions – *Mimetic behaviour*
    - Business groups → collaborate through information sharing, work in different industries
    - Others in industry
- **2 – Inter-partner learning in alliances**
  - Trying to learn what the partner does and how they do it – negates requirement of alliance
    - Learning race, cooperative specialisation
  - Trust between partners enhances learning capacities
- **Limitations:**
  - Free riding by limiting contributions
  - Opportunistic behaviour = capture more than agreed on
  - Unpredictable behaviour of partner
  - Rapid changes in environment
    - Change in needs of the org and strategic direction
  - Communication → e.g. potential language differences limits learning capacity

7 – REAL OPTIONS

- Successful alliances are characterised by longevity + stability
- Real options perspective towards joint ventures:
  - Limits downside risk and gain upside potential
  - Embrace uncertainties
- *What are options?*
  - Financial derivatives to limit risk in a speculative bet
  - Defined by strike price of underlying asset and expiration date
  - Buying <u>call</u> options → i.e. right to <u>buy</u> underlying asset at specified price
    - Fixed premium + profits when stock price > strike price (before expiration)
  - Buying <u>put</u> option → i.e. right to <u>sell</u> underlying asset at a specified price
    - Fixed premium + profits when stock < strike price
- *A real option is the right – but not the obligation – to undertake certain business initiatives, such as deferring, abandoning, expanding, staging or contracting a capital investment project*

INVESTMENT EVALUATION METHODS:

- ***Accounting rate of return:*** $\frac{Average\ Profit}{Initial\ Investment}$
- ***Payback rules***
  - E.g. Initial outlay: $20,000
    - RETURNS: Y1: $7,000 → Y2: $7,000 → Y3: $7,000
    - Total returns: $\$7,000 * 3 = \$21,000$ → 3 periods
- ***Net present value (NPV)***
  - E.g. Initial outlay: $20,000, discount rate = 10%
    - Returns:
      - Y1: $7,000 → $\frac{7,000}{(1+0.1)^1} = \$6,363.63$
      - Y2: $7,000 → $\frac{7,000}{(1+0.1)^2} = \$5,785.12$
      - Y3: $7,000 → $\frac{7,000}{(1+0.1)^1} = \$5,259.20$
    - NPV of $17,407.96 → need 4 years
  - $DCF = -CF_{0+} \frac{CF_1}{(1+r)} + \frac{CF_2}{(1+r)^2} + \cdots + \frac{CF_n}{(1+r)^n}$
  - Problems with NPV:
    - Survival of the least risk → risky ventures get screened out
    - Doesn't factor in managerial action / flexibility
    - May potentially lead to wrong investment decisions
- ***Real options***
  - Origins in capital budgeting and investment valuations (NPV)
  - BENEFITS: Provides managers w/ flexibility when investing into real assets (sell, invest further, wait, abandon)
    - Right (but not obligation) to acquire / sell
    - Contractual aspects
    - Mitigate investment risks
    - Increase upside potential (i.e. growth option)
    - Option value increases under uncertainty → i.e. beneficial asymmetry
  - E.g. Woolworths and Lowes, Masters
    - JV: Woolworths + Lowes Home Improvement from US – 2011 alliance to compete with Bunnings
      - 2015: tried different format stores
    - Shut December 2016 with losses over $3.2 billion → Exit plan of $835 million for WOW → said Lowes 33% stake was worth 0
      - Lowes said stake worth $654 million
    - Woolworths executed call option = force Lowes to sell shares – said worth $0
  - **Real options in alliance research:**
    - Why do companies form alliances?
      - To reserve the 'option' to manage uncertainty
    - How much of equity participation?
      - When faced with uncertain conditions, ceteris paribus, MNEs will value minority JVs
    - How does it affect alliance performance?
      - Increase alliance value = termination through acquisition by one parent
      - Decreased alliance value → ongoing or dissolution