

When Does Partnering Create Market Value?

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The dramatic increase in interorganizational partnering in the last two decades raises questions regarding the value impact of alliances. Using event study methodology, this paper tests whether stock market reactions differ when an alliance formation or termination is announced. In addition, it provides an in-depth analysis of potential determinants of stock market reactions. The results show that transaction cost theory and signaling theory in tandem provide predictive power explaining the effects of formation and termination announcements. However, the theories propose contradicting effects regarding the impact of firm and alliance characteristics on the value mark-up.

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Introduction and Motivation

The past two decades have witnessed a dramatic increase in interorganizational partnering. According to Deering *et al.* (2003), firm collaborations account for 25% of turnover in 2002 of the largest US companies. By 2004, an increase of up to 40% was expected. Whereas for decades, management literature mainly concentrated on hierarchical and market organization, the cooperative interorganization as an intermediate hybrid form (Williamson, 1985) is attracting more and more interest. Drucker (1995) considers this the greatest change in the way corporate structure and business is conducted. Teece (1992, 24) evaluates collaborative organizational forms as a “new and dramatic organizational innovation”.

The popularity of partnering suggests that entering alliances enhances the competitive position of the respective partners and thus increases their firms’ values (Häussler, 2005). Theories such as transaction

cost theory and signaling theory provide strong arguments for the attractiveness of alliances. However, despite the last 20 years of research on alliances, the knowledge about the value firms receive from such collaborations is still far away from being satisfying. This paper adds to the literature in two ways: (1) it presents a comprehensive study that takes firm and alliance characteristics as determinants for value enhancement into account and (2) tests the explanation power of transaction cost theory and signaling theory. In particular, the interplay between these theories regarding the formation and termination of alliances and the determinants of value mark-up of alliance formation is analyzed.

The paper focuses on stock market reactions to alliance announcements. It is assumed that the price change of a stock to published information on a firm’s alliance is directly attributable to the change in firm value as perceived by market participants. Using event study methodology,¹ I analyze alliance announcements from firms listed on German stock markets, which were published in the years 1997 to 2002. The study provides an in-depth analysis of potential determinants of stock market reactions to alliance formation announcements. While most other studies have used samples with a few hundred observations, this paper uses a far more comprehensive database of 1037 announcements. The German stock market is particularly well suited for this kind of study because issuers must immediately publish stock price relevant information and 99% of this information is published over electronic systems. Finally, the paper differs from previous work in analyzing both a period of a more bullish market from 1997 until March 2000 and a period of a more bearish market from April 2000 to the end of 2002.

The paper examines stock market reactions to alliance announcements pursuant to section 15 of the German Securities and Trading Act (WpHG). For the purpose of this study, alliances are defined as a voluntary, formal, cooperative agreement between two or more organizations involving either a pooling or trading of resources, linked with or without shared equity.²

The paper is organized as follows. Section 2 describes the overall value-creating mechanisms of alliances and discusses the hypotheses. Section 3 presents the research design. In section 4, the empirical results of the event study and of the multivariate analysis are reported. Section 5 concludes.

Alliances as Value-creating Mechanisms

Previous Studies

Previous studies have used different approaches to examine the importance of alliances for firm success. These studies provide mixed results. Some scholars explore the impact of alliances on firm survival. Whereas Baum and Oliver (1991) and Miner *et al.* (1990) find that interorganizational linkages are positively related to firm survival, Schoonhoven and Lyman (2000) find no survival benefits for new semiconductor firms.

Recently, studies looked at the influence of (prominent) partnerships on IPO success by *analyzing* venture-capital-backed biotechnology firms. In their study of 301 firms, Stuart *et al.* (1999) report that firms with prominent alliance partners go faster to IPO and earn greater valuations. However, in their sample of 858 biotechnology firms, Gulati and Higgins (2003) find no relation between partnerships and IPO success.

Another stream of studies used event study methodology to examine stock price responses to alliance announcements. Chan *et al.* (1997) discover a significant positive stock price response in their sample of 345 non-equity alliances announced in the USA from 1983 to 1992. The finding is consistent with Neill *et al.* (2001) analyzing 89 non-equity alliances in the information and technology sector published in the USA from 1987 to 1994. Das *et al.* (1998) report no significant market reactions to marketing cooperation announcements, but a positive significant reaction to technology collaborations in their sample of 119 announcements in the USA from 1987 to 1991. Meschi and Cheng (2002) analyze 68 Sino-European joint ventures and find a positive stock market reaction following the announcement of joint ventures. Similar results report Crutchley *et al.* (2001) examining the formation of joint ventures across the Japan-US—border. Regarding the determinants of value enhancement, Anand and Khanna (2000) study if alliance experience has an impact on the stock market reaction following licensing arrangements and joint venture formation. They report that learning effects appear to exist in R&D and production joint ventures but not in marketing and licensing arrangements. As a point of departure from these studies, this paper uses event study methodology to explore the impact of alliances on firm value and the determinants of value mark-up.

Theoretical Framework

Theory provides several explanations why alliances occur and in what way they influence firm value. The most common theories are the transaction cost theory and signaling theory in the form of interorganizational endorsement.

From the perspective of transaction cost theory, collaboration may be the least costly form of governance (Williamson, 1985) and therefore the most favorable coordination mechanism. Researchers also argue that collaborations provide organizational flexibility and allow rapid repositioning to changing demands and industry structure (Das *et al.*, 1998), and thus reduce transaction costs. With collaborations, a hybrid form between markets and hierarchies (Williamson, 1985), becoming increasingly popular, the well-known “make or buy decision” has been turned into a “make or buy or cooperate decision.”

From the perspective of the signaling theory, interorganizational relationships can act as a positive signal of endorsement to third parties (Stuart *et al.*, 1999), especially for young and small companies (Carter and Manaster, 1990; Gulati and Higgins, 2003). Market participants evaluate firms based on their own experience with the focal company or its observable quality. If the market actor has not dealt with the firm before, and/or the quality cannot be observed directly, other “references” have to be taken into account. One relevant signal is the firm’s network and its evaluation through the attributes of exchange partners.

Arguments of transaction cost theory and signaling theory have most often been used independently to understand alliances. Recently, Kumano and Rao (2000) emphasize that transaction cost theory is a close cousin to signaling theory. The two theories have a very different origin, though I show in the following, that they provide complementary arguments to understand partnering behavior. In addition, signaling effects directly impact transaction cost. When a partnership comes along with a positive signaling effect for a firm, the importance of the partnership for this firm increases. Thus, transaction costs such as resulting from monitoring requirements of the partner firm will decrease since the signaling effect increases the costs for cheating of the focal firm. The two presented theories shape the following hypotheses.

Hypotheses

Overall Reaction to Formation and Termination Announcements

The theories – transaction cost and signaling theory – suggest that there should be a positive relation between the announcement of alliances and the

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