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Financial slack and venture managers' decisions to seek a new alliance

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Abstract

We examine two distinct perspectives to analyze the role of financial slack in the decisions of technology venture managers to seek strategic alliances. According to the capabilities perspective, financial slack provides managers with the ability to maximize the benefits from acquiring missing capabilities through alliance formation, whereas according to the resource dependence perspective, financial slack buffers the managers' motivations to seek alliances as a reaction to external environmental scarcity. Drawing on an experimental design and data on 1632 decisions nested within 51 managers, we find support for a combined perspective demonstrating that managerial discretion in the form of financial slack moderates how internal capabilities and context encourage managers to seek alliances. We discuss implications of our work for the alliance literature.

Keywords: Strategic alliance; Decision; Capabilities; Slack; Environment

1. Executive summary

Two distinct viewpoints provide compelling reasons for technology venture managers' decisions to seek a new alliance. First, a capabilities perspective suggests that venture managers will evaluate whether their venture has the appropriate stock of necessary resources and capabilities, and the capacity to deploy them effectively. Entering into a new alliance offers managers the opportunity to acquire missing capabilities thereby enhancing the venture's capabilities stock and efficient capability deployment. Second, the resource dependence perspective, rather than focusing on building an organization's capabilities, emphasizes the need to focus on the management of external

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relationships with interest groups on which the firm is dependent for resources. Venture managers will decide to enter into alliances to contract and co-opt scarce resources that are held by others in the environment. What these perspectives do not explain are differences in decisions to ally among firms with similar capabilities and/or environmental contexts.

In this paper we introduce a model that describes how managerial discretion in the form of financial slack moderates the impact of internal capabilities and context on the venture managers' decisions to seek a new alliance. Financial slack facilitates the venture's development of non-financial capabilities, provides ventures with strategic flexibility, and enables adaptation to complex environments. Since financial slack is an important determinant of managerial decision making, we argue that it will impact the effect of a venture's capabilities and environmental conditions on its manager's decision to seek a new alliance. Specifically, we state that high levels of financial slack enhance the motivations of managers to acquire missing capabilities via alliances because slack facilitates the efficient deployment and exploitation of the acquired capabilities. Moreover, high levels of financial slack buffer the managers' motivations to enter into alliances in hostile environments because slack diminishes resource dependencies.

We tested the proposed model via an experimental design and conjoint analysis using data from 1632 decisions nested within 51 managers. Our results provide support for a combined perspective demonstrating that managerial discretion in the form of financial slack moderates how internal capabilities and context encourage managers to take on new alliance partners. It appears that managers' view of the relationship between financial slack and alliances varies between complements and substitutes. In the first case, managers see alliances as ways to leverage their financial slack to offset perceived weaknesses in their capabilities. In the second case, financial slack is viewed by managers as a substitute for entering an alliance, particularly during times in which access to equity capital is restricted due to market conditions.

The findings of this article make several contributions to the entrepreneurship and alliance literatures. While antecedents of alliance formation have been addressed by previous scholars, the role of moderating influences has not been examined to explain differences in alliance decisions for firms with similar capabilities and contexts. We address this issue grounding our arguments with two distinct theoretical perspectives showing that the venture's high-discretion financial slack is a major determinant of managers' motivations to seek alliances in order to acquire non-financial capabilities. More specifically, the venture's high-discretion financial slack enhances the desire of its managers to obtain missing capabilities through alliance formation. We also found that financial slack can substitute for the need to form an alliance under unattractive environmental conditions. Therefore, our experimental design allowed us insight into how the prior situation of a firm before alliance formation influences its subsequent engagement in alliances. Our findings also contribute to the understanding of previous empirical research on strategic alliance formation in the biotechnology industry. We provide evidence that high technology managers' decisions are, even if they were purely rational, complex and take into account more than just the firm's current rate of product development.

2. Introduction

One of the primary motivations for firms to enter into strategic alliances is the desire to acquire resources and capabilities (Das and Teng, 2000). Scholars have shown that, among others, knowledge (Chi, 1994), financial capital (DeCarolis and Deeds, 1999), and manufacturing and marketing capabilities (Audretsch and Feldman, 2003; Hagedoorn, 1993) can be acquired through alliances. However, while these and numerous other studies have identified capabilities that firms can access through alliance formations, they insufficiently explain why only some firms use alliances to access these capabilities while others do not. Indeed, the patterns of alliances across firms differ substantially, even for apparently very similar firms within the same industry and development stage such as young biotech ventures (Deeds and Hill, 1996). Why do some of these ventures seek alliances while others do not?

In this paper we address this question by analyzing managers' decisions to seek a new alliance. We define a new alliance as an alliance with a partner where no relationship existed before (and therefore no trust and partner-specific experience). In drawing the decision to seek new partners, venture managers examine two key variables: the combined resources and capabilities their venture possesses and the environment in which it operates. A capabilities-based perspective evaluates whether the firm has the appropriate stock of available assets and the capacity to deploy those resources for a desired end result (Amit and Schoemaker, 1993: 35). Following Gomes-Casseres (1996: 30), we define *capabilities* as "the set of tangible and intangible assets that enable an organization to develop, make, and market goods and services". It should be noted that this is a broad definition of capabilities and incorporates what has traditionally