



Drivers of alliance terminations: An empirical examination of the bio-pharmaceutical industry[☆]



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ABSTRACT

Strategic alliances are critical for firm performance, but are also highly susceptible to terminations. We utilize the exploration–exploitation framework to investigate how characteristics of the allying partners, observable at the time of alliance formation and, when possible, from both alliance partners, act as predictors of termination. We test our hypotheses using a data set of alliances in the bio-pharmaceutical industry. The results suggest that the perception of higher future returns from the alliance increases commitment by the focal company (the pharmaceutical firm) to the alliance and thereby reduces the probability of its termination. On the other hand, high levels of technological intensity of the alliance partners and high market density at the time of alliance formation will increase the propensity for termination. We further find that the relationship between product market diversity of the focal company and the propensity for termination is inverted U-shaped. Our research contributes to extant literature on alliances by introducing a more robust measure of firm commitment to the alliance and by introducing a model that measures factors observable at the time of the alliance formation to predict the propensity for alliance termination. Implications for managers and opportunities for future research are discussed.

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1. Introduction

Market inefficiencies, knowledge deficiencies, and financial constraints are some of the most frequently stated reasons for firms to enter into collaborative ventures with other firms. The main objective of alliances is to overcome these challenges and gain competitive advantage through accessing new technologies and markets, undertaking joint product development, obtaining situational knowledge and, in general, achieving a market position that would be unattainable for the alliance partners in isolation (Das & Teng, 2000a; Rothaermel & Boeker, 2008; Shah & Swaminathan, 2008).

However, alliances frequently fail to deliver on the partners' expectations, which in many cases lead to the termination of the alliance (Makino, Chan, Isobe, & Beamish, 2007). According to an estimate by Lunnan and Haugland (2008), inter-firm alliances are terminated at a rate of around 50%. As a result, increasing our understanding of the factors underlying alliance termination remains an area of interest for scholars and one of particular relevance for managers (Greve, Baum, Mitsuhashi, & Rowley, 2010; Shah & Swaminathan, 2008). In light of this apparent inconsistency between the role of alliances as a critical management and marketing tool and the high frequency of termination

(Lunnan & Haugland, 2008), we ask the question 'why are alliances terminated?' We aim to answer this question in a manner that contributes to the existing literature in three distinct ways.

First, by introducing a new conceptual variable, *perceived future value of the alliance*, we move beyond the traditional dichotomous equity measure of partners' involvement and commitment to the alliance. We propose that this continuous variable is a more comprehensive measure of a firm's level of commitment to an alliance. *Second*, by considering ex-ante predictors for alliance termination in the development of a model to predict the propensity for alliance termination, we are able to develop guidelines for managers that can potentially assist in the selection of alliance partners, a gap in extant literature earlier recognized by Park and Russo (1996). *Finally*, we control for relevant variables from both sides of the alliance, a theoretical requirement for alliance research often not met in alliance literature (Dyer, Powell, Sakakibara, & Wang, 2006).

2. Theoretical foundation and research context

High-technology industries are often described as systems of exploration and exploitation (March, 1991; Rothaermel & Deeds, 2004). Alliances are formed to explore new opportunities on the one hand, and exploit existing ones on the other (Lavie & Rosenkopf, 2006; Rothaermel & Deeds, 2004). Exploration alliances enable firms to share knowledge and learn new technologies, while exploitation alliances let firms build on complementarities, allowing one firm to

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benefit from the expertise of the other (Rothaermel, 2001). Rothaermel and Deeds (2004) present an evolutionary perspective of alliances, wherein exploitation alliances are a progression from prior exploration activities and alliances. According to this perspective, exploration alliances are considered antecedents to product development and the formation of exploitation alliances to bring product to market.

The ability to effectively manage both exploration and exploitation alliances thus reflects an organization's competence in combining resources into a dynamic capability for surviving the highly competitive and changing market environments faced in high-technology industries (Parise & Henderson, 2010). However, high-tech alliances do not always result in fruitful completion and are very often terminated prior to the completion of the stated goals. It is suggested that the divergent strategic objectives of the partners render alliances 'inevitably unstable' (Beamish & Inkpen, 1995; Kogut, 1989). Consequently, the alliance management literature offers contractual and procedural governance structures to avoid termination (Nielsen, 2010).

One of the more common contractual governance structures is the equity partnership. The shared ownership structure formalizes the requirement of continuing cooperation by the partners, and so streamlines alliance management (Rothaermel & Boeker, 2008). By encapsulating the partners' divergent objectives within the confines of the alliance, where they do not obstruct the partners' own corporate strategies, equity partnerships are considered to be more stable (Klijn, Reuer, Buckley, & Glaister, 2010). However, the effects of equity structure on alliance performance have also yielded contradictory research results. For instance, Blodgett (1992) finds evidence that equity ownership has no real effect on joint venture longevity.

Procedural alliance management strategies have also been shown to affect the propensity for alliance termination. Within this research stream, termination has been explained in terms of deviation from the partners' initial management strategy and procedures for the alliance (Cui, Calantone, & Griffith, 2010). Changes in resource allocation are used as a proxy measure for changes in strategy of the partnering firms (Cui, 2013). However, such changes in resource allocations can only be observed ex post facto termination, paying less attention to possible predictors of termination observable at the time of alliance formation.

This presents both a theoretical and practical opportunity to contribute to the alliance literature: we focus on alliance partners' characteristics and on market factors observable at the time of alliance formation. We investigate if and how these characteristics and market factors influence the propensity for alliance termination. We take a dyadic approach, operationalizing variables that signify the resources necessary for both exploration and exploitation of innovations, while at the same time introducing variables representing the dynamic market reality faced by the alliance partners.

The context for this study is the bio-pharmaceutical industry, an archetypical high-technology industry. It consists of larger pharmaceutical firms with well-established production, commercialization and distribution processes, and smaller biotechnology firms (biotechs), focused on the development of innovative technologies for future commercialization (IbisWorld, 2013). Growing technological complexity, fast product life-cycles, and high cost of product innovation compels many pharmaceutical firms and biotechs to combine forces in the development of new drugs and treatments and subsequent marketing and sales (Contractor, Kim, & Beldona, 2002; Oxley & Sampson, 2004). These partnerships are beneficial to the biotechs because they serve as a critical source of capital, and increase the odds of their approval by regulatory authorities. At the same time, they are also valuable to the pharmaceutical firms, because they keep their product lines broad and current.

Bio-pharmaceutical alliances are characterized by the different roles played by the partners. Biotechs are generally smaller and thus more agile innovator firms that license products and technologies to pharmaceutical firms that will bring drugs and treatments to market (Kotabe &

Swan, 1995; Rothaermel & Boeker, 2008). Therefore, while the technological abilities of the biotech are paramount for a successful alliance, the ability of the pharmaceutical firm to successfully manage the various therapeutic categories, i.e. market segments it operates in, is equally critical to alliance success. Consequently, exploration and exploitation alliances have become the prevalent theoretical framework used to investigate product innovations (e.g. Chandy, Hopstaken, Narasimhan, & Prabhu, 2006) as well as joint ventures and alliances (e.g. Rothaermel & Boeker, 2008; Rothaermel & Deeds, 2004) in the bio-pharmaceutical industry. Despite the importance of these exploration-exploitation alliances, bio-pharmaceutical alliances are plagued by high rates of alliance terminations similar to other high-technology industries (Lam, 2004).

3. Hypotheses development

3.1. Perceived future value of the alliance

Alliances require considerable effort and commitment from the alliance partners, and are therefore characterized by (sizeable) monetary investments (Parise & Henderson, 2010). Alliance partners face the challenge of "...allocating limited resources to where the pay-off is highest" (Corsaro & Snehota, 2010; p.993). Notwithstanding the complex phenomenological and situation-specific meaning of value when considering interfirm alliances, for most for-profit businesses, 'costs' and 'pay-off' (i.e. value originating in the alliance partnership) are still largely expressed in terms of economic or monetary value (Coombes & Nicholson, 2013; Corsaro & Snehota, 2010). The actual comparison between what is received from an alliance (i.e. its benefits) and the expended effort in financial and other resources (i.e. costs) will thus differ for each alliance partner. However, the expended financial resources at the time of the alliance formation remain a principal representation of the partners' expectation for the level of co-creation of value expected from balancing exploration and exploitation activities within the alliance (Coombes & Nicholson, 2013; Doz & Hamel, 1998).

We propose therefore that the focal company's expectation for such co-creation of value, i.e. the *perceived future value of the alliance*, can be expressed in terms of the level of financial resources committed to an alliance at its formation, effectively the investment in exploration and exploitation activities encapsulated in the alliance in anticipation of the future 'pay off' (Corsaro & Snehota, 2010; O'Reilly & Tushman, 2013). The financial commitment becomes a proxy measure for the *perceived future value of the alliance*, an expression of the firms' intention to continue the alliance relationship. Hence, as the *perceived future value of the alliance* increases, the likelihood that the alliance is terminated, decreases.

As such *perceived future value of the alliance* is different from measuring the presence or absence of equity investments as is customary in alliance literature. Our measure provides insight into the *level* of the partners' commitment to the alliance and thus their expectation of co-creation of value. If the *perceived future value of the alliance* is high, the financial commitment towards the alliance will be higher in anticipation of higher (economic) benefits over time. Vice versa, when the expectation of these future levels of co-creation of value is lower, the financial commitment will be lower.

Hypothesis 1. *An increase in perceived future value of the alliance is negatively associated with the propensity for alliance termination.*

3.2. Product market diversity

One of the reasons for allying is access to complementary assets that are needed for the exploration and exploitation of new opportunities. Partner selection is therefore critical in establishing the correct match for optimal performance and longevity (Hill & Birkinshaw, 2012).

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