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Risk management system in business relationships—Polish case studies

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ABSTRACT

The article discusses the problem of risk management in business relationships. The authors' research (including a case study analysis of 5 different relations) enabled them to identify and characterize the risk management systems based on a combination of formal control and relational mechanisms. In the authors' research it has been assumed that relational risk has a negative influence on the cooperation results and therefore it should be a subject of management. The main objective is not to avoid taking risk in relationships, but to reduce it to the minimum possible level. Companies' cooperation, including partnerships with different entities and participation in business networks, is an immanent characteristic of contemporary business. Therefore managers should look for the most efficient methods of dealing with additional relational risk and opportunistic behavior of potential partners.

In the paper the case study analysis of five relationships of companies operating on Polish market was presented. The main objective was to demonstrate the relation between the level of trust and the intensity of formal control (including contract and formal monitoring). The range of social control applied in analyzed relationships was also an important issue of consideration.

The research presented in the paper indicated that companies located in Poland in order to reduce relational risk aimed at diversification of its partners or full integration. Managers often underlined their fear of being dependent on one particular partner. This phenomenon could comprehensively decrease the advantages of intensive and deepened inter-organizational cooperation in Poland. Furthermore, the research demonstrated the decisive role of relational mechanisms and limited significance of contract in business relationship risk management. However, relatively higher importance of contract was observed in unbalanced relations between partners representing diverse bargaining power. A positive relationship between application of relational tools and cooperation results was identified as well.

The aim of the paper is to demonstrate the nature of the relationship risk management system and the role of particular mechanisms that enable to reduce risk and its negative influence on cooperation results.

1. Introduction

Uncertainty of the environment and behaviors which exert an influence on the problems in monitoring cooperation results of a partnership, on the level and risk of investment in specific assets, or adaptation difficulties together with unstable nature of alliances, constitute a high risk of business partnerships. Despite optional character of strategic cooperation, the economic situation, numerous benefits from business relationships as well as expectations of many stakeholders of an enterprise are responsible for the fact that avoiding strategic partnership risk is not a beneficial solution. Searching for and applying such strategies and instruments which will best respond to the undertaken risk of mutual exchange become a key task for decision makers. Success of many partnerships allows an assumption that in practice some enterprises skillfully use the mechanisms preventing and controlling behaviors harmful for long-lasting and sustainable relationships. These problems seem to be of crucial significance since companies seek inter-organizational cooperation and create business networks (Ford & Håkansson, 2006).

The authors have accepted a definition of strategic business relationships risk management according to which it is a process of identification, evaluation and control of the negative influence of strategic cooperation with an independent economic entity on assets and profit-making opportunities of an enterprise carried out by the Board, management or other company staff members. Business organizations carry out this process at different stages of organizational development. Risk-related activities mean the selection and implementation of some measures to modify the risk. The main activity is to limit the risk through controlling. Other possible reactions include risk avoidance, risk transfer or financing of risk through insurance (Chapman, 2008, pp.188–190). Concerning strategic relationships, risk avoidance and risk reduction seem to be the most feasible

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activities. The former strategy means that enterprises resign from establishing and participating in external inter-organizational relations both in the form of partnership relations with a single contractor and in larger network structures, including e.g. integrated supply chains. Due to constraints on growth and development, this situation cannot be maintained in the long term. Therefore, another solution for the companies which avoid the risk of business relationships is to obtain the necessary resources through hierarchical structures, namely mergers and takeovers. This method of expansion involves other governance problems which are beyond the scope of this paper. However, keeping in mind the main imperatives of today's business, such as globalization, competition within networks, pressure on creating value and pressure of time, it is difficult to imagine an effective enterprise without any support from contractors in the field of widely defined external resources and skills, frequently of strategic significance. Therefore, business relationships risk-related activities will come down, above all, to risk restriction thanks to the application of formal and informal instruments of control. It shall ensure effective and efficient functioning of an enterprise. The measure of control mechanisms effectiveness is to what extent a given risk is eliminated or restricted when certain measures are introduced. Profitability, on the other hand, refers to a comparison between the costs of implementation of risk-reducing mechanisms and the expected benefits.

The main aim of the paper is to identify, through the analysis of theory and research results, instruments of relationship risk management and the relations between them. The paper presents an empirical exemplification of the considerations in the form of case study analysis. The first part of the article develops a holistic model of risk management system in business partnerships based on the theory. The assumption concerning dependencies between the elements of the system is accepted. The research methodology was presented in the second part of the paper. Third part (case study presentation) contains the analysis of surveyed companies and relationships. All important findings and results of the conducted research and analysis, including conclusions and implications for managers, as well as further research directions, are presented in the final part of the paper.

2. Risk management system in business partnerships—theoretical framework

Business partnerships management is becoming an immense and important area of activity due to an increasing number of alliances in which an enterprise participates. Research carried out by Accenture proves that a typical large enterprise governs over 30 alliances which jointly account for 6–15% of the company's market value (Reuer & Ragozzino, 2006, pp.27). As enterprises frequently possess a portfolio of alliances and develop their alliance capability (Kale, Dyer, & Singh, 2002; Kale & Singh, 2007; Sluyts, Matthyssens, Martens, & Streukens, 2010) a portfolio approach to alliance management risk is also possible. In such a situation a tendency to minimize risk may be replaced by optimization of the joint risk of external business relationships. There exists a considerable cognitive gap in this area. How an enterprise responds to partnerships risk depends on many factors. The most significant determinants include level of risk acceptable for an enterprise (risk appetite), extent of expected benefits, alliance capability and attitude of the organization and its managers to risk-taking. A manager's characteristics may significantly influence not only the decision to establish and develop a strategic operation but also the perception of partnership risk (MacCrimmon & Wehrung, 1986; Sitkin & Pablo, 1992). Further considerations will concentrate on identification of instruments applied by the company to control business relationship risk. Defining the most effective mechanisms to minimize strategic partnership risk will be the main objective. The concept of mechanism is treated as a total of mutually dependent elements fulfilling the task of reducing or optimizing strategic relational risk in an enterprise.

2.1. Holistic model of strategic partnership risk management

Treating the system as a set of deliberately separated in the time–space interactive elements, the system of risk management may be defined as a set of instruments influencing the risk and the relations between them. Each concept of dividing the areas of risk accepted here is only a model trying to reflect the real external and internal uncertainty. The holistic model of business partnerships risk management system, including the elements which reflect different theoretical and managerial approaches, whose detailed impact is not fully recognized, is oriented towards reduction of risk through a broadly defined control (Fig. 1).

The holistic model contains the main determinants of strategic partnership risk management. The first group of determinants refers to responding to internal risk. Elements of control, including a formal mechanism represented by supervision structure and the contract, is another determinant. Finally, the relational mechanism, reflecting the aspects of social norms and trust in inter-organizational relationships, is included. These mechanisms illustrate two theoretical perspectives which find their reflection in the studies concerning the search for an effective mode of strategic alliance management. The former concentrates on structure and design of single transactions. It strongly emphasizes the significance of formal, written and legally binding contracts as an effective and efficient mechanism of governance. The latter perspective focuses on relational processes within the frameworks of the existing inter-organizational relationship and strongly emphasizes the significance of trust in securing and coordinating an alliance (e.g. Faems, Janssens, Madhok, & Looy, 2008). The structure of partnership governance is especially interesting in the context of formal mechanisms. It includes various formal ways of partnership management, from unilateral agreements (influenced by one dominating party) through bilateral agreements, exchange of minority capital shares, up to joint ventures. A general distinction between capital and non-capital alliances is particularly important. The former reveal characteristics connected with

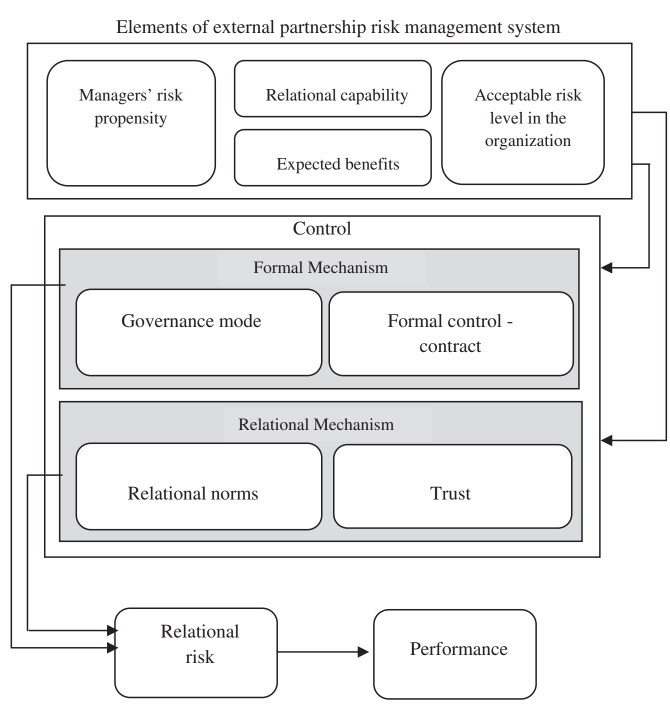

Fig. 1. Holistic model of strategic partnership risk management.