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# Impact of growth strategy on mode of governance in alliances

Marta Ortiz-de-Urbina-Criado [a,*], Ángeles Montoro-Sánchez [b], Eva-María Mora-Valentín [a]

[a] Universidad Rey Juan Carlos, Facultad de Ciencias Jurídicas y Sociales, Departamento de Economía de la Empresa (ADO), Paseo de los Artilleros s/n, 28032 Madrid, Spain
[b] Universidad Complutense de Madrid, Facultad de Ciencias Económicas y Empresariales, Departamento de Organización de Empresas, Pozuelo de Alarcón, 28223 Madrid, Spain

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ABSTRACT

The aim of this study is to analyse the way in which growth strategies influence the choice of governance mode in corporate alliances. Specifically, the study looks at how expansion, diversification and internationalisation strategies determine choice of joint ventures rather than other types of alliances. To that end, we analysed a sample of 918 alliances among companies from the European Union-15 between 2000 and 2004. The results suggest that companies prefer to set up joint ventures when their strategies are based on expansion and related diversification, whereas they prefer other types of alliances when they follow a strategy of unrelated diversification. Furthermore, in international alliances, it appears that the impact of growth strategy on alliance governance mode is similar for the entire range of companies employed in the sample.



## 1. Introduction

The complexity of the current environment, one of increasingly rapid organisational and technological change, makes it difficult for firms to develop in-house all of the resources they need to grow and to build up their competitive advantages. In light of this, strategic alliances are becoming of increasing relevance because they allow partner firms to join forces and combine their potential or actual strengths against their competitors' in order to reap competitive advantages they might not otherwise be able to achieve—or might achieve only in part—if acting individually (Speakman, Forbes, Isabella, & Macavoy, 1998).

Although it is true that interest in strategic alliances and the study thereof began in the seventies, it was not until the last decade that greater attention was placed on studying their forms of governance. One of the main reasons for this is the consideration of governance form of alliances, that is the way in which they are organised, as a factor of primary importance in determining the likelihood of their success or failure (Comino, Mariel, & Sandonís, 2007). Although there is no general consensus as to how to classify alliances according to their method of governance, most authors focus on the degree of ownership implicit in the agreement, and they distinguish two main types of alliances: non-equity and equity (Colombo, 2003; Hagedoorn & Narula, 1996). We therefore find different modes, ranging from contractual agreements such as long-term contracts or licensing agreements, to shareholder agreements, within which joint ventures imply the greatest degree of ownership control by the partners (Gulati & Singh, 1998). Various empirical studies—inspired mainly by transaction-cost theory and other approaches such as the resource-based view[1]—have studied the choice of governance modes in equity and non-equity alliances (Teng & Das, 2008).

Although many alliances are of a non-equity nature (Contractor & Lorange, 1988), most of the empirical literature has focused on joint ventures (Eisenhardt & Schoonhoven, 1996; Luo & Park, 2004; Tsang, 2000). Specifically, the use of this form of governance as an entry mode in international markets has been studied with great interest (Chang & Rosenzweig, 2001; Chang & Singh, 1999) as have various issues relating to its success or performance (Boateng & Glaister, 2002; Demirbag & Mirza, 2000), including the impact of its announcement on parent firm profitability (Hanvanich & Cavusgil, 2001) or its stability, or lack thereof (Dhanaraj & Beamish, 2004; Nakamura, 2005).

* Corresponding author. Tel.: +34 91 488 77 87; fax: +34 91 488 79 49.
*E-mail addresses:* marta.ortizdeurbina@urjc.es (M. Ortiz-de-Urbina-Criado), mangeles@ccee.ucm.es (Á. Montoro-Sánchez), evamaria.mora@urjc.es (E.-M. Mora-Valentín).

[1] Papers on the theory of transaction costs include Colombo (2003), Gulati (1995), Gulati and Singh (1998), Hagedoorn and Narula (1996), Pisano, Russo, and Teece (1988). Papers on the resource-based view include Comino et al. (2007), among others.

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There is also empirical evidence that looks specifically at joint ventures as opposed to other types of cooperation agreements (Comino et al., 2007; García Canal, 1996; García Canal, Valdés Llaneza, & Sánchez Lorda, 2008). Thus, authors such as Brown, Dev, and Zhou (2003), Chen and Chen (2003), Das and Teng (1998, 2000), García Canal et al. (2008), or Pateli (2009), among others, have shown particular interest in the factors that affect or determine the choice of governance mode. Some of these factors are: characteristics of the partner(s), knowledge, specificity of assets, technological and behavioural uncertainty, technology flows, company size, resource interdependence and complementarity, number of partners, industry idiosyncracies, certain knowledge about the host country, or prior experience in forming alliances.

However, less attention has been focused on carrying out a combined analysis of company growth strategies and governance forms of the alliances (Chatterjee & Singh, 1999), with the exception of several cases that indicate that both diversification by product or market, and their international nature have a beneficial and significant impact on the choice of joint ventures (Comino et al., 2007; Gulati, 1995). From the point of view of strategy, choice of growth strategy and fit it with the accurate method of growth is one of the most important corporate decisions. Although several authors believe that the choice of growth strategy and of the method of growth occur simultaneously (Chatterjee & Singh, 1999), many papers analyse and view these decisions as sequential, that is, the choice of strategy precedes the choice of growth method (Busija, O'Neill, & Zeithaml, 1997; Mudambi & Mudambi, 2002; Simmonds, 1990; Yip, 1982). This order of priority of the decisions means that growth strategy determines the form of governance of an alliance when the chosen method of growth is cooperation.

In this regard, studying the impact that growth strategies have on governance mode in an alliance is of great interest to companies insofar as it determines their successful growth. On the one hand, strategic alliances afford access to the resources required to implement the growth strategy chosen by the company. On the other hand, given that growth decisions are linked to the existence of surplus resources and the employment thereof, the choice of direction of growth will determine whether there are sufficient resources with which to implement the chosen strategy. Eisenhardt and Schoonhoven (1996) showed the paradox that arises in such situations, where the company needs to have access to resources in order to obtain the resources it needs. For this reason, the use of strategic alliances and, consequently, of the form of governance of these will be determined both by the available resources and the resources needed to complement the current portfolio of resources, such that the desired growth strategy may be implemented (Luo, 2001).

On the other hand, in addition to access to resources, the choice of governance mode for an alliance requires a series of aspects connected to the level of commitment of resources and to the desired degree of control over them (Hill, Hwang, & Kim, 1990). The growth strategy followed by the company sets the resource requirements and risks and, therefore determines the choice of governance mode of the alliance. For all of these reasons, the company will choose the mode of governance of alliances that best suits the requirements implicit in the choice of growth strategy. That is, it will analyse the features of the joint venture partners versus other forms of alliance with respect to use of resources, access to new resources, desired resource commitment and degree of control.

In order to provide supporting evidence and given the importance that governance mode has on the method of growth chosen to successfully implement the corporate strategy, the aim of this study is to analyse the effect that growth strategies (expansion, diversification and internationalisation) have on choice of mode of governance of the alliance, defined as the choice between a joint venture and other types of alliances. The study will be carried out using a sample of alliances among European Union companies. The results of this study will therefore provide additional empirical evidence regarding the European context in comparison to previous studies not only because of the scope of analysis was located in other geographic regions such as the USA (Comino et al., 2007) or the Far East but also studying additional and different determinants of the governance form of alliances (Chen & Chen, 2003; Wang, 2007). To achieve this, the following section sets out and defines the relationships between the various growth strategies and the choice of one or other form of governance. Section three contains an empirical comparison within the framework of the European Union, with a sample of alliances created by European companies over the period 2000–2004. The fourth section sets out the results of the empirical work and the discussion and section five concludes with the contributions and applied implications of the study, and a proposal for future lines of research.

## 2. Literature review

### 2.1. Forms of governance of alliances

The main theories used to analyse alliance governance forms are transaction-cost theory and resource-based theory[2] (Hoffmann & Schlosser, 2001). Transaction-cost theory provides a framework for assessing the effectiveness of alternative forms of economic organisation, on the basis of which alliances can be classified as either equity or non-equity (Hagedoorn & Narula, 1996). The main type of equity alliance is the joint venture, conceptualised as a relational contract having a unified governance structure (Williamson, 1979). It includes the establishment of an independent entity that is separate from the parent companies (Hennart, 1988). Non-equity alliances include a wide range of contractual arrangements such as licensing agreements, franchises and long-term contracts (Tallman & Shenkar, 1994). Whereas some of the relationships between non-equity firms are essentially market transactions, most non-equity alliances constitute intermediate governance structures lying somewhere between market structures and hierarchical forms.

In transaction-cost theory, the choice between a contractual based alliance (non-equity) and ownership-based alliance (equity) is the choice between governance by the market and governance by a hierarchy, or between a hierarchy and other hybrid forms of governance, depending on the type of alliance. According to this theory, the form of governance chosen depends on the desired degree of commitment, control and flexibility (Contractor & Lorange, 1988; Hagedoorn & Narula, 1996). Here, equity alliances have two main advantages: commitment and control. In an equity alliance, the partners make a formal commitment, and they make a greater investment in the project, making it more difficult for opportunistic behaviour to emerge (Williamson, 1975). In the case of joint ventures, because a new company is created, the partners have greater control over the activities they carry out jointly, and it is easier for them to exploit the synergies that might arise (Chen & Chen, 2003). Conversely, such alliances have numerous disadvantages deriving from the negotiation process, which is longer and more complex, and from the difficulties and costs that ensue when making any type of change in the relationship or in the agreements that have been reached, i.e., they are less flexible. Moreover, contractual alliances are faster and more flexible to implement, but

[2] For a comparison of theories, see Yasuda (2005). For a review of other theoretical perspectives, see García Canal et al. (2008).