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Alliance governance choices: Disentangling the effects of uncertainty and alliance experience

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A B S T R A C T

This article analyses the interaction between alliance experience and behavioural uncertainty to improve our understanding of alliance governance. We investigate the extent to which the effect of alliance experience on governance choices is explained by a reduction in “mundane” transaction costs or by a reduction in “opportunistic” transaction costs. Based on more than 12,000 firm experiences with equity and non-equity alliances, we demonstrate a reduction in mundane transaction costs over time by firms reusing the same governance structure in successive alliances. We also find that in high behavioural uncertainty alliances, firms rely on their experience as a substitute for equity governance to reduce opportunistic transaction costs.

Introduction

During the formation of a new alliance firms must make a decision on the governance structure of the alliance. Previous research has shown that governance decisions are heavily influenced by the potential for opportunistic behaviour by the firms' alliance partners (Madhok et al., 2015; Sampson, 2004; Williamson, 1996). The study of the hazard of opportunism, also referred to as behavioural uncertainty, has a long tradition in transaction cost economics (TCE). Empirical studies in TCE have shown that firms are much more likely to opt for strong governance safeguards in the form of equity sharing when behavioural uncertainty is high, but firms rely on non-equity alliances when they believe the potential for opportunism is negligible (Hennart, 1988, 1991; Mudambi and Tallman, 2010; Oxley and Sampson, 2004; Sampson, 2004).

Although these studies have contributed important insights on the efficiency of governance structures, they have also been criticized for taking a static perspective on governance (Faems et al., 2008; Reuer et al., 2016). They analyse governance structures as potentially efficient choices at a particular moment in time, but ignore that these choices are influenced by the alliance history of a firm (Gulati, 1995). An emerging research field argues that the study of optimal governance choices should be complemented by a consideration for alliance dynamics (Das and Teng, 2002; Reuer et al., 2016). This article contributes to this emerging research field, and shows that combining the study of alliance dynamics with the study of efficient governance modes leads to a better understanding of firms' governance choices. In this article we study the experience that firms have with different types of governance structures, and in particular their experience with equity and non-equity alliances during a five-year period preceding the new alliance. We propose that governance experience affects

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governance choices in two different ways; either by reducing "mundane transaction costs" over time or by "reducing opportunistic transaction costs" (Baldwin, 2008; Langlois, 2006).

The first effect is derived from studies that argue that governance choices are influenced by the governance structures that firms have experienced in the past (Argyres and Mayer, 2007; Faems et al., 2008). Firms reuse the same governance structures in successive alliances to reduce the costs of establishing and managing new alliances (Li et al., 2010). Langlois (2006) and Baldwin (2008) have referred to these costs as "mundane transaction costs". Examples of these costs include the costs of describing, communicating, and negotiating the transaction; the costs of measuring to verify the quality of the transacted object; and the costs of valuing the object and paying for it (Baldwin, 2008). Since equity and non-equity alliances are different types of governance structures, some of these mundane transaction costs will be more apparent in one governance form compared to the other: for instance, equity alliances will have higher bureaucratic costs, while non-equity alliances spend time and costs on describing contractual terms and conditions (Sampson, 2005). As firms accumulate experience with a particular governance form, they are able to reduce the mundane transaction costs over time when they choose the same governance form for a new alliance (Ryall and Sampson, 2006). We therefore expect firms with equity alliance experience to use equity alliances again, and firms with non-equity alliance experience to use non-equity alliances again.

The second effect is derived from studies that argue that alliance experience may reduce behavioural uncertainty and the associated opportunistic transaction costs, and consequently firms need to rely less on the strong safeguards of an equity alliance. Experience thus acts as a substitute for equity alliances (Schreiner et al., 2009; Shipilov and Stern, 2016; Teng and Das, 2008). Alliance experience provides firms with collaborative know-how (Simonin, 1997) that enables them to make better judgements on the potential for opportunistic behaviour (Gulati et al., 2009). Firms with equity alliance experience have not only dealt with behavioural uncertainty in the past, but their collaborative know-how allows them to reduce behavioural uncertainty in the process and, hence, rely less on strong safeguards in the future (Richards and Yang, 2007).

To empirically analyse the two effects of governance experience on governance choice, we studied 3724 alliance governance choices made by firms between 2009 and 2011. These firms have 8621 earlier experiences with non-equity alliances and 3486 experiences with equity alliances between 2004 and 2010. We first put our data to the test by replicating the comparative static finding prevalent in received theory that higher behavioural uncertainty is associated with equity alliances. Subsequently we introduce governance experience into TCE's comparative static analysis and our results show that firms are relatively consistent in their alliance governance choices: firms that have experience with non-equity alliances are more likely to choose non-equity alliances again, and firms that have experience with equity alliances are more likely to choose equity again in a subsequent alliance. However, the introduction of governance experience also has an effect on opportunistic transaction costs, which manifests itself in high-uncertainty alliances. Our results show that firms with a large experience with equity alliances are less likely to choose equity again to govern a high-uncertainty alliance. This corroborates that alliance experience acts as a substitute for equity governance (Shipilov and Stern, 2016), but only for alliances that are confronted by high behavioural uncertainty and therefore must mitigate opportunistic transaction costs.

The main contribution of our article is to show that governance experience affects governance choices. We offer a better understanding of governance choices by going beyond the traditional static analysis of governance structures. By integrating experience into the analysis, we show that firms choose the same governance structure over time to reduce mundane transaction costs and they rely on their experience to govern an alliance and reduce opportunistic transaction costs. We respond to recent studies that argue there is considerable scope for future research to examine how alliance experience and capabilities design safeguards against opportunistic behaviour (e.g. Wang and Rajagopalan, 2015).

Theory

Alliance governance: equity alliances versus non-equity alliances

We distinguish between alliances in which equity is shared and alliances in which no equity is shared. Previous research has highlighted the differences between these two types of alliance governance structures (Gulati and Singh, 1998; Oxley, 1997; Pisano, 1989; Reuer et al., 2016). Equity alliances involve the formation of a separate entity in which each of the partners owns a portion of the equity. The allocation of ownership shares in the new venture aligns incentives among the partners, and an administrative hierarchy of managers oversees day-to-day functioning and addresses contingencies as they arise (Gulati and Singh, 1998). A board of directors is the primary mechanism through which each partner exercises its residual rights of control, and by allocating these rights equity alliances reduce the need for partners to specify all contingencies in their initial agreement (Pisano, 1989; Reuer et al., 2014). In contrast, non-equity alliances do not involve equity sharing or the creation of a new entity (Gulati and Singh, 1998). A key distinguishing governance feature of non-equity alliances is the specification of an incentive alignment in (bilateral) contractual agreements (Oxley, 1997; Reuer and Ariño, 2007). Ongoing activities are jointly coordinated, with all partners working from their own organization, and when contingencies arise, new decisions are negotiated between the partners (Gulati and Singh, 1998).

Behavioural uncertainty and equity governance

The received view on governance structures (e.g. Tadelis and Williamson, 2012) has adopted the 'discriminatory alignment hypothesis' that aligns different governance structures to different transactions, so as to minimize transaction costs. In our

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