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The impact of strategic alliances on the market value of telecommunications firms☆

Beatriz Cuéllar-Fernández*, Yolanda Fuertes-Callén[1], José A. Laínez-Gadea[2]

Department of Accounting and Finance, Faculty of Business, University of Zaragoza, Gran Vía, 2, 50005 Zaragoza, Spain

A R T I C L E I N F O

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A B S T R A C T

This paper analyzes the impact of 130 strategic alliance announcements involving European telecommunications firms on capital markets. We use the event study methodology. We define the event as the public announcement of an alliance initiative by a firm in the media. Specifically, the data was collected from alliance-related news items posted in the Press Release pages in corporate websites. Our findings indicate that investors appreciate the importance of alliance initiatives by European telecommunications firms, and this is reflected in their effect on the volatility of share prices surrounding announcement date. In view of the null effect of alliances on returns, however, it would seem that the expectations generated in the market are mixed.

On considering the influence of firm-specific characteristics on the effects of alliances disclosure in capital markets, our results show that in young companies, with a smaller size, less profitable, and with growth perspectives more uncertain, the effect of announcements of alliances is negative.

Comparison of our results with the evidence for the US market reveals a smaller reaction in European markets which could be explained by both differences in the legislative, economic and social environment and the specific features of the firms operating in the two markets.

1. Introduction

Defined as voluntary collaborative agreements between firms involving the exchange, sharing and co-development of products, services and knowledge, alliances have become a critical strategy in all industries, overtaking mergers and acquisitions in terms of both results and the number and scope of agreements (Gulati, 1998; Park, Mezias, & Song, 2004; Parkhe, 1993).

The characteristics of individual business sectors usually determine which resources are critical to create competitive advantage and firm value, and the importance of alliances therefore depends on the industry concerned (Hagedoorn, 1993; Harrigan, 1985).

The telecommunications industry has undergone far-reaching change since the second half of the 1980s (Levine, Pitt, & Pinto, 2000). In the first place, it has seen rapid technological convergence, and this has influenced internationalism and corporate strategies. Second, it exhibits a distinctive regulatory dualism, consisting of EU harmonizing legislation and an extensive additional layer of national legislation. Finally, one of its key features has been the formation of alliances aimed at gaining access to resources and maintaining or strengthening the competitive position of the partners. In the fast-changing and knowledge-intensive

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* Corresponding author. Tel.: +34 976 762784.
E-mail addresses: bcuellar@unizar.es (B. Cuéllar-Fernández), yfuertes@unizar.es (Y. Fuertes-Callén), lainez@unizar.es (J.A. Laínez-Gadea).
[1] Tel.: +34 976 761000x4652.
[2] Tel.: +34 976 761794.

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technology industries, partnership is often the fastest and least costly avenue to obtain the resources necessary to keep up with competitors (Mowery, Oxley, & Silverman, 1996).

One of the most widely used measures to assess the success of alliances is shareholder value creation. Managers decide on alliances when they believe the future benefits of partnership will be higher than their firms could obtain by going it alone. If the announcement of an alliance provides new information about the future of the firm, meanwhile, in an efficient capital market investors are assumed to adjust their expectations of value, and this will in turn affect the share price.

The view of the capital markets is of particular interest to the telecommunications industry, because firms rely heavily on them for funding. Understanding how the capital markets view and value alliances is therefore critical to strategic management and communication. Despite evidence in a variety of other sectors to show that strategic affect share values; however, relatively few studies have examined the impact of alliances in the telecommunications industry on the markets, especially outside the United States.

This study extends previous research in the telecommunications industry by examining stock market reactions to the announcement of alliances by European firms. The existence of significant differences between the sector in the United States and Europe (see Levine et al. (2000)) prevents the extrapolation of American findings to Europe. It is in this light, together with the increasing importance and number of alliances in the European market, that we see a need for a specific European analysis. Furthermore, institutional, legal, and cultural differences among all the countries of the EU could make it unsuitable to treat the European market as a sole entity. That is why our paper also analyzes the possible differences between countries in alliance announcements market valuation.

Finally we also investigate the importance of differences in firms' characteristics in the value relevance of alliance announcements. The introduction in the analysis of the specific firms' characteristics allows us to make a comprehensive inter-relation between the information content of alliance announcements and firms' profiles, determining how the disclosure of alliances affects what types of firms and in what way.

We use the event study methodology to analyze the announcement of alliances by firms listed on European markets in the period of 2003 through 2005. This paper focuses on the alliance related return and volatility effects. Responding to the call for researchers to consider different kinds of alliances (Neill, Pfeiffer, & Young-Ybarra, 2001), this study looks at market reactions to the announcement of technology and marketing alliances.

The rest of this paper is structured as follows. Section 2 presents the theoretical background and hypotheses. The sample and empirical design of the study are described in Section 3, and Section 4 contains an analysis of findings. We present our main conclusions in Section 5.

2. Theoretical framework and hypotheses

As Koza and Lewin (1998) make clear, research into strategic alliances is not a new endeavor. Economists have always been interest in the potential of joint ventures and other forms of cooperation between firms.

The benefits of alliances have been examined in a variety of different theoretical frameworks, including transaction cost theory, resource-based studies, signaling theory, social networks theory, organizational behavior and the organizational learning theory to name but a few. Meanwhile, the most widely used arguments to explain their potential for the creation of value are access to new resources (Gulati, Nohria, & Zaheer, 2000; Pfeffer & Salancik, 1978; Wernerfeldt, 1984), the reduction in transaction costs due to gains in organizational flexibility and speed of response to changes in demand and the structure of the industry (Das, Pradyot, & Sengupta, 1998; Porter & Fuller, 1986) and inter-organizational endorsement, since partner firms in alliances may serve as a guarantee or benchmark for third parties (Gulati & Higgins, 2003; Stuart, Hoang, & Hybels, 1999), especially in the case of s start-ups.

However alliances are not without cost as shown by Das et al. (1998) and Robson and Dunk (1999). Indeed, managers may sometimes enter into strategic alliances when this is not in the best interest of their firms. For example, they may do so to protect their own jobs, which might otherwise be lost in the event of merger or acquisition. Hence, investors should bid down the share price if they observe that poor strategic decisions are being, or have, been made due to agency problems. Meanwhile, the flexibility of the business arrangements allowed in strategic alliances means that property rights associated with alliance output and future income are not always well defined. Such agreements, therefore, can expose firms to opportunistic exploitation by their partners (Williamson & Ouchi, 1981), leading to renegotiation and unequal sharing of the gains.

Some scholars, such as Eisenhardt and Schoonhoven (1996), have claimed that the above arguments do not capture the strategic and social factors that propel many firms into cementing alliances, even though these are fundamental to the decision to go ahead with such arrangements. Meanwhile, Kauser and Shaw (2004) argue that behavioral factors play a more significant role in explaining overall alliance performance than organizational issues. High levels of commitment, trust, coordination, interdependence and communication are found to be good predictors of success in international strategic alliances.

After the decision to form an alliance, once the profitability and costs previously mentioned have been weighed up, the companies must make a decision to communicate such a fact to the public. Its disclosure can be carried out before signing the agreement (thus only showing the intention or possibility of the alliance) or once set up, through different news media as announcements or press releases, on a voluntary basis.

Accounting theory suggests that a key determinant of discretionary disclosure is managerial incentives. Managers possess a great deal of discretion over their voluntary disclosures. Moreover, auditors are not obliged to review or audit voluntary disclosures, and compliance regulations are less rigid on press releases than on financial statements. Selective disclosure is a less