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The relations between transactional characteristics, trust and risk in the start-up phase of a collaborative alliance

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Abstract

The aims of this paper are to, first, explain how managers' perceptions of trust in partners and alliance risk, at the start-up phase of an alliance, may influence the choice of governance structure and control mechanisms, and second, to study how processes and activities may enhance levels of trust between partners, mitigate risk and complement formal controls to form an effective control package. A case study of a collaborative alliance in the construction industry is drawn on to examine these relationships and processes. The alliance was characterised by high asset specificity, high environmental and behavioural uncertainty, and high transaction frequency. Activities that were undertaken in the period leading up the formation of the alliance (the pre-alliance phase) and during the interim alliance, led to an increase in goodwill trust and reduced managers' perceptions of both relational and performance risk. Alliance governance structures, as well as behaviour controls, output controls and social controls, and processes that led to the development of trust and mitigation of risk, formed part of the control package.

Keywords: Management control systems; Strategic alliances; Risk; Trust; Controls

1. Introduction

Strategic alliances are not new. They have been with us for many decades. However, there is renewed interest and awareness of these types of ventures among managers and researchers, partially due to increased opportunities provided by developments in global markets and technology (Nooteboom, 2004). Also, pressures for organizations to improve their competitiveness have encouraged collaborations with other organizations, to access complementary competencies that would be too difficult or too time consuming to develop alone (Groot and Merchant, 2000; Inkpen and Ross, 2001). One way of achieving collaboration is through the formation of strategic alliances.

Strategic alliances are inter-firm cooperative arrangements aimed at achieving the strategic objectives of the partners (Das and Teng, 2002). These voluntary organizational relationships involve meaningful and durable exchange, sharing, or co-development of new knowledge, products, services or technologies (de Rond, 2003, p. 90). There are many types of strategic alliances, including horizontal alliances between competitors, vertical alliances between buyers and suppliers, and diagonal alliances between firms in different industries (Nooteboom, 1999, p. 1).[1] They can take many forms, including outsourcing, franchises, joint ventures, joint product development, joint research and development and joint marketing arrangements.

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[1] In the literature the terms *alliance* and *strategic alliance* are used interchangeable, and there appears to be no difference in meaning (Inkpen and Ross, 2001).

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While strategic alliances are said to be a source of competitive advantage there is also a growing body of evidence of high failure rates (Gerwin, 2004; de Rond, 2003). One cause is the high level of risk associated with alliances, compared to "in-house" activities (Das and Teng, 2001a). This risk is associated with differences in partners' objectives and orientations, and the potential for partners to opportunistically exploit the dependence relationship (Groot and Merchant, 2000; Dekker, 2004). It has been argued that appropriate governance structures,[2] management control systems (MCS) and trust work together to reduce alliance risk and decrease the probability of failure in strategic alliances (Das and Teng, 2001a; Speklé, 2001; Dyer et al., 2001; Nooteboom, 2004).

Since the 1980s, strategic alliances have been of research interest across a variety of disciplines, including engineering, management, marketing, accounting and international business. The relationship between MCS and trust has been the subject of several case studies that have focused largely on outsourcing and strategic supplier relationships (Seal and Vincent-Jones, 1997; van der Meer-Kooistra and Vosselman, 2000; Das and Teng, 2001a,b; Mouritsen et al., 2001; Langfield-Smith and Smith, 2003; Dekker, 2003, 2004; Cooper and Slagmulder, 2004; Kamminga and van der Meer-Kooistra, 2006) or on joint ventures (Yan and Gray, 1994; Groot and Merchant, 2000; Chalos and O'Connor, 2004). There are also theoretical papers that have focused on risk, trust and control in strategic alliances (Das and Teng, 1996, 2001b; McCutchen et al., 2004; Nooteboom, 2004), which have drawn mainly on transaction cost economics.

However, few *empirical* studies have considered how managers' perceptions of trust and risk may influence the choice of governance structure and other aspects of the control package and how processes can lead to the development trust, mitigation of risk and hence enhanced control. Also, few papers have studied MCS in alliances beyond outsourcing and supplier relationships, or at the formation stage of an alliance. Compared to stand-alone organizations, the formation stage of an alliance is considered particularly challenging due to the initial negotiation processes between potential partners, and the complex interactions between an alliance and its environment, which is complicated by the involvement of multiple partners (Das and Teng, 2002; Ring and Van de Ven, 1994; Brouthers et al., 1997). Even if some of the partners of a prospective alliance have prior shared work histories, the formation of a new alliance new dynamics creates new *alliance conditions.* Three alliance conditions have been described as relevant to the formation (and development) of an alliance: the collective strengths of the alliance; inter-partner conflicts arising from divergence in preferences, interests and practices, and; interdependencies which arise when the partners deal with each other (Das and Teng, 2002).

The aims of this paper are as follows: first, to explain how managers' perceptions[3] of trust in partners and alliance risk, at the start-up phase of an alliance, may influence the choice of governance structure and control mechanisms; and second, to study how alliance processes can enhance levels of trust between partners, mitigate risk and complement formal controls to form an effective control package for the alliance. A case study of a collaborative alliance in the construction industry is drawn on to examine these relationships. The alliance was an unincorporated joint venture involving several partners, set up to operate for the 4-year life of the project.[4] The case focuses on the period leading up to the formation of the alliance (the pre-alliance phase) and the interim phase of the alliance. The processes that led to the emergence of trust and mitigation of risk during the pre-alliance phase are outlined and the choice of the governance structure is interpreted by drawing on transaction cost economics and the MCS and trust literatures.

This paper contributes to the literature in several ways. First, it demonstrates how processes, which lead to the development of trust and mitigation of risk, interact with the governance structure and control mechanisms to form a control package. Second, the case study highlights that TCE prescriptions for the "ideal" alliance governance structure need to be interpreted in the light of trust, broader aspects of the control environment and the context of the alliance, which may include the fixed term life of an alliance. Third, the case study provides a better understanding of the relationships between risk, trust and control in alliances, to contribute to our knowledge of the design of effective control systems, which may decrease the probability of alliance failure.

This paper is structured as follows. In the following section, concepts from transaction cost economics (TCE) are combined with theories of trust and risk to explain how trust, risk and transactional characteristics at the start-up phase

[2] In this paper "governance structure" indicates the formal ownership structure or contract which sets in place the general principles under which the alliance will be managed, including the source of legitimate decision making authority. Management control systems are the systems, processes and mechanisms put in place to ensure that alliance objectives are achieved.

[3] The focus is managers of the entity who initiate the alliance.

[4] As the term joint venture is often used for alliances that are separate incorporations, in this case the venture will be termed a collaborative alliance.