Journal of Business Venturing 27 (2012) 355–371

Contents lists available at ScienceDirect

Journal of Business Venturing

Alliance portfolios and shareholder value in post-IPO firms: The moderating roles of portfolio structure and firm-level uncertainty

Nacef Mouri [a,*], M.B. Sarkar [b,1], Melissa Frye [c,2]

[a] Department of Marketing, School of Management, George Mason University, Fairfax, VA 22030, United States
[b] Department of Strategic Management, Temple University, Philadelphia, PA, United States
[c] Department of Finance, College of Business Administration, University of Central Florida, Orlando, FL 32816-1400, United States

ARTICLE INFO

Article history:
Received 24 October 2009
Received in revised form 21 January 2011
Accepted 4 February 2011
Available online 26 March 2011

Field Editor: D. Jennings

Keywords:
Strategic alliances
IPOs
Alliance portfolios

ABSTRACT

Using longitudinal data for initial public offering (IPO) firms, we examine the role played by structural differences between different types of alliance portfolios in the relationship between IPO firm alliance portfolios and shareholder returns. We show that because of the different signals they send to the capital market, different types of alliance portfolios affect IPO firm performance differently. Namely, financial markets seem to reward firms whose alliance portfolio is diversified across different types of alliances (a portfolio high in functional diversity), but not those who align their alliance partners into multiple functional points in the value chain (a portfolio high in vertical scope). We also examine the signaling role of alliance portfolios under different IPO firm uncertainty conditions. We note that uncertainty about the IPO firm is not limited to pre-IPO quality uncertainty. Investors also face transition uncertainty, post-IPO uncertainty about the ability of the firm to adapt to the new managerial challenges it faces and succeed post-IPO. We find that these two types of uncertainties moderate alliance portfolio effects in different ways. The beneficial effects of alliance portfolios in mitigating liabilities of newness is of greater importance for firms associated with higher quality uncertainty and for those associated with lower transition uncertainty.

Published by Elsevier Inc.

1. Executive summary

The relationship between strategic alliances and new venture performance has long been of interest to entrepreneurship researchers. Extant research shows that strategic alliances are especially important to firms that have recently undergone their IPO because they offer access to valuable resources and capabilities that help mitigate newness related vulnerabilities, thus enabling the firm to rapidly adapt to the potential changes in the firm's environment. Accordingly, several studies have shown a positive association between an IPO firm's interorganizational relationships and some measure of the IPO performance. In this study, we answer calls by scholars to move towards a portfolio view of alliances and examine how structural differences between portfolios and perceptions of firm capabilities affect the relationship between alliances and firm performance through the signaling mechanism.

Regarding the first objective, we find that financial markets reward firms whose alliance portfolios are diversified across substantive domains (a portfolio high in functional diversity), but not those who tend to have multiple touch points along the value chain with the same partner (a portfolio high in vertical scope). These findings regarding portfolio scope support the argument that for transition firms, efficiency in portfolio governance is less of a concern than knowledge appropriation by

* Corresponding author. Tel.: +1 703 993 1769.
E-mail addresses: nmouri@gmu.edu (N. Mouri), mbsarkar@temple.edu (M.B. Sarkar), mfrye@bus.ucf.edu (M. Frye).
[1] Tel.: +1 407 770 7017.
[2] Tel.: +1 407 823 3097.

0883-9026/$ – see front matter. Published by Elsevier Inc.
doi:10.1016/j.jbusvent.2011.02.002

partners, a threat that increases in probability as scope increases, which requires proprietary knowledge to be shared across the value chain. Given that proprietary information is often the core rent yielding resource for such firms, capital markets associate increase in a portfolio's vertical scope with increased exposure and vulnerability to knowledge loss, which in turn, translates into lower shareholder value. On the other hand, the investor community values an alliance portfolio high in functional diversity, equating it with an ambidextrous strategy by the firm which balances both value creation and appropriation while providing a richer knowledge and capability base to the firm.

The second objective of this study is to examine how perceptions of firm capabilities affect the value of alliance portfolios. Extant research has mostly focused on ex-ante uncertainty (the lemons problem) relating to the intrinsic 'quality' of the firm's capabilities prior to it going public. Such quality related uncertainty arises prior to the IPO due to information asymmetry between the issuer firm and the investor community, and reflects the latter's doubts about the overall survivability of the venture and/or its readiness to go public. In addition, these firms also face transition uncertainty about their ability to adapt to new managerial and growth challenges post-IPO. We find that these two types of uncertainties focus investor attention on different sets of factors and therefore moderate alliance portfolio effects in different ways. Given the benefits that portfolio alliances confer on firms in general and new ones in particular, the investor community is likely to be particularly receptive to the firm's inter-organizational relationships when there is greater uncertainty associated with the firm. On the other hand, the value of alliance portfolios are likely to be compromised when the capital markets perceive that the firm lacks governance capabilities that will enable it to weather through the dramatic changes brought about by its transition to a publicly listed company. In such situations, alliances are likely to be perceived as an additional managerial challenge that management may not be able to fully exploit.

2. Introduction

In place of the prevalent dyadic and industry network approach, researchers have recently proposed a portfolio view to studying strategic alliances (Hoffmann, 2007; Vassolo et al., 2004). Instead of atomistic studies of individual alliances, or of holistic studies of industry players' relative structural positions within networks, the study of alliance portfolios shifts the analysis to an intermediate level by focusing on an individual firm's collection of immediate alliance relationships (Lavie and Miller, 2008). Considering the portfolio as a unit of analysis "eschews the reductionism that occurs when an analyzed pair of firms is abstracted out of their embedded context" (Sarkar et al., 2009), while enabling the study of issues that emerge from the management of multiple simultaneous alliances with different partners (Wassmer, 2010). However, "accumulated alliance research offers only limited insights into the phenomenon" (Lavie, 2007). Moving this body of work forward, we investigate the following research questions: How is the value of a firm's alliance portfolio, as perceived by the capital market, influenced by portfolio structure and uncertainty concerning firm capabilities?

We examine our research questions in the context of firms that have recently undergone their initial public offerings. Considered to be threshold companies (Zahra et al., 2009), such firms go through a major transition in their organizational lifecycle during the IPO process. While this transition phase confirms that these firms have successfully overcome the early challenges of their existence, moving to the next stage of the organizational lifecycle also raises new challenges in governance capabilities as these firms learn to operate in the spotlight of analysts and public investors (Zahra and Filatotchev, 2004). While a lot more information is publicly available post IPO, research indicates that residual uncertainty due to information asymmetry continues to exist between the firm and the investor community (Certo, 2003; Ibbotson et al., 1988; Rock, 1986). In this context, signaling theory suggests that certain visible manifestations of strategic behavior such as alliances would provide clues to the investor community about the capabilities of the firm (Deeds et al., 1997), thus impacting performance (Sanders and Boivie, 2004). In investigating alliance portfolios through the lens of signaling theory, we depart from previous research in one important way: while literature shows that alliances can serve as signals that can mitigate newness related liabilities (Stuart et al., 1999), our main premise is that the structure of the alliance portfolio and threshold firm characteristics also serve as signals communicating strengths and vulnerabilities to the capital market, thereby affecting valuation.

In anticipation, we begin by investigating how certain structural characteristics of a firm's alliance portfolio serve as signaling mechanisms to influence the relationship between alliances and shareholder returns. We find that shareholder returns are lower for firms whose alliance portfolios are characterized by higher levels of vertical scope, thus supporting our logic that capital markets are particularly concerned about the appropriation risks that are inevitably associated with increased portfolio vertical scope (Gulati and Singh, 1998) over and above the efficiency rewards that such structures may bring. Conversely, we find that shareholder returns are higher for firms with alliance portfolios characterized by higher levels of functional diversity — which serves as an indication that capital markets are particularly receptive to signals indicative of alliance portfolios spanning the exploration–exploitation continuum. We then investigate how the context of the firm itself influences the value perception of its alliance portfolios. In line with the view that uncertainty is multidimensional (Milliken, 1987) and that "different types of market uncertainty focus investor attention on different sets of factors" (Gulati and Higgins, 2003), we examine the role of alliance portfolios under different uncertainty conditions facing the IPO firm. We suggest that in addition to quality uncertainty, that is, pre-IPO uncertainty related to the intrinsic 'quality' of the firm and its readiness to go public, IPO firms also face transition uncertainty, or post-IPO uncertainty about the ability of the firm to adapt and succeed in the face of new managerial and governance challenges that arise after a firm goes public. Our findings indicate that the value of alliance portfolios vary across different types of uncertainty relating to firm capabilities. Since alliances serve as endorsements which legitimize and ratify the firm's value, they are perceived to be even more valuable to firms which suffer from greater quality uncertainty. On the other hand, alliances are perceived to be of greater value to firms associated with lower transition uncertainty since these firms are perceived

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