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The source of abnormal returns from strategic alliance announcements

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Abstract

This study links together theoretical models of strategic alliances with an empirical examination of stock returns on the announcement of strategic alliances. Using a sample of 123 strategic alliance announcements, the results find strong support for the hypothesis that strategic alliance announcements generate significant positive abnormal returns on the announcement day. Although strategic alliances are more prevalent in the higher technology industries, the source of the abnormal stock returns is a subsample of firms with the lowest market to book values. This is found to be supportive of the hypothesis that the announcement of a strategic alliance is additional information for firms with low growth. There is no empirical support for the knowledge, flexibility and the hubris hypotheses.

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Keywords: Strategic alliance; Firm value

1. Introduction

An alliance is an agreement between parties that is formed to advance common interests or causes in an attempt to achieve a particular aim. Alliances between firms

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can be used to avoid the rigidity of some organisational forms such as mergers and takeovers and to gain access to knowledge and skills otherwise not available. Alliances are generally cooperative associations between two or more firms to share their knowledge, experience and assets and to potentially create greater value. They can take many forms from simple agreements with no equity ties to more formal agreements involving equity ownership and share managerial control over joint activities. This study focuses on alliances that agree to pool resources and documents results of analysis of the stock market response to a sample of strategic alliance announcements. Furthermore, the study identifies the source of abnormal returns that accompany such announcements.

Three main theoretical arguments are suggested for the source of abnormal share price reaction when a firm announces a strategic alliance. Strategic alliances may be more cost effective than other organisational restructures in obtaining access to specialised knowledge, strategic alliances may improve organisational flexibility and/or they may signal to the market improved investment opportunities. Although the existing literature provides theoretical support for the source of abnormal returns, very little evidence has been documented on whether abnormal returns occur on the announcement of a strategic alliance and the source of those abnormal returns. The aim of this paper is to help fill that void. Therefore, this study seeks to add value to the existing literature by linking together theoretical models of alliances with an empirical examination of stock returns surrounding strategic alliance announcements.

The remainder of the paper is structured as follows. The next section reviews the literature and develops the hypotheses that will be tested. Section 3 overviews the data collection process and the characteristics of that data, and outlines the methods used to test the hypotheses. The results of the tests are documented in Section 4 and Section 5 provides tests of robustness of the results. Section 6 summarises the paper.

2. Hypothesis development

The main hypothesis is whether the announcement of a strategic alliance generates positive abnormal returns to shareholders. In other words, is the announcement of strategic alliances regarded as unexpected good news for shareholders?

Chan et al. (1997) in a study of strategic alliance announcements in the US report significant announcement day abnormal returns of 0.64% and Gleason et al. (2003) report significant announcement day abnormal returns of 0.66% for strategic alliance in the US financial services industry. These studies suggest that the announcement of a strategic alliance is unexpected good news.

The source of the abnormal returns from strategic alliance announcements is difficult to identify due to the interaction of many explanatory variables and to date there has not been any theoretical model that completely explains the origin of the abnormal returns. There are at least three possible sources of these abnormal gains: increased knowledge, increased flexibility and improved investment opportunities. These are discussed below.