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Formal controls and alliance performance: The effects of alliance motivation and informal controls

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ABSTRACT

In this research, we study the use of formal control types (outcome, behavior) across different alliance motivations (exploitation, exploration, ambidextrous) and the effects on alliance performance. This study further examines whether this relationship is moderated by the use of informal controls. Survey data from 236 organizations pursuing strategic alliances indicate that when firms opt for one primary strategic alliance motivation, firms' emphasis on either outcome controls (in exploitation alliances) or behavior controls (in exploration alliances) increases alliance performance. Results also support a complementary relationship between outcome and behavior controls in explaining alliance performance in ambidextrous alliances. Furthermore, our findings reveal that while informal controls enhance the effectiveness of behavior controls in exploration alliances, the benefits of informal controls disappear in the context of outcome controls and exploitation alliances. In ambidextrous alliances, firms need to carefully proportion the informal control level because beyond a moderate level, informal controls seem to negatively affect a control configuration using outcome and behavior controls. Our analysis provides a more nuanced view on how organizations may successfully control alliances with different motivations.

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1. Introduction

As technology advances and competition intensifies, firms form alliances to share and exchange resources. Such alliances permit firms to *exploit* their existing knowledge and/or *explore* new opportunities (e.g., Koza and Lewin, 1998; Kristal et al., 2010; Levinthal and March, 1993; March, 1991). While recent research has examined whether firms are better off pursuing a single strategy (exploitation or exploration) or simultaneously pursuing two strategies (exploitation and exploration), commonly known as *ambidextrous alliances* (Lavie et al., 2011), much more remains to be understood about how firms effectively control alliances with different motivations. This study examines the use of controls across different alliance motivations and the effects on alliance performance.

In particular, little consensus exists on the effectiveness of *formal controls* to shape alliances. For example, innovation literature

features a predominantly pessimistic attitude toward formal controls. Extensive research emphasizes the adverse effects of formal controls on creativity in exploration alliances and highlights the importance of intrinsic motivation and freedom (e.g., Amabile, 1998; Carson, 2007; Lee and Cavusgil, 2006). A parallel literature in management has simultaneously argued that formal controls have a role in new technology alliances, for example, by preventing potential opportunism, facilitating joint problem solving, and implementing radical innovative (i.e., exploration) ideas (e.g., Argyres et al., 2007; Mayer and Argyres, 2004). A third stream of literature finds that formal controls may be useful to develop both exploration and exploitation objectives (e.g., Jansen et al., 2006). Thus, although formal controls are ubiquitous in alliances, research on their actual effects has shown an inconsistent pattern.

We aim to address this gap in two ways. First, we deviate from previous studies and differentiate types of formal controls. That is, while alliance research has typically approached formal controls in terms of the *degree* to which firms rely on hierarchical elements (e.g., detailed contracts, the use of equity as a “hostage”, and joint venture structures), we focus on the concrete formal mechanisms a firm can use to control its partner. We also describe in more detail *how* the required behavior will become motivated. Therefore, following organizational control theory (e.g.,

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Cardinal et al., 2004; Das and Teng, 1998; Eisenhardt, 1985; Kirsch, 1996; Kirsch, 2004; Ouchi, 1979) and previous empirical accounting research (e.g., Dekker, 2004; Dekker and Van den Abbeele, 2010; Emsley and Kidon, 2007; Langfield-Smith, 2008; Mahama, 2006), we distinguish between outcome and behavior controls. Historically, organizational control research has generally advocated one or the other type of formal control (e.g., Eisenhardt, 1985; Govindarajan and Fisher, 1990; Ouchi, 1979), but more recent work has suggested the complementary use of the different types (e.g., Cardinal et al., 2004; Choudhury and Sabherwal, 2003; Dekker and Van den Abbeele, 2010; Langfield-Smith, 2008). We investigate both the individual and interactive effects of outcome and behavior controls on alliance performance across different alliance motivations. Our rationale is that (mis)alignment between the alliance motivation and the mechanisms of formal control is associated with subsequent increased (decreased) alliance performance. We adopt a multifaceted approach to alliance performance (i.e., financial, operational, satisfaction) that describes a global perception of it based on one firm's experiences (i.e., the firm exercising control) (see, also, Krishnan et al., 2006).

Second, we note the potentially critical relationship between formal and informal controls. Some studies suggest that informal controls may help shape formal control performance effects (e.g., Cardinal, 2001; Dekker and Van den Abbeele, 2010; Fryxell et al., 2002; Gulati and Nickerson, 2008; Heide et al., 2007; Poppo and Zenger, 2002). Informal controls are based on *social* or *people* strategies (Das and Teng, 2001; Eisenhardt, 1985). Unlike formal control situations, explicit incentives are not needed to align partners' goals. Firms become more committed to the alliance through socialization and consensus-making. Informal controls may positively moderate the relationship between formal controls and alliance outcomes because they may buffer the adaptive limits of formal controls. One such limit is that formal controls may have a restricted capacity to control alliance partner activities because foreseeing all possible contingencies is difficult (Poppo and Zenger, 2002). Another potential limit is that formal controls may offend a partner's sense of autonomy (Christ et al., 2008; Deci and Ryan, 1987; Heide et al., 2007; Stouthuysen et al., 2012). However, informal controls also carry potential costs and disadvantages, and complementary effects of formal and informal controls cannot be assumed (e.g., Das and Teng, 1998; Hoetker and Mellewigt, 2009). So far, little empirical evidence indicates exactly how informal controls moderate the effectiveness of formal controls matched with different alliance motivations.

Our findings from moderated hierarchical regression analyses on survey data from 236 organizations pursuing strategic alliances show that when the alliance specializes in either exploitation or exploration, firms' use of outcome controls (in exploitation alliances) or behavior controls (in exploration alliances) increases alliance performance. However, in ambidextrous alliances, outcome and behavior controls are shown to have complementary effects on performance. Further, our results reveal nuances in the effectiveness of informal controls dependent on the alliance motivation and the formal controls with which they are paired. In particular, while informal controls increase the effectiveness of behavior controls in exploration alliances, the benefits of informal controls disappear when alliances are characterized by outcome controls and exploitation. In ambidextrous alliances, our findings suggest that firms should carefully consider the level of informal controls to get the intended effect on alliance performance when a firm already relies on outcome and behavior controls.

Overall, our findings elucidate how organizations may successfully pursue alliances through the effective use of controls. Following Anderson and Dekker (2014) and Vélez et al. (2008), we argue that a more nuanced approach encompassing the different types of formal control and alliance motivations may provide a

more complete assessment of the effectiveness of formal controls and their interrelationship with informal controls.

2. Literature review and hypotheses

2.1. Strategic alliance motivations

March (1991) distinguishes between exploration and exploitation as motives for organizational adaptation. Exploitation refers to the intensification of existing capabilities and improvements in efficiencies. Exploration refers to experimenting with or establishing new assets and capabilities.

Building on March (1991), Koza and Lewin (1998) advance a coevolution theory that highlights two basic motivations for entering strategic alliances and explains three types of alliances. The first type links firms with strong exploitation motivations, but little to no exploration intent. The overriding objective of an exploitation alliance is to secure new incremental revenues by combining specific assets unique to each partner (Koza and Lewin, 2000). Value is added, for example, by leveraging economies of scale or technology access to cut costs and deliver enhanced, well-managed service levels (Lavie and Rosenkopf, 2006).

In the second alliance type, firms share strong exploration motivations, with limited or no exploitation intent. Firms typically engage in exploration alliances to offer new designs, create new markets, and develop new distribution channels (Kristal et al., 2010). Lavie and Rosenkopf (2006) suggest that exploration alliances enhance an organization's adaptation to environmental changes by allowing it to attain knowledge outside its domain. In exploration alliances, partnering firms share risks and gains as they collaborate on transforming key business processes into competitive tools (Youngdahl et al., 2008).

The third alliance type, ambidextrous alliances, links firms with strategic motivations that include strong exploration and exploitation intents. The firms seek to simultaneously capture value from leveraging existing capabilities, assets, and so forth and create new value through joint learning activities (e.g., see Lavie et al., 2011; Yang et al., 2014). We ultimately regard exploration and exploitation as two *distinct* dimensions of alliance motivation, rather than two ends of a unidimensional scale.¹

2.2. Formal controls and alliance performance

We rely on organizational control research and empirical accounting research to differentiate two types of formal control—outcome and behavior controls (e.g., Cardinal, 2001; Cardinal et al., 2004; Choudhury and Sabherwal, 2003; Das and Teng, 2001; Dekker, 2004; Dekker and Van den Abbeele, 2010; Eisenhardt, 1985; Emsley and Kidon, 2007; Kirsch et al., 2002; Langfield-Smith, 2008; Mahama, 2006; Ouchi, 1979). These controls are often equated with the conceptions of market and hierarchy types of formal governance (e.g., Dekker, 2004; Ouchi, 1979). A firm that relies on outcome controls defines outcomes to be realized but then allows alliance partners to decide how to achieve them, such that its "Performance evaluation then focuses upon the

¹ In unidimensional models, alliance motivation has been conceptualized as a continuum bounded by the diametric poles of exploitation and exploration. In contrast, the bidimensional view posits that there is potential value in viewing exploitation and exploration as separate but related constructs in which the lack of exploitation does not necessarily signify exploration. Bidimensional models of alliance motivation are founded on exploration and exploitation motivations containing fundamentally different logics that require very different strategies and structures (Tushman and O'Reilly, 1996) as well as research on conditions of ambidexterity (e.g., He and Wong, 2004; Jansen et al., 2006; Kristal et al., 2010; Park et al., 2002; Rothaermel, 2001; Rothaermel and Deeds, 2004).

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