



## Do extant management control frameworks fit the alliance setting? A descriptive analysis<sup>☆</sup>



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### ABSTRACT

We examine the portfolio of management controls used to mitigate alliance risk at three separate firms in order to analyze the suitability of management control frameworks proposed by Simons (1995), Merchant and Van der Stede (2007), and Jensen and Meckling (1992) as descriptors of controls used in interfirm alliances. We find that, for the most part, these frameworks generalize to fit the data on how firms manage risks of strategic alliances. However, in applying these frameworks successively to the same data, we find that the researcher's theoretical lens imparts a distinctive understanding of the function of alliance management controls in relation to alliance risk. Specifically, we conclude that alliances that have value-creation at their root engender management controls that are well described by the management control frameworks of Simons (1995) and Merchant and Van der Stede (2007). These frameworks comprehend both economic and behavioral aspects of interfirm exchange and place much weight on coordination and communication between alliance partners. The management controls employed in alliances focused on transaction efficiency and cost minimization are described equally well by the framework of Jensen and Meckling (1992), which relies heavily on economic theory.

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### 1. Introduction

In recent decades, strategic alliances have become an enduring organizational form in business and are associated with a substantial proportion of most large firms' revenues (Anderson & Sedatole, 2003; Ernst, 2002). Management accounting scholars have responded with studies of how firms use management controls to mitigate the risks associated with interfirm exchange (e.g., Anderson & Dekker, 2005; Emsley & Kidon, 2007; Langfield-Smith, 2008). Alliances are purported to engender two general types of risk: *relational risk* and *performance risk* (Das & Teng, 1996, 2001). Relational risk is associated with a lack of cooperation between alliance partners that could result in opportunistic behavior and appropriation of firm value by the other partner. Performance risk is the risk of failure despite full cooperation, and might arise from the complexity and uncertainty of alliance tasks, and

from influences of the alliance environment (e.g., competition, uncertainty, technology changes). Management controls are considered primary mechanisms for managing these risks by aligning partners' interests and coordinating their actions across firm boundaries. However, Caglio and Ditillo (2008) raise the concern that research on alliance management controls has uncritically transplanted variables and frameworks that were developed to describe firms' internal management controls, without considering their suitability for the alliance context. We build on this criticism and examine the suitability of three such frameworks to be used as descriptors of the management controls that are employed by three large firms with extensive alliance activity: Simons' (1995) levers of control framework, Merchant and Van der Stede's (2007) adaptation of the Ouchi (1979) framework, and Jensen and Meckling's (1992) agency-based control framework.<sup>1</sup> We select these frameworks as different interpretive lenses because they are widely used for the study of firms' internal management control

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<sup>1</sup> Throughout the paper we limit our consideration to one firm's use of management controls for managing the risks that this firm experiences by engaging in an alliance. While this one-sided analysis is consistent with the majority of prior studies on interfirm control, it does not address the question how or to what extent these choices are negotiated or jointly designed with the alliance partner, and how they relate to the partner's experienced risks and use of controls.

systems and have been applied in studies of alliance management control.<sup>2</sup> Our aim is not to address the elusive question of which framework fits ‘best’ to the alliance setting, but instead to consider how and when each framework in itself provides an adequate description of the portfolio of alliance management controls employed by the three case firms. While establishing the descriptive validity of these frameworks can be considered a critical prerequisite for their use in the alliance context, a logical subsequent step that goes beyond the aims of this study, is testing their predictive validity by relating control choices to conditions hypothesized to affect their use.

Prior studies that examine alliance management control have also been criticized for giving limited attention to the specific control problems of the alliance (Caglio & Ditillo, 2008), and typically have no direct assessments of the risks that management controls are meant to mitigate. For example, many studies are based on transaction cost economics and measure risk using Williamson’s (1985) indirect indicators of transaction hazards (i.e., asset specificity, uncertainty and frequency) rather than capturing direct managerial assessments of specific risk exposure (e.g., price renegotiation, intellectual property loss, quality concerns, failure to innovate). Furthermore, many studies rely exclusively on formal contracts to measure management control practices in spite of evidence that firms typically use a broad portfolio of different controls to manage risk (Caglio & Ditillo, 2008; Dekker, Sakaguchi, & Kawai, 2013).

To address our research question regarding how well the three selected management control frameworks describe management controls between allying firms, we use field research. This enables us to directly assess alliance risk exposure and the use of a wide array of alliance management controls. By using the three frameworks as different interpretive lenses with which to successively analyze the same dataset, we provide evidence on the applicability of each framework to alliance management control, and we identify unique contributions that each framework offers for understanding how firms manage risk in strategic alliances.

To develop in the field research a rich description of alliance risks and management controls, we assemble an inventory of specific alliance risks and specific management controls from a broad review of the literature. We use the inventory of alliance risks to probe the specific risks that our research firms face, and to sharpen the focus of interviewees on the alliance management control practices that are used to mitigate risk. We interview 38 key managers with primary risk management responsibility and perform content analysis of the interview transcripts to identify alliance risks and alliance management controls.<sup>3</sup> We analyze the observed alliance risks in relation to two extant risk typologies: the Das and Teng (1996, 2001) categorization of relational and performance risks, and the COSO (2004) classification of risk according to threats to entity objectives (i.e., strategy, operations, reporting and compliance). While the first categorization is widely used in the alliance literature to understand the *sources* of risk, the COSO framework was designed by standard setters to provide managers with “guidance on risk management,” and focuses on *how* risk jeopardizes firm well-being. In doing so, it also includes risk categories (compliance and reporting risks) that are less easily related to the Das and Teng

categorization. Recent guidance from COSO (2013) states that the framework is intended to address risk of the entire entity and therefore also includes risks concerning alliance activities (Christ, Mintchik, Chen, & Bierstaker, in press; COSO, 2013). We use the COSO framework as a complementary lens to analyze how different risk types threaten firms’ alliance objectives. Our analysis of the data confirms that each field site has significant alliance risk exposure.

We then analyze the fit of the data to the three management control frameworks. Examining the same data using different interpretive lenses highlights both the distinctive contributions and the potential limitations of each framework as a lens for understanding alliance management control. Although overall we find that the frameworks fit well with the interfirm setting, we also identify controls that do not easily map to them and portions of frameworks that are not well represented by the observed portfolio of alliance controls. For example, using the Simons (1995) framework in alliances we identify a pronounced emphasis on boundary controls aimed at setting rules and criteria for selecting the right partner, defining boundary conditions and allocating decision rights as compared to belief systems or diagnostic and interactive controls. Similarly, the Merchant and Van der Stede (2007) framework highlights the importance of personnel controls enacted through partner selection processes in addition to the broad use of action and results controls. Of the three control frameworks, only the Jensen and Meckling (1992) framework is somewhat deficient in comprehensively representing the observed portfolio of management controls. The framework fits well when “management control” is limited to formal contractual arrangements and when the focus is on mitigating relational risk (i.e., opportunistic behavior), but does less well capturing non-contractual approaches to control that are critical to coordination and communication within the alliance. This comparative finding is consistent with arguments in the management literature that alliances focused on value-creation instead of cost minimization may require different modes of control (Zajac & Olsen, 1993), and with Miller, Kurunmäki, and O’Leary’s (2008) criticism that a risk management approach focused only on controlling hazards is insufficient to explain contemporary developments in hybrid organizational forms.

Taken together, our findings demonstrate that the three management control frameworks are sufficiently general to serve as an adequate basis for describing the portfolio of alliance management controls. However, in applying them successively to the same data, we find that the lens that the researcher employs imparts a distinctive understanding of the function of alliance management controls in relation to alliance risk. We conclude that alliances that are focused on value-creation, and subject to significant performance risk and relational risk, engender management controls that fit well with the management control frameworks of Simons (1995) and Merchant and Van der Stede (2007), which comprehend both economic and behavioral aspects of exchange and place a premium on facilitating coordination and communication between alliance partners. Alternatively, the management controls that focus on cost minimization and transaction efficiency, for which relational risks play a more prominent role, seem to fit equally well with all three frameworks.

The next section provides an overview of research on strategic alliances and interfirm management controls, and discusses the risk typologies and management control frameworks that inform the data collection and analysis. Section 3 describes the field research sites, research methods and methods of analysis. Section 4 analyzes the data on the case firms’ exposure to alliances risks in relation to two risk frameworks, and Section 5 analyzes their use of alliance management controls in relation to the three management control frameworks. Section 6 then takes each framework successively and provides vignettes and rich descriptions to elucidate distinctive features that were suggested in the comparative analysis. Section 7 summarizes the key findings and discusses the study’s limitations.

<sup>2</sup> We recognize that our choice of frameworks covers only some of the concepts and frameworks that have been used or could be used to help understand alliance management controls. We chose frameworks that are among the most widely examined in the accounting literature. Our choice to examine the Merchant and Van der Stede (2007) framework instead of the Ouchi (1979) that several prior alliance studies have relied on (and which is the precursor of the MV framework) is based on the concrete granular management control categories that the MV framework provides.

<sup>3</sup> The field research for this paper was used in the development of the survey instrument that is the basis for the study of Anderson, Christ, Dekker and Sedatole (2014). Anderson, Christ et al. (2014) draws upon the interview data to provide contextual background and independent corroboration of the statistical associations documented in the survey data between risk and the use of management controls.

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