Corporate alliances? Don't forget portfolio effects!

*How much value will a new corporate partnership bring your firm? To maximize benefits and avoid hidden dangers it's crucial to look beyond that one resource exchange alone and assess your full network of business relations. This is the conclusion of original research that **BMI lecturer Pierre Dussauge**, Dean of Faculty and Research at HEC Paris, and **Ulrich Wassmer** of EMLYON Business School in Lyon, France, recently published in the **Strategic Management Journal**.*

Companies form alliances to access valuable resources, whether property or knowledge, which they otherwise couldn't get, at least not without great cost: infrastructure, geographic reach, expertise and exclusive rights, for example. Partnerships let firms focus on those activities where they are most competitive and benefit from partners' advantages. Thus airlines seek code-sharing arrangements and mobile communication firms build roaming networks, while software and biotechnology companies enter licensing agreements for making, using and marketing protected products.

Previous research of value creation in networks took a single-alliance perspective, examining the identification and realisation of synergies between two partner firms. Yet rare is the company that doesn't have strategic links with multiple other firms. Thus, to more fully capture the value-creating capacity of alliances for a firm, Wassmer and Dussauge add a portfolio perspective. They analyse interdependencies among network resources accessed through simultaneous alliances with multiple partners. Adding a new partnership to a firm's existing portfolio of alliances, they explain, can create value not only through the combination of newly accessed resources with the firm's own resources, but also through combination with resources from all the firm's other partnerships.

To take a simple example, an airline flying Vilnius-Warsaw will benefit from code sharing with a second airline flying Warsaw-London since it can now offer customers a Vilnius-London itinerary. If, however, it already has a code-sharing agreement with a third airline that flies London-Washington, it can now also offer the itinerary Vilnius-Washington. This extra benefit is an alliance-portfolio effect, which would be ignored if the new alliance's value were assessed merely on a stand-alone basis.

But not all alliance-portfolio effects yield positive value! They can also destroy it. The main reason is that resource combinations in a new link-up may create substitutes –

competitors! – for offerings of the firm's other partners and so may harm relations with those partners. In the previous example, if the third airline has European flights to Washington, it may well lose business because of our firm's alliance with the second airline. We would thus need to spend more time and effort to re-establish trust and goodwill with that existing partner, who might even terminate the partnership. Such portfolio transaction and coordination costs decrease a firm's overall value from any new alliance.

Wassmer and Dussauge test their insights empirically using data for actual alliance activity and equity performance in the global passenger air transportation industry, where firms regularly engage in alliances with resources that can be clearly identified. Controlling for other important factors in network value creation, such as direct resource complementarity between a firm and its new partner, its experience managing alliances, recent financial performance and market size, they find, with statistical significance, that portfolio-synergy potential increases the value that firms get from new alliances as measured by otherwise unexplained changes in their stock prices, while network-resource substitutability decreases the value firms get, also as measured by stock prices.

Managers, they conclude, should stop treating alliance formations as stand-alone transactions. Companies need to effectively configure, monitor and coordinate their full alliance portfolio in order to optimally exploit all synergies between network resources and avoid competitive overlap. In other words, managers should not only evaluate the benefits of new network resources, but must also always consider potential costs related to conflict with existing partners.

By Bryan P. Bradley, BMI, based on: Ulrich Wassmer and Pierre Dussauge. Network resource stocks and flows: how do alliance portfolios affect the value of new alliance formations? Strategic Management Journal, Vol. 33, No. 7 (July 2012), p. 871-883.

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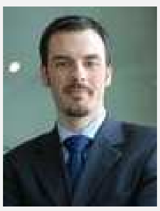

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