Transparency and disclosure of information in strategic alliances

Abstract: Trust, vital to all human relationships, is necessary for the success of any business corporation. Managers with more power are less likely to be transparent with the shareholders, and corporate governance is important in establishing trust between the two sides. Conflict of interest usually becomes an issue when the stakeholders do not share the same objectives. A number of mechanisms can be emplaced to minimize tension, such as agency theory. Additionally, strategic alliance is viewed as a long-term partnership that brings businesses together to achieve strategic objectives beneficial to the partnering firms. The objective of this paper is to examine transparency and information disclosure in firms engaged in strategic alliances, as well as trust. This issue is of concern, because of the importance of selecting suitable governance mechanisms to ensure the enforcement of trust and communication between partners, in order to reduce conflict.

Keywords: corporate governance, transparency, strategic alliances, trust, information ...
Introduction

Trust is a word that has many meanings. Within a corporate or organizational framework, the definition of trust is the art of lowering fear, inhibitions, and thoroughness of human relationships, and increasing the level of commitment to performance. Human achievements and economic performance are mutually reinforcing in a company marked by high trust, whilst they oppose one another in a company with little trust.

Inter-organizational trust has increasingly become an important factor affecting the performance and behavior of an organization engaged in dyadic and network relationships, in the form of strategic alliances. As it applies to trust, the term relational has two implications: first, relational as social trust, otherwise known as calculative trust or trust as quasi-rational choice, possessing a social orientation or implying the inclusion of relational elements; second, relational as dyadic trust favors a dynamic and reciprocal view of trust rather than dispositional and suggests trust relative to an identified other.

A spate of regulatory actions has been rendered prominent in recent years, related to the development and disclosure of corporate governance structures resulting in part from governance failures in response to financial scandals. Institutional investors have increasingly called for increased voluntary governance disclosure alongside corporate governance activities.

Information transparency is becoming more significant and efficient, and tends to have two types of effects: first, receiving accurate information allows firms to choose strategies suitable to the market and improve the profit with a positive effect. However, it may also affect the degree of correlation among the strategies of all firms.

Therefore, managers must choose between two approaches when talking about alliance governance—an approach based on control or an approach based on trust. The debate about these approaches revolves around two issues. First, whether control and trust are complements or substitutes, and second, on the link between control, risk and trust.

Strategic alliance is viewed as a long-term partnership between two or more firms that conduct business together to achieve strategic objectives beneficial to the partnering firms. In order to grow and expand, firms have increasingly seen strategic alliance as an attractive form of cooperation in order to remain competitive and achieve their objectives. Partnering firms must always have contingency plans in order to react to the ever-changing environment. The implementation of strategic alliance requires choosing suitable governance mechanisms that would ensure the enforcement of trust and communication between partners in order to reduce conflict.

In this paper, we will study governance mechanisms ensuring the enforcement of trust and communication between partners to minimize tension, in order to reduce conflicts between shareholders and managers. In order to preserve transparency, governance must ensure that the disclosed information is meaningful, relevant and reliable.
In the first section, we will examine trust and transparency in corporate governance alliances and how such alliances are established to reduce conflict of interest. In the second section, we will study governance structure in strategic alliances and their impact to maintain transparency between partners.

I) Transparency and trust in corporate governance alliances

Trust is better built when complexities are controlled. However, we distinguish three types of complexity:

- First complexity: trust touches the deepest and innermost layers of the individual.
- Second complexity: trust is not tangible, or easily palpable or quantified.
- Third complexity: building trust requires consistency.

Moreover, trust is not an objective; it must be built especially when the company faces a challenge. The key to building trust is to open a debate; the goal is not to update a tangible or observable reality but to perceive a perception or a reality.

1) Trust and transparency

New tools have been developed and highlighted to evaluate the value-creation, and to communicate and inform stakeholders about strategy and corporate creative activities. Among the most prominent of these is communication; the approach is based on a set of regulatory initiatives and technological advances, which are based in providing reliable reporting and outlining the strategy and performance of a particular company to investors. Some companies think that they mustn’t disclose so much information due to the costs they engage firstly and to go beyond the needs on the other hand.

In a context where communication is more and more present, non-disclosure by a company is perceived as a lack of transparency. Once the company decides to communicate, we distinguish six important targets:

- Institutional investors such as insurance companies, financial institutions, …
- Individual shareholders who are more faithful to the company than institutional investors.
- The employees who are most stable and faithful shareholders.
- Financial analysts who are recognized by both institutional investors and individuals.
- The press.
- The investor club which is constituted by informed readers making intellectual and financial investments.

It is argued that trust is very important in relational exchange, and is considered to be a central feature of a strategic partnership. Parties are seeking to partner with firms that exhibit trust, because investments in allied firms traditionally entail vulnerability. Once trust is established,
as Anderson and Narus (1990) suggested, firms learn that joint efforts will lead to outcomes that exceed the expectations for what they could achieve if they had acted alone in their own interests. In addition, partnerships which feature trust will survive stress, be adaptable, and survive for a long period of time.

According to Barney and Hansen (1994), alliances characterized by strong trustworthiness may have a great competitive advantage over other alliances, due to potential to decrease agency costs and governance.

Williamson (1993) in his description of trust distinguishes between three forms:

- Calculative trust: referring to a rational form of trust frustrated by mutual hostages and other economic commitments.
- Personal trust: only applies in personal relationships and does not depend on calculation of self interests, according to Williamson.
- Institutional trust: according to Williamson, this is a type of calculative trust, deriving from social and organizational embeddedness.

The first and the third forms of calculative trust are described by Barney and Hansen (1994) as semi-strong trust. They argued that when the cost of opportunistic behavior is greater than its benefits, it will be in the rational self-interest of exchange partners to behave in a trustworthy manner. Consequently, trust and trustworthy behavior between partners is a result of rational decision making in each firms’ own interest. According to social exchange, trust is a type of expectation that reduces the fear that one’s exchange partner will behave opportunistically.

Madhoc (1995) described trust as “having a structural component, consisting of mutual hostages and other economic commitments, and a behavioral component based on confidence in the partners’ integrity and reliability”.


- Knowledge based trust: emerges as firms interact and learn about each other to develop trust around norms of equity.
- Deterrence based trust: comes from consideration leading a firm to believe that a partner will not be engaged in opportunistic behavior due to costly sanctions.

Thus, trust can be characterized by three elements:

- Dependability: the expectation that the partner will act in the best interest of the alliances’.
- Predictability: the consistence of action by the partner.
- Faith: the belief that the partner won’t act opportunistically even if he has the chance to do so.
Taking these elements into consideration, we may define trust as the confidence in a person to fulfill his obligations, behave in a predictable manner, and to negotiate and act fairly when the possibility to behave opportunistically exists.

Nowadays, information is being exchanged between supplier and manufacturers, buyers and sellers and also among competitors, making the flow of information more transparent. Also, information transparency is typically considered as a good thing because of possible efficiencies, thanks to its precision.

Information aggregation tends to have two types of effects:

- Direct effect on the firm: receiving accurate information allows the firm to choose the strategies suitable to the actual state of market and improve the profit; therefore, the increased transparency of information has a positive effect for a firm.
- Cross effect on the rivals: transparent information, on the other hand, may affect the degree of correlation of all firms.

In recent years, in the public debate, transparency has become one of the most important concepts in corporate governance. The need for transparency to support governance suggests that greater transparency must be associated with financial systems with more developed equity. Conceptually, we distinguish transparency from disclosure. Transparency is viewed as a strategic ex-ante decision while disclosure is an ex-post decision of uncertain reliability.

Corporate transparency can be defined as the availability of firm’s specific information to other traded firms. Two factors contributing to corporate transparency can be isolated:

- Financial transparency: the timeliness and intensity of financial disclosure and their interpretation and dissemination by analysts and media.
- Governance transparency: the intensity of governance disclosures used by outside investors to hold direct accountable.

2) Corporate governance alliances

One form of alliance between parties that are not in direct competition is partnering between a client and a contractor. Alliances between firms with similar activities have both cooperative and competitive aspects. The first enables the firms to leverage their complementarily capabilities for common benefits, while the second tends to push the allied firms to engage in competition to learn the capability of the partner for private benefits.

Alliances are defined as a voluntary arrangement between firms involving exchange, codevelopment or sharing of products, technologies or services. Alliances take a variety of forms, and occur across vertical and horizontal boundaries as a result of a wide range of motives and goals.

Among alliance structures, there is a distinction in term of the degree of hierarchical elements included, and the extent to which they replicate coordination and control features associated
with organizations considered to be the hierarchical end of the spectrum. On one end, there are joint ventures, which involve partners creating new firms in which they share equity and most closely replicate the hierarchical control characteristics of organizations. At the other end, there are alliances such as partnering with no sharing of equity and having few hierarchical controls built in.

Joint ventures are employed in case of similar activities of partners such as contractors joining forces to leverage their complimentary capabilities to carry out work. However, they are simultaneously cooperative and competitive firms.

The cooperative aspect arises when firms need access to the know-how of each firm and collectively use their knowledge to produce something commonly beneficial to all. The competitive aspect is a consequence of each firm attempting to use the other partner’s know-how for its private gain and the possibility of one firm exploiting knowledge that it has learned from its partners before other partners can do the same.

On the other hand, partnering is essentially the establishment of an informal group among construction partners such as a client and a contract or to create permanent relationship.

Crowley and Karim define partnering as “... an organization that implements a cooperative strategy modifying and supplementing the traditional boundaries that separate companies in a competitive climate. In this way, partnering wraps the major project participants into an alliance that creates a cohesive atmosphere for the project team members to openly interact and perform”.

We distinguish two types of partnering in the literature:

- Project partnering, in which the relationship is established for a single project.
- Strategic partnering, in which a long term commitment is established beyond a discrete project.

The internal and external circumstances over the lifetime of an alliance may change, often in unexpected ways. The way partners adapt to these changing circumstances determines whether the alliance succeeds or fails.

Successful adaptation of these changes calls for a delicate balance between reliability and flexibility. Thus there are two types of uncertainty: uncertainty regarding unknown future events and uncertainty regarding partner’s response to those future events. It is this double environment of uncertainty that trust emerges as a central organizing principle in alliances.

Therefore, Coleman defines trust as “committing to an exchange before you know how the other person will reciprocate”. Sabel said that trust “is the mutual confidence that no party to an exchange will exploit another’s vulnerabilities”.

We argue that trust has the following main attributes:

- It inherently involves uncertainty about the future.
- It implies vulnerability, that is, the risk of losing something value.
- It is placed in another whose behavior is not under one’s control.

Three types of trust can be identified then:

- Weak form trust: it emerges because there are limited opportunities for opportunism.
- Semi-strong form trust: it depends on governance devices such as a market for reputation and contracts to safeguard against threat of opportunism.
- Strong form trust: it emerges in response to a set of internalized norms and principles that guide the behavior of exchange partners and is dependent of whether or not specific governance mechanisms exist.

When we talk about successful alliances, trust always comes to mind, it’s often a necessity and an absolute must. The opposite is also true; the major failure of most alliances is the lack of trust.

By increasing transparency through a firm’s disclosure policy, directors make the acquisition of information easier by outsiders, thereby reducing the need for internal monitoring as an alternative channel for governance through outside actions. By making boards more independent, firms have strengthened their governance, charging directors to enhance corporate transparency through higher disclosure standards and adopting new technologies in order to generate and disseminate financial information.

Technological advances make governance reforms easier by ensuring the timely generation and cost-effective dissemination of corporate information. The ability to identify inefficiencies doesn’t depend only on the screening effort of particular firms, but also on the degree of transparency. Whenever transparency is great, the cost of acquiring information is reduced. Directors choose the degree of transparency through the firm’s disclosure policy and decide what resources to dedicate to monitoring.

Moreover, board and shareholders’ interests can diverge since directors pursue the maximization of firm value alongside with their own interests which make their probability or management replacement reduced.

II) Governance structure in strategic alliances

Across all business sectors in recent years, strategic alliances have gained increasing popularity and emerged as an organizational design that enables firms to deal with the increasing complexity of building new sources of competitive advantage in order to compete in the global market.

Strategic alliances are formed between two organizations combining cooperation and competition to create a collaborative strategy. Through it, firms can gain access to desired strategic capabilities by linking to a partner with complementary resources or by pooling its internal resources with partners possessing similar capabilities. Synergy is created in such alliances between resources that enhance or reshape competition within the market.
1) Strategic alliances

Being a creature of contract as opposed to formal legal firms, with their prescribed rules and requirements with respect to governance, strategic alliances provide significant potential for opportunism and risks that both or one of the partners exploit the fruits of pooling resources, and use combined resources in ways that avoid the requirement to share profits with other parties.

Strategic alliances’ management committees are often compared to the board of directors of a company; however, some differences must be appreciated and understood. The board of directors of a large corporation is composed of independent members working for the interests of all shareholders in a manner consistent with established fiduciary responsibilities and duties. In this situation, the purpose of the board is to make centralizer decisions making easy and oversight activities of the managers appointed by the directors.

The management committee of a strategic alliance isn’t concerned so much with governing the alliance but preventing parties from behaving opportunistically and deviating from the original goals and objectives in a manner that undermines the alliance and effectively triggers a potential termination of the alliances.

More specifically, the alliance management committee is generally established to improve the flow of information between the partners and improve the processes for making major decisions relating the alliance by establishing a governance structure that forces the parties to either reach consensus, or begin a series of stations that must be visited to take the drastic step of terminating the alliance.

Management committee are composed of representatives from each firm, and are tasked with collecting and analyzing information regarding the alliance activities, and at the same time assessing the effectiveness of progress of alliance initiatives, and possible changes in the market and operational strategies of the alliance.

The management committee, an information sharing forum, is required to meet regularly at least twice a year or quarterly, with each party having the right to call a special meeting. In addition, the committee must file reports on alliance activities that must be prepared and disseminated among committee members.

Participation in alliances has become an increasingly popular strategy for companies to strengthen the ability to compete and innovate. Formed for their potential to create joint value that would be difficult to get independently or via other arrangements, partnerships are often formed with different partners and are referred to as multi-partner alliances.

Multi-partner alliance as Lavie, Lechn and Singh (2007) mentioned is “collective voluntary organizational association that interactively engages multiple members in multilateral value chain activities, such as collaborative research, development, sourcing, production, or marketing of technologies, products or services”.


The main purpose of multi-partner alliances is to improve competitive status by creating exchanges among independent corporations as long as they share and exchange ideas, information, knowledge, and other resources.

It is evident that trust among partners plays a vital role in multi-partner alliances because alliances based on the idea of voluntary exchange will fail if the partners do not trust the other alliance firms enough to confront the risks associated with contributing. However we have two streams of discussion on trust production in the literature:

- The first stream puts the trustor in a rather passive mode.
- The second stream the trustor can also actively produce trust by taking certain actions.

As Blau (1964) mentioned, firms’ trust in partners is a product of firms’ perception of their alliance partners’ ability and willingness to keep promises and show commitment to mutual exchanges.

Once partners trust one another, there is an enhanced solidarity, a rich exchange of information, decisions are simplified and made faster, contractual safeguards are reduced, potential for conflict among partners decreases, and the likelihood of continued collaboration increases.

Two forms of exchange have been distinguished by theorists:

- Restricted exchange: occurring in alliance dyads, where two parties exchange among themselves and discharge obligations to one another.
- Generalized exchange: occurring in exchange systems of three and more firms, where one firm actor gives to and receive from a group of firms of actors, brief, being givers and takers.

Therefore, multi-partner alliances constitute a typical form for generalized exchanges. Both types of exchange are guided by norms of reciprocity; actors who receive something from another must become givers.

**2) Corporate disclosure and governance mechanisms**

In a context of leader/follower game, we study how disclosure and competition interact to influence the operating strategies of firms. The leader firm makes a binary operational choice and issues an accounting report that the follower observes before making an operational choice identical to the leader.

According to Fisher Black (1993) “accounting is a language that people within a firm can use to discuss its projects and progress with one another, and that people they can use to tell outsiders what’s happening in the firm without giving too many of its secrets to competitors”.

We analyze then three disclosure environments:

- First environment: the leader’s verified report reveals no useful information: one of the firms must adopt a less promising operational choice if the state of nature is highly
uncertain. This strategy allows the company to distinguish itself and expect to earn a high profit if it turns out to be successful in opposite of its rival who does not.

- Second environment: the leader’s verified report reveals whether its operational choice generates high or low profit but nothing more. The report allows the follower to distinguish which operational choice leads to success if he can predict the leader’s choice. However, the leader develops a desire for operational unpredictability to leave the follower without any competitive advantage.

- Third environment: the leader’s verified report reveals its operational choice as well as its profitability. The leader’s complete transparency leads to a more promising choice, but leaves the leader vulnerable to the follower by stripping from it the unpredictability afforded to it by mixed strategies under the non-disclosure of operational data.

To equalize the marginal benefits of internal and external governance actions of a firm, the board chooses transparency. However, the more shareholders and the board interests diverge, the less incentive the board has to either disclose information or monitor management.

Even if the information gathering activities of the board and the acquirer are substitute instruments for increasing firm value, the company’s disclosure policy is complementary to the acquirer’s screening activities. According to Berger and Hann (2002), greater transparency encourages more external security and, hence, more active takeover market whereas more internal monitoring reduces the incentive for an acquirer to screen.

It is argued that technological progress, by increasing the returns of information acquisition or reducing the cost of disclosure, mitigates the underlying agency problem between shareholders and their boards. The board indeed increases its monitoring as its ability to process company specific information improves. It is surprising, however, that this improvement in internal oversight leads also to increasing transparency to counteract the acquirer’s tendency to reduce the firm’s activism in response to the board’s increased monitoring. On the other hand, advances in technology for disseminating information, by reducing the cost of corporate disclosure, encourage great transparency and leads to more activism by the acquirer.

The board tends to reduce transparency when acquirers are fiercely competing against one another, because they are providing external governance. Additionally, firms benefit from such competition, as it provides better governance at low costs. Hope (2003), reports that the level of a firm disclosures are positively related to forecast accuracy. He suggested that better disclosures foster more accurate external analysis.

Hodge et al. (2004), reports that technologies that allow alternative presentation formats for financial information may facilitate the investor’s gathering of information, thereby improving disclosure transparency and influencing the investor decision process. The firm may, therefore, improve its disclosure transparency with both the content and presentation format of internet disclosure.
Corporate governance mechanisms are involved in monitoring and determining the firm’s overall information disclosure policy. Governance mechanisms have two roles in determining disclosure policy: complementary or substitutive.

Governance mechanisms are considered complimentary when the adoption of such mechanisms strengthens the internal control of the firm and makes it less likely for managers to withhold information for their own benefits, leading to improvements in disclosure comprehensiveness and in the quality of financial statements. On the other hand, they are considered substitutive when adopting governance mechanisms reduce information asymmetry and opportunist behavior in the firm, resulting in a decrease in the need for more monitoring and disclosure.

In the literature, two general views on governance are found: the control view and the trust view. The level of control and trust in alliances depend on the level of the risk that the alliance faces. According to Das and Teng, there are two elements of risk:

- Relational risk in which partners can deceive each other, it is perceived as a threat that the firm will behave opportunistically and consciously harm its partner’s interests.
- Performance risk in which the alliance will not deliver the expected business result, as factors such as market uncertainty, competition and governmental regulation may have negative effects on alliance results.

Firms use a variety of mechanisms to develop a governance structure. The most-mentioned are equity and extensive safeguards.

- Equity: giving a firm a formal say in a partnership or joint venture. Also, it may create a hostage situation in which opportunistic behaviors by one partner against another damages the first partner.
- Extensive contractual safeguard: it may include confidentiality or exclusivity agreements as well as the right to examine the partner’s books.

Another control mechanism is the use of incentive systems to motivate managers to contribute to the alliance. Boards of management also play a role in alliance governance. In a control situation, they will be involved in supervising the alliance more frequently; whereas, when trust mechanisms are employed, boards will intervene less often but act as coach for alliance managers.
Conclusion

Alliance governance has two distinct forms: contractual integration and procedural coordination. While the first may help set the legal parameters of alliance agreements, day-to-day coordination of activities and processes determine the effectiveness of such contracts.

One of the forward-looking frameworks commonly used in thinking about trust is the game theoretic view on the evolution of cooperation proposed by Axelrod (1984) who showed that expectations of continued interaction change the behavior of relationship partners.

The globalization of companies, especially in the construction industry, is rendering the familiar model of a single company doing all things in-house outdated. The technological, political, financial and competitive capabilities that are required to operate in the global construction market means that firms need to establish alliances with participants in order to survive.

Trust is essential for strategic alliance for three reasons. Firstly, no contract or agreement, no matter how complete or detailed, can count for every issue or every contingency that might arise. Secondly, the alliance of two or more firms creates a strong potential for dysfunctional conflict and mistrust as the partners differ in organizational culture and management philosophies, among other things. Finally, learning that is often cited as one of the major benefits and motivations for strategic alliances may suffer if the partners do not trust each other.
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