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Organizational Identity and Interorganizational Alliances

by

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A dissertation submitted in partial satisfaction of the

requirements for the degree of

Doctor of Philosophy

in

Business Administration

in the

Graduate Division

of the

University of California, Berkeley

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Fall 2012

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Abstract

This dissertation examines the relationship between organizational identity and the early formation and performance implications of interorganizational alliances. Chapter 2 investigates how the comprehensibility of an identity—a fundamental issue a new organization faces—affects how it forms its initial portfolio of alliances. The findings indicate that comprehensibility affects the search for alliance partners in terms of the speed of alliance formation and the diversity between the new organization and its partners. Chapter 3 investigates how organizational identity affects the impact that alliances have on performance outcomes. Results indicate that weak identity reduces the impact that an organization's exploration alliances have on its performance.

Introduction

This dissertation examines links between organizational identity and the formation and performance implications of interorganizational alliances. Organizational identity is defined by attributes of an organization that are central, enduring, and distinctive (Albert and Whetten, 1985). Such attributes belong to both the micro and macro levels of an organization. This dissertation is concerned with organizational identity at the macro level, which is influenced by social forms, categories, and group affiliations (Whetten, 2006). Identity typifies an organization by its category or group affiliation, and compels the organization to remain consistent with the social codes related to its claimed identity (Hsu and Hannan, 2005; Pólos, Hannan, and Carroll, 2002).

Organizational identity at the macro level is an important feature of industry dynamics: it explains why industries are distinguished from one another, why new markets can be founded in mature industries, and why some market segments do not grow (Carroll and Swaminathan, 2001; Hannan and Freeman, 1977; McKendrick and Carroll, 2001). At the same time, industry dynamics create complementarities and competition among firms, which affects the formation of interorganizational alliances (Eisenhardt and Schoonhoven, 1996; Gulati, 1995; Stuart, 1998).

A connection between organizational identity and alliances undoubtedly exists, but little prior research has systematically investigated this connection. Some exceptions can be found in sociology and management research. They have provided us with the insight that when selecting alliance partners, organizations consider their identities. For example, Lincoln and McBride (1985) demonstrated that grounded on the principle of homophily, organizations tend to form relationships based on similar identity attributes such as internally held social values.

Also, Stuart (1998) showed that firms tend to select partners that are classified in technology segments that are similar to those firms. Finally, related to social-psychological literature and theories of sense-making, Ring and Van de Ven (1994) proposed that when two organizations have a congruent understanding of each other's identity in relation to other organizations, formalizing an alliance between them becomes likely. Because little research has explicitly investigated the connection between organizational identity and alliances, we lack full knowledge about the conditions under which identity matters to such important strategic actions as alliance formation. We also lack understanding of whether alliances that deviate from an organization's identity would substantively impact its performance outcomes.

Nevertheless, both organizational identity and alliances have important implications on organizational survival and merits closer examination together. In rapidly changing technology industries, an organization must acquire legitimacy by offering a clear identity—in the sense that the organization can be understood and is considered a member of a legitimate market category (Kennedy, 2008; Zuckerman, 1999). An organization must also access important resources and knowledge; it is likely to do so by establishing partnerships with other organizations in its environment. Yet, applying the adage "you are known by the company you keep" suggests that an organization's choice of partners should matter in forming or maintaining a clear identity. For example, alliances with partners that on balance are congruent with the organization's classification are likely to confirm its identity and present the organization coherently; conversely, partners that on balance are incongruent with the organization are likely to portray it incoherently. The focus of this dissertation is to more closely examine this connection between organizational identity and interorganizational alliances.

Chapter 2: How the Comprehensibility of Identities Affects Early Alliance Formation

Chapter 2 analyzes the effect of an organization's identity on its initial alliance portfolio formation. It asks the question, how does the comprehensibility of an identity—a fundamental issue a new firm faces—affect how it forms alliances? While prior studies have investigated how new firms use alliance strategies to overcome their liabilities of newness, the focus of this chapter is how the very issue of being new shapes these strategies.

I draw upon the theory that new firms are more or less comprehensible as a function of how well they resemble a set of preceding firms that constitute a category and the degree to which that category has been clearly differentiated by those preceding firms (Aldrich and Fiol, 1994; Hannan and Freeman, 1977; Hannan et al., 2007). New firms that resemble existing firms that constitute a differentiated category will be more comprehensible than those that resemble ambiguous firms that constitute a less differentiated category. For a new firm, being comprehensible is a primary concern because it determines whether an audience will be able to identify the appropriate comparison set for the firm and thus be able to evaluate it further (Philips and Zuckerman, 2001).

By forming alliances to signal information about its product, a pioneering firm may help potential customers understand the firm. By choosing partners whose products have overlapping characteristics and then announcing these partnerships, a new firm can convey information about its own product. This proposal is founded on the principles of homophily (Lazarsfeld and Merton, 1954) and the argument that a firm's set of alliance partners acts as signals from which an audience can make inferences about the firm (Podolny, 1993). Varying levels of comprehension about new firms should affect how they form alliances to convey information to potential customers, yet we lack perspective on this issue. Would an extremely low comprehensible new firm be more likely to form more partnerships to help potential customers understand it than a familiar new firm would? Or, would the firm's extremely low comprehensibility prevent the new firm from forming more partnerships than a familiar new firm would?

The empirical setting of this study is the U.S. business software industry. I examine a sample of 499 firms founded between 1992 and 1997 and the alliances they formed during their first seven years of existence. During the period the firms were founded, the Internet was first commercially available and the software industry began to experience significant changes. The Internet attracted many entrepreneurs who introduced new software products or experimented with new business models related to the new technology. Due to this setting, we observe variation in organizational comprehensibility, which is measured by how distinctly the software product categories are established by market participants.

My analysis found support for the claim that the more comprehensible a new firm is, the less pressure the firm will face to signal its identity and therefore the slower will be the firm's rate of alliance formation. Additionally, my investigation indicated that due to constraints on new firms' identities, a curvilinear (inverse-U) relationship exists between a new firm's degree of comprehensibility and the degree of partner set diversity—that is, the degree to which the organization's partners have product profiles different from its own. Less comprehensible new firms, such as those that pioneer new products, face pressure to signal their identities more clearly and thus tend to associate with partners in categories similar to themselves; therefore, these firms tend to have a low degree of partner set diversity. However, the more comprehensible a new firm becomes, the clearer its identity and customers will take notice of it. Recognition from customers will relieve the firm of clarifying its identity through alliances with firms in categories similar to its own. The recognition will give the firm the opportunity to engage with partners in categories different from its own, and thus demonstrate pragmatic legitimacy. At a certain point, however, a new firm's comprehensibility can be so high that it becomes constrained by identity expectations and the competition within its highly differentiated category; once a firm has passed this point, it will tend to engage with partners whose categories overlap with its own in order to maintain its coherence. Hence, due to constraints on their identities, new firms at both the high and the low end of comprehensibility will tend to have a low degree of partner set diversity, while firms in the middle, due to the desire to gain pragmatic legitimacy, will tend to have a high degree of partner set diversity. While a firm with low comprehensibility will tend to have many partners, its partners will tend to be firms of its own type. In comparison, while a firm with high comprehensibility will also tend to have partners of its own type, it will tend to have few partners.

Chapter 3: An Organizational Perspective on the Effects of Exploration Alliances on Firm Performance

Chapter 3 investigates how organizational identity affects the impact of alliance portfolios on organizational performance. More specifically, this chapter focuses on exploration alliances, which tend to negatively impact performance, at least in the short term. I propose that this negative impact depends on the strength of the organization's identity in terms of how coherent and taken-for-granted its categorization or social grouping is. The view that exploration alliances are indications of an organization's intention to change its core identity leads to the presumption that when the organization's identity is strong, expectations on the firm to maintain its identity are also strong; thus, the change indicated by exploration alliances would lead to negative reactions towards the organization, which would hamper the organization's performance outcomes. However, when the organization's identity is vague or weak, expectations on the firm to maintain its identity are weak as well. Thus, the change indicated by exploration alliances would be less of an issue, and the negative effect of such alliances on performance outcomes would be lower.

I investigate the proposals in two empirical settings and test context-specific hypotheses, finding general support for the proposals. The first empirical setting is start-up software firms. One indicator of a start-up software firm's early success is its ability to transition from private ownership to public ownership through an initial public offering (IPO) event. A start-up firm that reaches this milestone indicates that it has 'made it,' establishing itself as a viable business that will continue to grow. Although not all start-up firms choose to go public, the benefits of doing so motivate many firms to choose that path. During the time period in which I analyze software firms, 1993-2003, the IPO market was very attractive, especially during the late 1990s; the successful IPOs of America Online in 1992 and Netscape in 1995 were credited with starting a strong IPO market in the e-commerce and software industries that lasted until the end of 2000. In this time period, an IPO event was a common performance milestone for start-up technology firms—accomplishing an IPO was generally not a matter of if, but when.

The empirical findings reveal that new firms that engaged in extensive exploration alliances (indicated as partners in product categories that are far-reaching) went public at a relatively low rate, but that this low rate was reduced when a start-up firm had a less clear identity, as indicated by its lack of clear categorization.

The second empirical setting is Japanese keiretsu firms in the electronic industry. In this context, I determine the extensiveness of a new exploration partner by using a partners' keiretsu affiliation, identifying a new partner that is independent of a keiretsu as more "distant" and extensive in exploration than a new partner in the same keiretsu as the focal firm—this partner would be considered a "closer" partner and less extensive in exploration. I take advantage of historical events in the Japanese economy to determine when the keiretsu identity was strong and then weakened. In 1991, Japan entered a sharp economic recession, which the news media attributed to the keiretsu system. As a result, beginning in 1991, the keiretsu groups seemed to lose legitimacy and unravel (Auerback, 1991). I construct my sample around this event, treating the years before 1991 as a period in which keiretsu identity was strong and the years beginning in 1991 as a time when it was weak.

The empirical analysis of the keiretsu firms also supports identity strength as a contingency between exploration alliances and their negative effect on performance. The findings indicate the return on assets performance ratio was lower among firms in extensive exploration alliances (indicated as alliances with new independent partners), but that this negative effect on return on assets was reduced during a period when the keiretsu identity was contested and weakened.

The implication of these findings is that under conditions of weak organizational identity, be it from an organization's ambiguous categorization or from the delegitimization of the category group in which it belongs, organizations may somewhat avoid the short-term deleterious effects of exploration strategies, thus giving a boost to its strategic positioning in the meantime. However, given the imperative for firms to establish a clear and strong identity in order to be evaluated, the question for future research is, how long will the disadvantages of having a weak identity catch up and render the positive boost in strategy no longer useful? In general, in order to coherently pursue goals and be evaluated an organization needs to stake a claim on an identity, or reestablish their next identity if environmental conditions change. Though in the meantime, internal and external organizational constituents might be frustrated and confused about the organization (Tripsas, 2009), at least the exploration strategies they will pursue to help establish their new identity claim will be regarded with less criticism than normal.

Contributions

This dissertation contributes to the general study of organizational theory, and in particular to the study of alliance formation and its performance implications. I draw from categorization theory to identify how the groups of which organizations are members will determine their degree of identity coherence and strength, and how this variation affects the formation of alliance portfolios. I also draw from organizational learning perspectives on alliances to understand how organizational identity may play a contingency role on performance outcomes. This work has expanded our understanding of the important implications of comprehensibility and strength of organizational identity on interorganizational alliances, laying the foundation for more research on the important link between them.

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