Pooling of resources in housing development through strategic alliances: Theoretical framework and options for the Swedish market

by

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Abstract:
The purpose of this paper is to discuss different types of strategic alliances that a developer might establish in order to undertake risky development projects. Individual developers as well as cities and municipalities can become more competitive by mobilizing resources and allocating risks efficiently. Based on the general literate on strategic alliances, we argue that developers and other actors in the development process may realize a large number of potential benefits of alliance activity. Strategic alliances can be designed to meet critical resource and risk management needs of a residential developer throughout a typical development process.

Keyword: Strategic alliances, housing finance, construction
1. Introduction

1.1 Background

Property development is ’a process that involves changing or intensifying the use of land to produce buildings for occupation’ (Wilkinson and Reed 2008, p. 2). This process combines a large number of resources like land, infrastructure, labor, materials, professional services and finance. We may regard the construction of a building as

‘a complex, information dependent, prototype production process where conception, design and production phases are compressed or concurrent and highly interdependent, in an environment where there exist an unusually large number of internal and external uncertainties’ (cf. Pryke 2004, and references therein).

The monetary goal of (rational) private sector real estate developers is assumed to be to maximise profit given a certain risk constraint. The developer is responsible for the success or failure of a specific development project. Successful property development depends on the developer’s ability to both secure and coordinates a large number of resources from both private and public actors that are typically needed in development processes, as well as to manage the many different types of risks and uncertainties that development projects are subject to.

From a theoretical perspective, there exist basically three types of organizational forms that a developer can employ in order to have access to the necessary resources and to manage risks of development projects: via market exchanges in which coordination takes place through the price mechanism, via internal organizations in which a number of other forms of coordination are used, and via different types of hybrid organizational forms, in which coordination between different organizations takes place by using the price mechanism and various other coordination mechanisms simultaneously (Douma and Schreuder, 2008).

For instance a developer can access external resources and manage risks via market exchanges, different type strategic alliances, mergers and/or acquisitions. In most literature on property development, market exchanges are described as the dominating relation between the developer and various suppliers. The developer buys land, hires architects,
engineers and subcontractors and borrows money from a bank. However, developers might instead engage in cooperative activities such as the establishment of strategic alliance with other organisations, in order to increase the pool of available resources and enhance the developer’s opportunity to decide what risks to retain and what risks to allocate to other actors in the development process.

In general, cooperative activities between organizations have indeed ‘become increasingly necessary due to the limitations and inadequacies of individual firms in coping successfully with a world where markets are becoming increasingly global in scope, technologies are changing rapidly, vast investment funds are regularly demanded to supply new products with ever-shortening life cycles, and the economic scene is becoming characterized by high uncertainty and turbulence’ (Faulkner, 2003, p. 119).

As with most other industries, the housing construction industry also faces a continuously changing competitive environment. It is therefore interesting to discuss strategic alliance activities that might play a critical role in enhancing the competitive advantage of housing developers as well increasing the efficiency of housing production.

1.2 Purpose

The purpose of this paper is to discuss different types of strategic alliances that a developer can establish in order to undertake risky development projects. Indeed, strategic alliances can be designed to meet critical resource and risk management needs of a residential developer throughout a typical development process, which usually includes site acquisition, construction, and sale or management of property after completion. For instance a developer can establish equity joint ventures with capital providers, several capital providers can syndicate investments, and developers can establish marketing alliances with professional service providers such as estate agents.

Establishing strategic alliances seem to be a critical strategy in a broad range of industries, and during the past decades alliances have become a very important organizational form (see e.g. Bamford et al 2003; Gulat 1998; Harrigan 1988; Kale et. al. 2002). Because of the high rate of alliance failures reported in the general literature, for instance due to problems
with asymmetric information, coordination, cooperation, disagreement and trust between alliance partners, we also discuss some of the major problems that may arise in alliances and how they can be avoided, or at least mitigated. Although this paper focuses on housing construction, the discussion may be applied to other type of development projects as well.

Both equity and contractual arrangements are discussed, where we study the pooling of both financial and non-financial resources, as well as the management of the many kind of risks inherent in development projects. We do it by creating a new frame of references for establishing strategic alliances in the residential development industry.

This research is based on an extensive literature study, in combination with observations and inspiration from seminars, news, as well as contact with industry practitioners.

The paper is structured as follows. The following section presents a number of key theoretical and empirical alliance issues from the general alliance literature. The subsequent section discusses different type of alliance constellations for the purpose of developing residential properties, with a specific focus on the Swedish situation. The final section concludes this paper.

2. Strategic alliances: Key issues

2.1 The increasing importance of strategic alliances and alliances research

In the last two to three decades, both practitioners and academicians have greatly increased their attention on strategic alliances between firms, also referred to as ‘hybrid organizations’. In the same way as strategic alliances have moved from a peripheral tool of applied business management, mostly focused on joint ventures between local and foreign firms, to a centrepiece of corporate strategy and competitive advantage, so has also strategic alliance research blossomed greatly, changing the focus from conventional international joint ventures towards a large number of other types of collaboration between firms (Bamford et al 2003; Koza and Lewin 1998; Wright and Lockett 2003). The increasing attention of strategic alliances between firms has also challenged the single firm as the traditional unit of analysis in economics and strategy (Koza and Lewin 1998; Wright and Lockett 2003).
The blossoming research on strategic alliances reflects the increasing incidence and importance of strategic alliances in business practice, both intra-industry and inter-industry (see e.g. Koza and Lewin 1998). Grant and Badenfuller (2004, p. 61) notes, ‘One of the most important trends in industrial organization of the past quarter century has been the growth of collaboration between independent companies’. It is common to see alliances account for 20-50 percent of corporate value – whether measured in terms of revenues, assets, income, or market capitalization (Bamford et al 2003). Cooperative forms of doing business is likely to continue to grow rapidly, as firms of all sizes and nationalities in an increasing number of industries and countries perceive value in such arrangements (Faulkner 2003).

Already two decades ago, Contractor and Lorange (1988), whose influential text may represent the start of modern research on strategic alliances, characterized the strategic alliance literature as fragmented (cf. Koza and Lewin 1998). A decade later, Osborn and Hagedoorn (1997) noticed that no overreaching framework has yet emerged. In their study of joint ventures (a form of strategic alliance, see below), Reuer and Koza (2000) point out that ‘the growing variety of theoretical perspectives on joint ventures raises significant questions regarding the complementary or competing nature of these perspectives, their relative explanatory power in different empirical settings, and the specific relationships between theories of joint ventures’ (p. 81). The literature admits that there is still very much to learn, that we are far away from a fully understanding strategic alliances as a phenomenon. Ménard (2004) writes ‘Steps in exploring these issues have been taken recently…But a lot remains to be done’ (p. 370).

The growing significance of strategic alliances has attracted the attention of scholars representing a large number of disciplines, such as economics, international business, marketing, organization theory, sociology, strategic management, and operations management, and ‘employs the gamut of methodological and theoretical framework indigenous to those fields’ (Koza and Lewin 1998, p. 255). Indeed we should acknowledge that advancements must derive from several scientific disciplines. Williamson (1991) states that

‘Further developments of conceptual, theoretical, and empirical kinds are needed. Taken together with related developments in information economics,
agency theory, and population ecology, there is reason to be optimistic that a "new science of organization" will take shape during the decade of the 1990s...Whether that materializes or not, organization theory is being renewed in law, economics, and organizational respects. These are exciting times for interdisciplinary social theory’ (p. 294).

One major problem is that while a large number of theories are increasing the body of knowledge regarding reality (what is going on out there), this reality is not standing still: alliances are continuously transforming the nature of competition (Gomes-Casseres 2006). It is from these perspectives that many believe in an emerging perspective, which spans several scientific disciplines with contributions from a great many interdisciplinary set of scholars. For instance, Douma and Schreuder (2008) expect that the complexity perspective ‘will have a significant impact on the future development of our family of economic approaches to organizations’ (p. 291). In other words, we may state that no single theory, nor single school of thought, can be expected to explain the phenomenon of alliances and hybrids.

2.2 Key issues in strategic alliance research

Table 1 below shows five key alliance research issues (Gulati 1998):
(1) The formation of alliances;
(2) the governance structure (choice of alliance type);
(3) the dynamic evolution of alliances;
(4) the performance of alliances, and
(5) the performance consequences for firms entering alliances (the partnering firms).

The academic community admits that there still exist many important research questions that must be further addressed. For instance, Gulati et. al. (2000) note that scholars have many answers to the question ‘Why do alliances and networks exist’, but fewer answers to the question ‘Do alliances and networks really matter when it comes to firm performance’ (p. 199). Furthermore Gomes-Casseres (2006) point out that ‘we know a lot about what alliances are and how they work as organizational mechanisms, but we still have much to learn about why and how they matter to competition in industry’ (p. 50).
Table 1. Examples of representative questions for five key research issues (cf. Gulati 1998).

<table>
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<th>Research issue</th>
<th>Example of research questions</th>
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| 1. The formation of alliances                       | • What are the rationales and motivations for entering alliances? (Faulkner 2003)  
• Does it make sense to use strategic alliances, as opposed to relying on internal resources, acquiring a company, or buying services and products on the market? (Bamford et al. 2003)  
• What are the determinants of the emergence and development of inter-firm coopetition? (Dagnino 2007)  
• Which firms engage in alliances and whom do firms choose as alliance partners? (Gulati 1998) |
| 2. The governance of alliances                       | • What determines the choice of a specific form among the various alliance possibilities? (Ménard 2004); What are the determinants of governance structure choice? (Teng and Das 2008)  
• What are the options for structuring the alliance, and what effects will these structures have on governance and value sharing? ((Bamford et al. 2003)  
• How are syndicated venture capital investments structured and managed? (Wright and Locket 2003) |
| 3. The evolution of alliances                        | • Which ex ante factors and evolutionary processes influence the development of individual alliances and networks? (Gulati 1998)  
• Which ex post factors can be linked to governance changes in alliances? (Reuer et. al. 2002) |
• How can partner firms manage performance and relational risks? (Das and Teng 2001)  
• How do alliances reshape competition? (Gomes-Casseres 2006) |
| 5. The performance for firms entering alliances      | • Do strategic alliances create value? (Chan et. al. 1997); Do alliances and networks really matter when it comes to firm performance? (Gulati et. al. 2000)  
• Do firms receive social and economic benefits from their alliances? (Gulati 1998) |
It is outside the scope of this paper to present a comprehensive review of the very large and growing body of literature around each of these issues. Instead we focus on a number of selected research issues and questions that we regard to be of interest when we discuss alliances in residential development in below.

It is the diversity and complexity of the phenomenon strategic alliances that challenge our ability to develop all-encompassing theories (cf. Grant and Baden-Fuller 2004). ‘The nature of links between firms can be subtle and complex…’ (Milgrom and Roberts 1992, p. 575). Indeed, Borys and Jemison (1989) state that

‘The richness of hybrid forms, combined with their distinctive duality, makes them particularly difficult to analyze…theories cast at a sufficient level of generalization…achieve generality at the expense of the richness of explanations that is required by the variety of issues raised by hybrids’ (p. 235).

Because the structure of markets, basis of competition, and institutions constantly change, organizations must constantly seek new ways to achieve comparative advantages. In the language of the rather recently developed complexity perspective, we say that there is coevolution between markets and organizations; as markets change, organizations have to adapt (see Douma and Schreuder 2008), and as organizations change so do markets. Complexity typically refers to systems in which numerous agents are interacting with each other in great many ways. Waldrop (1992, referred to in Douma and Schrueder, 2008) notices that

‘Whenever you look at very complicated systems in physics or biology…you generally find that the basic components and the basic laws are quite simple; the complexity arises because you have a great many of these simple components interacting simultaneously. The complexity is actually in the organization – the myriad possible ways that the components of the system can interact’ (p. 86).

If we accept this signification of the term complexity, it is probably quite straightforward to imagine that strategic alliances and other organizational combinations take various

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1 The advantage over competitors gained by giving consumers better value (Wortington et. al. 2005).
forms in order for organizations to adapt to the rapidly changing environmental conditions. But first we will discuss some definition issues.

2.3 Definitions of strategic alliances

In the same way as the numerous ways of theorising about strategic alliances results in fragmented theories of causes and consequences of strategic alliances, so does it affect the perception and definition of the term ‘strategic alliances’. Trott (2008) even writes that ‘research on collaborative activity has been hindered by the wide variety of different definitions’ (p. 221; cf. Nyström 2005). But this is perhaps what we should expect in a world characterized by continuous change, and with circumstances of high uncertainty and complexity. The nature of strategic alliances has changed over time (cf. Dunning 1992; Ernst 2003) and it is highly likely that it will continue to do in a rather random way in the future: it is in the nature of strategic alliances to evolve over time as companies and other organizations alter their strategies in order to adapt and create competitiveness and client value (cf. Ingirige and Sexton 2006; Inkpen 1998; Doz and Hamel 1998). This corresponds well to Mintzberg’s and Waters’s (1985) terminology and empirical observation that strategies arise in organizations in (a mix of) two ways: deliberate and emergent (cf. Douma and Schreuder 2008). However, the decisions made by collaborating firms to adopt a special form among the diversity of hybrid arrangements (e.g. joint venture) may not be random (Ménard 2004).

Typically, definitions of strategic alliances emphasize that they involve longer-term more substantial collaboration between companies, excluding casual or loose cooperative projects between companies without long-term commitment as well as projects that have a beginning and preordained end (cf. Faulkner 2003; Grant and Baden-Fuller 2004). However Peng (2006) views strategic alliances as ‘compromises between short-term pure market transactions (such as spot transactions) and long-term, complete ownership solutions (such as mergers and acquisitions’ (p. 255). Several scholars view strategic alliances as a tool for seeking and acquiring resources. Teece (1992) refers strategic alliances to ‘agreements characterized by the commitment of two or more firms to reach a common goal entailing the pooling of their resources and activities’ (p. 19). Eisenhardt and Schoonhoven (1996) consider strategic alliances as ‘cooperative relationships driven by a logic for strategic resource needs and social resource opportunities’ (p. 137). Gulati (1998)
states a relative explicit definition: strategic alliances are ‘voluntary agreements between firms involving exchanging, sharing, or codeveloping of products, technologies, or services’ (p. 293).

Ernst (2003) point out some typical major implications of getting involved in strategic alliances: ‘An alliance is a relationship between separate companies that involves joint contribution and shared ownership and control’ (p. 20). Focusing on increasing the involved companies competitive advantage, Das and Teng (2000) writes that ‘Strategic alliances are voluntary cooperative inter-firm agreements aimed at achieving competitive advantage for the partners’ (p. 33), and Bronder and Pritzl (1992) mean that a strategic alliance exists when the value chain between at least two organizations (with compatible goals) are combined for the purpose of sustaining and/or achieving significant competitive advantage (cf. Holt et al. 2000).

The definitions above mainly correspond to the language of the strategy and management literature, and above all they typically draw upon the resource-dependency theory (Pfeffer and Salaníc, 1978) and resource-based theory of firms (Penrose, 1959). Despite the abundance of definitions of strategic alliances, we can observe that a common feature is the quest for resources through the establishment of inter-organizational relations and the encouragement of collaborative behaviour (see e.g. Grant and Baden-Fuller, 2004 and references therein; Holt et al. 2000). We also notice that it is possible to have a strategic alliance without an explicit contractual agreement among organizations involved in the alliance (Trott, 2008).

In the language of transaction cost economics, strategic alliances are usually defined as ‘hybrid’ or ‘intermediate’ forms of organizational arrangements, or just ‘hybrids’ (Douma and Schreuder 2008; Grand and Baden-Fuller 2004; Ménard 2004, Williamson 1991). For instance Douma and Schreuder (2008) define a hybrid form as ‘a set of organizations such that coordination between those organizations takes place by means of the price mechanism and various other coordination mechanisms simultaneously’ (p. 339).
In other words, this general definition emphasizes that hybrid organizations are neither standard markets based on prices and explicit sales contracts\(^2\), nor standard organizations in which coordination of transactions are based on employment contracts and hierarchical orders. Markets and hierarchies are polar modes, and the hybrid mode is located between these modes (Williamson 1991). Hybrid organizations rely neither on the ‘visible hand’ nor the ‘invisible hand’, but rather employ ‘continuous handshake’ (Gerlach 1992; cf. De Wit and Meyer 2004).

2.4 Typology of strategic alliances and hybrid forms

There is a growing richness of alliance structures or hybrid forms – both intra-industry and inter-industry – that blur firm boundaries. Strategic alliances include joint ventures, syndications, licensing, franchising, supplier-buyer relationships, shared manufacturing, joint R&D, co-marketing, cross-selling, distribution agreement, collaborations and consortia.

Therefore it is not surprising that several scholars (as well as practicing executives and consultants) find it challenging to analyze collaborative arrangements. For instance Ménard (2004) acknowledges the conceptual problem of defining hybrid organizations: ‘The vocabulary itself is not stabilized. Besides hybrids, one can read about clusters, networks, symbiotic arrangements, supply-chain systems, administered channels, non-standard contracts, and so forth’ (p. 347). Furthermore, Mintzberg et al (2009) point out that

“Networks, alliances, collective strategies, outsourcing – all of this taken together is making it increasingly more difficult to figure out where one organization ends and another begins (Afuah, 2003). In other words, the boundaries of organizations are becoming increasingly blurred as networks replace rigid hierarchies on the inside and open markets on their outside” (p. 270).

\(^2\) When the price contains all the information an agent needs to base his or her transaction on, it is a sufficient statistic (Hayek, 1945, see also Douma and Schreuder 2008).
Theoretical and empirical investigations of alliances become even more challenging as we recognize that today, many companies have portfolios of twenty or more alliances – and some more than hundred (Bamford et al. 2003). Furthermore it is not surprising as “we move from the analytical world (with its sharp distinctions) to the messy real world, we often find bundles of coordination mechanisms operating together (Douma and Schreuder, p. 361).

Despite the inherent challenges and problems of categorizing different alliance forms in a structured way, academicians have proposed ways to organize and structure the large and growing collection of alliance forms. Several academicians divide strategic alliances into two broad categories: equity alliances and non-equity (contractual) alliances that do not involve equity exchange (see e.g. Peng 2006; Das and Teng 2000, and references therein). Based on this dichotomy, figure 1 below illustrates a typology of the variety of strategic alliances in which they are perceived as representing a trade-off, or compromise, between short-term, pure market transactions and long-term, complete ownership solutions (Peng 2006).

**Figure 1.** A typology of strategic alliance forms.

![Diagram of alliance forms](chart)

This illustration is derived from Peng (2006).

In a similar fashion, Oxley (1997) presents a sequence of alliance forms arranged from the least hierarchical (unilateral contractual agreements) to the most hierarchical (equity-based alliances). In the 1990s, non-equity alliances were the most common form of alliance, representing an estimated 80% of alliances created that decade (Bamford et al. 2003).

*Joint ventures* involve the creation of a new legally independent firm owned by at least two alliance partners. A joint venture could be created via greenfield (i.e. new plant, new employees, etc.) or via a divisional merger whereby the parent firms contribute an existing division to the alliance (see e.g. Inkpen and Ramaswamy 2006).

In *minority equity alliances* one or more partners take an equity position in others, allowing partners to share equity control. For instance, in cross-shareholding alliances, partners invest in each other, while one partner invests in another as a strategic investor in a strategic investment alliance (cf. figure 1). Because only (equity) joint ventures involve the creation of a new legally separate company, it is common to say that a joint venture is a ‘corporate child’ given birth by two (or more) parent firms, while a minority equity alliance can be regarded as two (or more) firms ‘getting married’, but not having ‘children’ (cf. Peng 2006). In line with the literature, we exclude minority equity investments that are purely financial investments, or arranged in order to seek protection against potential raiders, from the definition of strategic alliance (cf. Inkpen and Ramaswamy 2006; Bidault and Salgado 2001). We will below discuss various alliance objectives.

*Non-equity or contractual alliances* can include comarketing, research and development contracts, strategic suppliers, strategic distributors, and licensing, (see figure 1).

Licensing agreements (such as ‘technology for cash’ exchange), distribution agreements, and research and development contracts constitute the main forms of unilateral contract-based alliances. On the other hand, partners having sustained production of property rights characterize bilateral contract-based alliances (Das and Teng 2000). Joint R&D, joint marketing and promotion, joint production, and enhanced supplier-partnerships are examples of bilateral contract-based alliances. In other words, while the level of integration between partners is relatively low in these unilateral alliances, it is tighter in bilateral contract-based alliances (Das and Teng 2000; Mowery et al 1996).
‘Strategic networks’, ‘alliance networks’ and ‘constellations’ are other broad terms found in the literature that attempts to construct structures and typologies of alliance forms. Not unexpectedly, the definitions of these terms are not always clearly spelled out. For instance, Gulati (1998) and Gulati, Nohria and Zaheer (2000) encompass a large number of interfirm relationships like joint ventures, long-term buyer-supplier partnerships in the term ‘strategic networks’, other make a clear distinction between the terms ‘strategic alliances’ and ‘strategic networks’. Furthermore Das and Teng (2002) point out that Gulati (1998) in a review of the literature on alliances and networks does not discuss the differences between these two kinds of interfirm relationships.

On the other hand, other scholars define strategic alliances, and alliance or strategic networks in a more restrictive way in order to differentiate between them. For instance Peng (2006) simply defines strategic networks as ‘strategic alliances formed by multiple firms to compete against other such groups and against traditional single firms’ (p. 256), as opposed to alliance relationships between two firms. Indeed Peng (2006) use the terms ‘strategic alliances’ and ‘strategic networks’ to refer to cooperative interfirm relationships.

In the view of Das and Teng (2002), ‘an alliance network is simply a collection of several alliances, whereas a strategic alliance is one cooperative arrangement involving two or more firms, such as in equity joint ventures, joint R&D, and joint production. A strategic alliance is a single arrangement that includes two or more firms, and an alliance network includes several alliances…Thus, a network consists of at least two alliances, each with two partners or with multiple partners’ (p. 446).

The term ‘constellations’ creates yet another level of confusion. While some scholars avoid differentiating between the terms ‘constellations’ and ‘networks’ (as defined above) in a clear-cut way (see e.g. Gomez-Casseres 2006 and references therein; BarNir and Smith 2002), other advocate a clear distinction between these terms, typically based on the number of firms constituting an interfirm collaboration establishment. For instance Das and Teng (2002) argue that ‘whereas alliance networks are collections of alliances, constellations are a particular kind of strategic alliance. By definition, constellations are alliances formed by at least three partner firms…’ (p. 446). Thus Das and Teng (2002) make a clear distinction between dyadic (two-way) alliances and multiple-partner (at least three firms) alliances. The current status of the instability in the language is further
exemplified by the number of other terms akin to the term constellations: multilateral alliances (Doz and Hamel 1998), Peng’s (2006) definition of strategic networks (see above), and alliance groups (Gomes-Casseres 1994).

Indeed Das and Teng (2002) argue that research on multi-partner alliances has been hindered by the absence of a clear distinction between two-party and multiple-party alliances: despite the presence of many significant differences between dyadic alliances and alliance constellations ‘research attention on constellations has been sporadic, as most researchers have not regarded constellations as a distinctive form of alliance’ (p. 446). Das and Teng (2002) find support for this view in the game-theoretical article by Hwang and Burgers (1997), who show that games played by multiple parties (as in constellations) are fundamentally different from the games played by two parties (as in dyadic alliances). Das and Teng (2002) illustrate the differences among dyadic alliances, alliance constellations, and networks using an illustration similar to figure 2 below.

**Figure 2.** Dyadic alliances, constellations (multiform alliances), and networks. There are five individual firms (A, B, C, D, E). The dyadic alliance DA1 is formed by the firms A & B, and the second dyadic alliance DA2 is formed by the firms B & C. The alliance constellation AC is formed by four firms (A, C, D, E). All these entities and relationships together represent the network (A, B, C, D, E, DA1, DA2, AC).

This illustration is adapted from Das and Teng (2002).

The numerous and fragmented definitions of ‘strategic alliances’, ‘strategic networks’ and a number of other terms belonging to them yielded by the literature has created a situation
in which authors commonly establish definitions that fit the purposes and context of their papers and discussions. In a similar fashion, to avoid confusion and for the purposes of this paper, we use ‘strategic alliances’ as the generic term for all types of contractual and equity-based long-term cooperative inter-firm relationships.

We also recognize the term ‘alliance portfolio’ which considers an alliance network from the perspective of a focal company. Typically, scholars use this term when they study the strategic management of a focal company’s multiple alliances: a firm’s alliance portfolio strategy (Gomes-Casseres 1996; Hoffman 2007). Indeed instead of relying on single high-profile alliances, firms use several coordinated alliances that provides access to required external sources (Gomes-Casseres 1996). In other words ‘what really matters is not the success or failure of a single alliance but that the company will reach its strategic goals with the bundle of its alliances, thus placing the structure and strategic orientation of the whole alliance portfolio at the centre of interest’ (Hoffman 2007, p. 828).

3 Strategic considerations underlying alliance formations

3.1 Introduction

The diversity of strategic alliance definitions and alliance types mentioned above indicate that there should exist a number of underlying strategic aspects that firms take into consideration when they decide to engage in collaborative activities. Of particular interest in the early stages of alliance formation is to first identify who the potential alliance partners are (section 3.2), and second, to discuss the motivations behind why a firm should engage in alliance activities (section 3.3). Naturally these two issues are interrelated.

3.2 Who are potential alliance partners?

Figure 3 below shows the eight major groups of external parties that constitute potential alliance partners to a firm (see De Wit and Myer, 2004). A distinction can be made between a firm’s alliances with industry and contextual actors.
3.2.1 Alliances and relations with industry actors

As noticed above many firms engage in a number of alliance activities. The four major categories of alliances and relationships between a firm and other industry actors are (1) upstream vertical (supplier) alliances; (2) downstream vertical (buyer) alliances; (3) direct horizontal (industry insider) alliances; and (4) indirect horizontal (industry outsider) alliances (see e.g. Porter, 1980; Reve, 1990).

In the input side, a firm may engage in upstream vertical strategic alliances with suppliers of a vast number of production factors such as land, raw materials, capital, labor, technology, entrepreneurship, and knowledge and information. The suppliers can either be the actual producers of the inputs, or an intermediary such as brokers, agents and distributors.
On the output side, a firm can engage in downstream vertical (buyer) alliances with its buyers or customers. The buyers can either be the actual and final users of the firm’s output, or intermediaries trading the output such as brokers. A firm that engages in direct horizontal (industry insider) alliances collaborate with rivals and competitors in the same industry (they produce similar outputs). A firm can establish alliance with companies outside its industry, which is referred to as indirect horizontal (industry outsider) alliances.

3.2.2 Alliances and relations with contextual actors

Besides the industry-based relationships, a firm can establish alliances or at last loose relationships with a large number of contextual actors in which institution-based considerations are taken into account. Institutions that govern economic activities and strategic alliance considerations include both formal and informal constraints supported by regulatory as well as normative/cognitive pillars (Peng 2006). Following four broad categories of contextual actors can be identified - the so called SEPTember distinction (see De Wit and Meyer 2004):

- Socio-cultural actors (e.g. media, communities and opinion leaders),
- Economic actors (e.g. unions, employers’ federations, bank associations, tax authorities),
- Political and legal actors (e.g. governments, political parties, regulatory bodies, lobbyists), and
- Technological actors (e.g. universities, research institutes, standardization bodies, patent offices).

In reality, the distinction between different relations between a firm and other industry actors or contextual actors, as well as the distinction between industry and contextual actors, may be blurred and thus not as clear as described above.

3.3 Why do firms engage in alliance formations?

A basic reason for a firm to engage in collaborative activities is that it assumes a larger benefit from the strategic alliance than if it had proceeded on its own. Naturally, strategic alliances cannot be one-sided, instead mutual value creation should be the objective of all alliance partners (cf. Inkpen and Li, 1999).
Although there may exist an infinite number of reasons, ranging from those very clear and open objectives to those that are more loosely defined, or even including hidden agendas, it has been argued that strategic alliances play a critical role in enhancing the competitive advantage of firms (De Wit and Meyer, 2004; Doz and Hamel, 1998; Kale et. al., 2001; Kogut, 1989). Therefore we first briefly state some general key competitive advantage issues that are largely based on the works of Porter (section 3.3.1). Next we discuss the role strategic alliances may play in increasing a firm’s or any other type of organization’s (e.g. local government or municipality) competitive advantage (section 3.3.2). Again, we have in mind that the debate on this issue within the field of strategy is far from being concluded (De Wit and Meyer 2004).

3.3.1 Some key competitive advantage issues

According to Porter (1985) ‘the essence of strategy formulation is coping with competition’. Furthermore the rules of competition are according to Porter embodied in five competitive forces: the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among existing competitors. These five forces influence prices, costs, and required investments of firms in an industry, and thus determine return on investment and industry profitability.

Porter (1985) argues that the fundamental basis of firm’s above-average performance in the long run within its industry is sustainable competitive advantage, and that a firm can possess two basic types of competitive advantage: low cost or differentiation. Porter (1989) presents a real estate development example for each type: a real estate developer that has a cost leadership is able to finance and develop a project and deliver it at a lower cost which allows the developer to get a higher margin at prevailing price levels. A differentiation strategy allows a real estate developer to be rewarded for producing developments with for instance unique design, new conceptions of projects, or better utilization of the land, that makes it possible for the developer to charge a premium price. Firms that try to achieve both cost leadership and differentiation may fail to achieve any of them and therefore become ‘stuck in the middle’, which in turn may cause below-average performance. However firms may succeed in achieving cost leadership and differentiation simultaneously. Such firms will be highly rewarded since the benefits from differentiation and cost leadership are additive (premium prices plus lower cost).
A firm that competes by offering products at lower costs than its competitors, or by offering products that the customers perceive as more valuable than the competitors’ products has access to certain resources that its competitors lack. Indeed according to the resource-based view of the firm, a competitive advantage is always based on the possession of, or at least the access to, certain resources, capabilities and skills that are valuable, rare, not easily copied (in-imitable) and non-substitutable (Douma and Schreuder 2008, Trott 2008 and references therein). Resources, according to the resource-based view of the firm, include human, financial, tangible (such as plants, equipment, buildings) and intangible resources (such as patents, know-how, brand names, experience and organizational routines) (Douma and Schreuder 2008). For instance, a firm may attain cost leadership through large-scale production (economies of scale) or through experience.

To summarize, in order for a firm to create competitive advantage, its business system must create superior value for buyers. In order to reach this, De Wit and Meyer (2004) state that alignment between the following three elements of a firm’s business system must be achieved:

- **Product offering**: An attractive product needs to be targeted at a particular segment of the market and have a superior mix of attributes (e.g. price availability, reliability, technical specifications, image, colour, taste, ease of use, etc.).
- **Activity system**: A successful firm must have the capability to perform the necessary value-adding activities (e.g. R&D, production, logistics, marketing, and sales) in an effective and efficient manner.
- **Resource base**: A successful firm must have access to necessary resources (e.g. know-how, patents, facilities, money, brands, and relationships).

### 3.3.2 The role alliances may play in order to increase competitive advantage

Environmental uncertainty (e.g. globalization for markets, aggravated economic cycles of boom and recession, market regulations and deregulations, financial crisis, volatile raw material prices and interest rates) has increased most firms’ strategic vulnerability. Due to factors such as globalization and emerging technologies, it is increasingly difficult for firms to obtain sustainable competitive advantage in rapidly changing environments. The increasing environmental uncertainty constitute a major underlying reason for why many
business firms establish strategic alliances that can serve the strategic objectives of partner firms (Doz and Hamel, 1998).

Peng (2006) presents a model of strategic alliances and networks that is based on following three perspectives on strategy:

1. Resource-based considerations, and
2. Industry-based considerations,
3. Institution-based considerations.

Resource-based considerations

The resource-based considerations involve accessing essential and valuable resources from another party, and reducing risk by sharing it. These two aspects constitute two fundamental reasons behind strategic alliances (see e.g. Bamford et al 2003; Das and Teng 2000; Dyer and Singh 1998; Grant and Baden-Fuller 2004). In fact, resource-based aspects are many times put forward as being the most critical and important reasons for inter-firm cooperation activities.

Alliances help to bridge the gap between the firm’s present resources and its expected future requirements (Hoffman and Schlosser 2001). Alliances provide partners with opportunities to access complementary assets like skills and know-how, ideas and technology that they can use to develop and commercialize new products and services (Ernst 2003; Hamel 1991). Learning-oriented alliances may also involve the joint pursuit of new know-how (De Wit and Meyer, 2004). Other complementary assets can be experience, capital, raw materials, production capacity, products, or manpower (Faulkner 2003). In fact multipartner alliances have emerged in technology-driven industries in response to shortened product cycles, increased demand for research and development investments, need for product interoperability, and high levels of technical risk and market uncertainty (Lavie, Lechner and Singh 2007).

For cooperation to be appropriate, the partnering organizations must be able to provide some resource the other needs, or reach a critical mass together that they each do not reach alone. If the needs are not reciprocal, then the best course of action is to buy the necessary resources, or if appropriate, buy the firm possessing it (Faulkner 2003). Faulkner states four forms of resource dependency that provide motivations for cooperation (p. 130):
• Access to markets
• New technology
• Access to special skills
• Access to raw materials.

Enhanced risk management is another important area. The business and strategic risks that companies face stem from uncertainty in their market, technological, financial, regulatory, and competitive environments, to name a few. First, involving two or more partners in a risky project reduces the exposure that each partner has to face. Furthermore, the typical feature of partial commitments involved in alliances may leave a company with resources to invest in other projects, including other alliances, thus spreading and diversifying the risk.

Alliances also make it possible to buy options on the future. This real option creates value for at least one of the involved companies through the flexibility the option offers to act in the future as new information and events unfold (Kogut, 1991). For instance firms that are interested in acquiring other companies, exploring new markets or technologies, Indeed companies can use an alliance to stepwise and sequentially increase their investments and partial commitments in a risky project should favourable events unfold, or they may use the option to stop investing or scaling down investments in the project. For instance, because acquisitions, which together with mergers should be viewed as an alternative to strategic alliances and organic growth as a means of achieving corporate growth (Schoenberg 2003), are costly and risky. Alliances allow the potential acquirer (the bidder) to sequentially increase their investment (e.g. by buying shares in the target company) should they decide to pursue the acquisition (Peng 2006). The higher the uncertainty in the environment about future events and information, the higher the value of the flexibility and thus this real option (Schoenberg 2003).

The flexibility of alliances as compared to integrated firms is yet another argument in favor of alliances. Different alliance types enable ‘cooperative enterprises’ to grow or decline flexibly, to match environmental uncertainty:

‘The advantages of alliances and networks over integrated firms are in the areas of specialization, entrepreneurship, and flexibility of arrangements, and
these characteristics are particularly appropriate to meet the needs of today’s turbulent and changing markets’ (Faulkner 2003, p.128-129).

The current financial and economic crisis illustrates this clearly and can be an event that leads to the creation of new constellations of actors in the housing production process.

Industry-based considerations

The industry-based considerations can be closely related to the dynamics of the five forces of competition. Table 2 below summarizes some examples of industry-based reasons behind why a firm may be willing to engage in horizontal and vertical alliance activities.

Table 2. Examples of reasons behind why a firm may be willing to engage in horizontal and vertical alliance activities with other actors in the same industry: industry-based considerations.

<table>
<thead>
<tr>
<th>Type of alliance with industry actor</th>
<th>Examples of industry-based considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Upstream Vertical Alliances</td>
<td>• Turning potential competitors into partners (Peng, 2006).</td>
</tr>
<tr>
<td>(Alliances with suppliers)</td>
<td>• Fewer number of key suppliers for longer terms (Dyer, 1997).</td>
</tr>
<tr>
<td></td>
<td>• Key suppliers become more willing to make specialized investments to produce better inputs (Subramani and Venkatraman, 2003).</td>
</tr>
<tr>
<td>2. Downstream Vertical Alliances</td>
<td>• Turning potential competitors into partners (Peng, 2006).</td>
</tr>
<tr>
<td>(Alliances with buyers and distributors)</td>
<td>• Reaching more customers (Peng, 2006).</td>
</tr>
<tr>
<td>3. Direct Horizontal Alliances</td>
<td>• Tying up competitors (Peng, 2006).</td>
</tr>
<tr>
<td>(Alliances with competitors or industry insiders)</td>
<td>• Combining forces to enter new and unknown markets at a lower cost or risk (Peng, 2006).</td>
</tr>
<tr>
<td>4. Indirect Horizontal Alliances</td>
<td>• Unlocking market opportunities for substitute products and services, diversifying into another industry (De Wit and Meyer, 2004).</td>
</tr>
<tr>
<td>(Alliances with complementors or industry outsiders)</td>
<td>• Assisting or attempting to block the entry of industry outsiders (De Wit and Meyer, 2004).</td>
</tr>
</tbody>
</table>

The content in this table draws heavily from Peng (2006).
Institution-based considerations

Alliances may also provide access to external legitimacy and status similar to that provided legitimating institutions (see Baum, Calabrese and Silverman 2000 and references therein). This is an example of institution-based considerations.

3.4 Factors affecting alliance outcomes

Although strategic alliances have become a popular tool, many of them fail to live up to expectations (Kale et. al., 2001, 2002). The literature has identified a large number of various factors that might affect alliance outcomes. Although environmental factors such as industry demand shocks and changing industry concentration levels constitute important factors affecting alliance outcomes (see Reuer et. al., 2002 and references therein), the literature has emphasized partner characteristics and relationship factors.

Examples of partner characteristics are dedicated alliances functions (Kale et. al., 2001; 2002), and prior experiences with collaboration (Berkema et. al., 1997). The concept of trust is the most highlighted relationship factor in the literature (see Krishnan and Noorderhaven, 2006, and references therein). Faulkner (2003) emphasizes that commitment (e.g. reflected by having dedicated alliance functions) and trust are the two key factors for achieving successful alliances.

Thus, by establishing alliances, firms seek increasing business performance, however many times at the cost of increasing relationship risks. In other words, the partners of an alliance have to deal not only with the uncertainty in their environment but also with the uncertainty arising from each other’s behaviour (Harrigan, 1985, referred to in Krishnan and Noorderhaven, 2006). Furthermore, Williamson (1985) points out that an important difference between single-firm strategies and collaborative strategies is the presence of behavioral uncertainty or uncertainty regarding the behavior of exchange partners (Williamson, 1985).

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3 Gulati et. al., (2008) propose that prior experience with the same partners, i.e. ‘partner-specific experience’, provides greater benefits than ‘general partnering experience’ that includes all prior alliances with any partner.
The importance of trust and commitment in construction alliances is highlighted in Beach et al. (2005), Wilkinsson and Reed (2008) and McGeorge and Palmer (2002).

The business-oriented best practice literature has also recognized the importance of commitment and trust as foundation of successful collaboration. For instance, good communication in the early phases increases the likelihood that the alliance partners will be able to structure the expected payoffs of a development project such that they align the developer’s interest with those of the alliance partners. To meet the challenge for the alliance partners to provide an estimate of what they require as a compensation for the risk each actor take, good communication and exchange of knowledge are important elements of successful alliance.

3.5 Potential Benefits of alliance activities in the construction industry

In construction, a distinction is usually made between long-term (strategic) partnering and short-term partnering. Strategic partnerships typically involves long-term co-operation intended to include several projects and search for long-term benefits, while short-term or project partnerships are created and sustained for the life of a project, focusing on short-term benefits (See Beach et. al., 2005 and references therein). The examples we have presented above may start as project partnerships, or even as a traditional market transaction. However, it is likely that a sequence of successful short-term partnerships gradually may change to fully-fledged long-term strategic alliances. In other words, short-term alliances may take the leading role in promoting close relationships in the construction industry.

Clearly a large number of firms invest in alliance activities. We have seen that firms may formulate alliance strategies based on a set of resource-based, industry-based, and institutional-based considerations. It is thought likely that the potential benefits of alliance activities presented above may be valid for the actors involved in housing construction. Cheng et al (2004) suggest a number of potential benefits of strategic alliances in construction (see table 3 below).
Table 3. Potential benefits of strategic alliance in construction

| Project level benefit          | Reducing risk                                    |
|                              | Improved quality                                 |
|                              | Reduced cost                                     |
|                              | Completion on time                               |
|                              | Reduced rework                                   |
| Business level benefit        | Increased profits                                |
|                              | Increased market share                           |
|                              | Enhanced competitive position                    |
|                              | Competitive bidding                              |
|                              | Broadened client base                            |
| Corporate level benefit       | Cost effectiveness                               |
|                              | Increased labour productivity                    |
|                              | Improved efficiency                              |
|                              | Increased opportunity for innovation             |
|                              | Continuous improvement of quality, products and services |
|                              | Increased cultural responsiveness                |

This table is adapted from Cheng, Li, Love and Irani (2004)

In a similar way, Egan (1998, referred to in Beach et al., 2005) present a number of tangible benefits of alliance activities in the construction industry, such as a reduction of capital costs (excluding finance), reduction in construction time as well as an increase in the number of projects that are completed on time.

3.6 Summing up

As we have noted above our understanding of the phenomenon strategic alliances is incomplete and fragmented. However we believe that enough knowledge exist in this area so it can yield interesting guidance and new frames of references regarding alliance strategies in the real estate development business. Different type of alliance constellations between the many actors that are involved in the housing production process can help the alliance members to cooperate better and also to compete better (cf. Gomes-Casseres 2003), such that the efficiency of housing production will increase, e.g. measured as both the speed of adjustment of supply to increases in demand, and the relationship between capacity utilization and profitability (cf. Porter 1985).

Continuing long-term collaborative relationships that last for many development projects might facilitate the partnering organizations’ quest to reach sustainable competitive...
advantage. Note particularly though that we should not judge the success or failure of an alliance formation ‘by its longevity – a common mistake when evaluating strategic alliances – but by the shifts in competitive strength on each side’ (Hamel, Doz and Prahalad 1989, p. 1).

From the perspective of housing development these more specific advantages of forming alliances can be condensed into the following two competitive aspects:

- The alliance can lead to cost leadership
- The alliance can lead to advantages in the area of differentiation, creating a more competitive product.

Finally, alliances have played important roles in a large number of challengers making successful attacks against industry leaders (Porter, 1985). Thus alliances can be an interesting tool to increase competition in the housing construction industry.

4. Some interesting non-financial alliances and alliance possibilities in the development process

4.1 Developer, contractor, subcontractor and suppliers

A major alliance strategy challenge is to identify combinations of functions and actors in which there exist good reasons for establishing strategic alliances. The link between an actor’s competitive strategy and alliance strategy may indeed be very complex. The models developed in Warsame (2009) can be used as a framework for discussing alliance formation between developer, contractor and subcontractor and various suppliers of goods and services to these. Of the models of the supply structures developed by Warsame the three models described below seems to be the most interesting starting points.

In his first model (see figure 4 below) the owner/developer/contractor is one integrated firm and this can historically have arisen through mergers and acquisitions. In Sweden there are large private companies like JM, PEAB, Skanska and NCC who have a structure like this, and they have also control over a number of firms supplying construction materials. Few strategic alliances are necessary in cases like this, but as Warsame
underlines it is a structure that has several weaknesses that reduces its competitiveness. The integrated firm have more problems in adjusting to changes in the level of production and it does not put each part of the organisation under continuous competitive pressure.

**Figure 4. Model 1 ODC:** Integrated Owner-Developer-Contractor

![Figure 4. Model 1 ODC](image)

In the following models the developer and contractors are separate companies, and here the possibility of strategic alliances are obvious. In model 2 (see figure 5) there are still large integrated contractors, while in model 3 (see figure 6) specialized subcontractors are used.

**Figure 5. Model 2 ODC:** Owner-Developer and separate Contractors

![Figure 5. Model 2 ODC](image)

**Figure 6. Model 3:** OD-SpCs

![Figure 6. Model 3](image)
In both these cases the possibility of strategic alliances between developer and contractor are obvious. In the private sector there are a number of examples of developers that have more long run but informal alliances with a contractor or a number of subcontractors. An example in Sweden that has gotten a lot of attention is the company BoTrygg. Furthermore, Psilander (1999, 2004) describes a number a smaller developers that have informal alliances with subcontractors.

In the public sector there are possible legal problems with forming strategic alliances as it might conflict with public procurement rules, but there have been some cases where options have been included in housing construction contracts (see Warsame 2006). This means that if the parties are satisfied with the work, then the next project will be built by the same contractor, without any further procurement. It is however unclear how long this type of contract can be extended.

Strategic alliances might also arise between contractors and subcontractors and suppliers of materials and parts. Warsame presents the following model 4 (see figure 7) that describes a rather typical situation in Sweden.

**Figure 7. Model 4: Owner-Developer and a separate Contractor contracting with subcontractors**

 Warsame also notes the existence of cooperation between subcontractors that are examples of a resource pooling and risk management perspective. Typically when a subcontractor wins a large order, they do not have the personnel needed. Personnel are then hired from
the competing firms that lost the order. This is not regulated in a formal way, but it seems to be an established practice and of course logical from an efficiency perspective.

Different strategies have also been observed in recent years concerning how to "industrialize" the housing construction process. NCC tried and failed with a strategy with a wholly owned subsidiary, while Skanska seems to be more successful with its strategy where the core was to form alliances with a small number of firms that quickly can deliver custom made parts. An integrated IT system for design and production is one important part of this alliance.

Most of the alliances described above focus on the production process, but alliances can also involve the design process. In the housing sector architects are then one important group and there are problems from a risk, resource and quality perspective for a developer to have their own staff of architects. Hiring external architects on a short run basis can also be problematic as it is important that the architects know the intentions of the developers and have incentives to follow them. Strategic alliances are then a natural solution and an example is the case recently reported in the Swedish media where NCC and the large architect firm Tengbom announced an alliance. NCC especially mentioned that Tengboms had good knowledge about 3D-models that make it possible to integrate design and production. NCC further mentioned that they plan to write similar partnering contracts with a small number of other architect-firms. The stated aim is both to increase quality in terms of functions and aesthetics and to be more cost-efficient. Tengbom's director underlines that continuity in the relation creates a lot of opportunities.

4.2 Alliances involving a local government

Another interesting type of alliances is those that involve a local government. A first type of alliances focuses on increasing the attractiveness of the whole city.

4.2.1 Alliances to make a city more competitive

The housing market is a local market and the products can in practice not be moved to other cities. This means that one important motive for forming alliances in to increase the competitiveness of the city or region as a whole.
It is reasonable to assume that growth of the municipality (e.g. measured as increase in population, employment, number of firms locating) constitute a common overall objective for the local actors within a municipality (or local city), e.g. the municipality itself, landowners, and developers. All these actors will in some way gain from growth. Firstly, when municipalities grow, land values are likely to increase, especially if the growth takes place within given municipal boundaries, and market forces drives land to be used efficiently in line with the concept of highest and best use (cf. Pyhrr and Cooper 1982). Secondly, increasing population will sooner or later increase the demand for new housing. This should in a positive way affect the core business for developers, to produce new houses. Finally, the municipality with all its local public authorities may have advantages economically and politically from a growing municipality.

In fact, we may consider a municipality (or city) to be a firm, and all other agents who locate their activities in that city (including households who choose to reside in the city) to be its customers. Indeed, the idea of creating competitive advantage for cities (or municipalities) that are facing inter-city competition has emerged in the literature lately. Cities compete with each other on different levels. Major world cities compete at a global level, cities within a country compete with each other, and municipalities are engaged in competition at a local level (cf. Lever and Turok, 1999). In the same way as firms compete to sell products, Collins (2007) suggests that cities compete with each other for additional local economic development opportunities made possible by:

- Attracting and retaining people (who provide a local tax base and who may trigger and create enterprise, wealth and more jobs).
- Acquiring central government sourced funds (comprising operating subsidies and investment funds).
- Attracting and retaining private sector investment (p. 1).

If these local economic development opportunities constitute a common interest among municipalities, landowners and developers, then they should be able to arrange collaborative arrangements to increase the municipalities’ competiveness. In fact, these actors may many times need each other to succeed in reaching their . As noted, alliances may be powerful tools not only to pool resources, including networks, but also to create skills and learning, which constitute the building blocks of future competitive advantage (Bamford 2003). In fact several studies of strategic alliances have identified the sharing of
knowledge (including technology, know-how and organizational capability) as their dominant objectives (see Grant and Baden-Fuller 2004, and references therein). Lind (2002) discusses how competitive pressure has lead to more co-operative forms of physical planning and forced various actors in a city to work with informal alliances.

In an analysis of English urban regeneration policy and practices since 1991, Oatley (1998) argues that the pressures of inter-urban competition have lead local partnerships to concentrate on economic investment at the expense of social expenditure. Cochrane (1993, p 95, quoted in Oatley 1998, p. 155) summarises the accentuation on the enterprise state and partnerships between the local government and business organizations that:

Local government needs to be more business-like, literally more like a business, and not only in the field of economic development. They want to see a change in focus – what they call a move beyond welfare – in which local well-being becomes defined as economic success, based on close liaison (or partnership) between council and business: ‘to work it requires the whole of the council’s approach to be planned to achieve the required economic objectives and to balance these with wider service demands’ (Bennet and Krebs, 1991, p. 177).

Florida (2005) develops a creative capital theory of regional development, which suggests that creative people perhaps are the driving force in regional economic growth. According to this perspective, talent represented by knowledge and creativity, is the key factor of inter-city and inter-region competition. Therefore the fundamental questions Florida (2005) sought to answer is ‘Why do creative people cluster in certain places? In a world where people are highly mobile, why do they choose some cities over others and for what reasons?’ (p. 33). Florida argues that the rise of the creative economy radically alters the ways that cities and regions establish and maintain competitive advantage. The key to success in the industrial age and during the mass production era was the overall costs of doing business, manifested by firms’ access to natural advantages in resource endowments, transportation access, the cost and productivity of labour, and by reducing overall cost. Today in the era of the creative economy, it is the ability to generate, retain, and attract talent that creates regional advantage:

Regional advantage comes to places that can quickly mobilize the talent, resources, and capabilities required to turn innovations into new business
ideas and commercial products. […] This is particularly true because creative workers are extreme mobile and the distribution of talent is highly skewed. […] In this regard, quality of a place, a city or region, has replaced access as the pivot point of competitive advantage (p. 50).

This discussion suggests that the local actors should seek to first identify key place-based quality factors that may play a role in creating an environment that can attract, and retain talent or human capital, and next, how to pool production resources necessary to produce the key factors identified. The first step naturally involves producing knowledge about factors that can increase the attractiveness of an area. This issue may require the joint effort of local public authorities, developers, landowners and all other actors. In this regard, strategic alliances between key actors may foster local city or regional development strategy by facilitating the information and knowledge flow between partners. Indeed, an alliance’s raison d’être is a market driven response to change, globalization and aims to achieve customer focus.4

Thus a crucial knowledge issue concerns how each party form judgements about future demand of housing in the municipality. Traditional market analysis tries to give an answer to questions like how many housing units that should be produced in a specific area, or for which specific target group. However, markets are complex and many times market analysis tools may just not be good enough to give accurate forecasts of future housing demand. An alliance can facilitate the way a municipality, landowners and developers share information and knowledge regarding methods and assumptions underlying market analysis studies. A market analysis tool that incorporates the latest information from the partners can help the alliance and its partners to adjust quickly to changing market conditions.

4 In an interesting debate article in the Swedish daily news paper Dagens Nyheter (published 2009-06-30), the leaders of the Södertälje municipality, the Södertälje municipal company Telje, and the private construction company Peab, announce that they will establish a joint venture company. They argue that joint venture’s aim is to both increase housing construction, and to mitigate the problems with increasing unemployment in the municipality (www.dn.se/opinion/debatt/kommuner-och-foretag-bor-ga-ihop-och-skapa-jobb-1.901263).
What makes market analysis for housing production especially challenging as compared to other investments is the duration; both the physical and economic life cycle of housing investments go beyond most other long-lived assets. Yet another feature that makes demand analysis of homes more difficult is the connection between the building itself and its surroundings with all its natural and manmade amenities. Combined, these two factors simultaneously lay stress upon our ability to make reliable market analyses, and challenge our ability to make such reliable forecasts of future demand and attractiveness. As time goes by, economic conditions change, and under new economic conditions, ‘an originally satisfactory building may require significant redesign and reconstruction’ (Bon 1989, p. 10).

The Swedish “million program buildings”, manifested by the very large investments in mainly multifamily dwellings from 1961 to 1975, represent good examples of the challenges that local actors face, as well as an example of our limited ability to foresee the future consequences of our actions, an important consequence bounded rationality’ (cf. Bon 1989). These residential investments may be regarded as representative for the mass production era as described above. Today, many of these million program-housing areas constitute one of the hardest challenges for municipal and private real estate owners, developers, contractors, households and other actors.

It is the role of strategic alliances between the municipality and other actors (e.g. landowners developers, architects, builders) to increase the likelihood that housing investment decisions have the highest likelihood to yield long-term economic success, which in turn may result in new profitable development projects. One important scope of an alliance is to make use of different actors’ tacit knowledge. Tacit knowledge combined with other type of knowledge will though still be incomplete and cannot remove genuine uncertainty about the future. However, ‘Although unknowable, the future is not unimaginable’ (Lachmann, 1978b, p. 3, quoted by Bon, 1989, p. 9). Furthermore, Lachmann (1977, p. 264, 1978b, p. 16, referred to in Bon, 1989) argues that ‘economists should acquire the skills needed to classify, describe and compare many possible situations’ (p. 108). In other words, a primary task of an alliance could be to analyze and focus on what can happen in different situations.
Alliances can also involve other actors such as real estate brokers. For instance a broker and the alliance may engage in a relationship in which the broker delivers the very latest market information. The alliance will in turn hire the broker to market and sell future developments.

The type of alliances described above can also be seen as a case of joint marketing, which for instance may involve the partnering organizations’ marketing activities, and this is another popular objective in alliances (Teng and Daz 2008; Buckling and Sengupta 1993).

4.2.2 Alliances related to more specific projects

A local government has legal and political resources, but might lack knowledge and economic resources. This creates, as discussed from a Swedish perspective in Cars (1992), a situation where an alliance between the public actor and one or more private actor around a development project. The local government reduces private sector risks related to various permits and gets influence over the use of the economic resources in return. In most cases there is an explicit contract concerning the specific project, but a more informal alliance between the actors can exist in the background.

The same situation can be observed in a number of Swedish Public Private Partnership projects. Andersson (2008) describes several such projects, e.g. sport arenas and concert buildings, and in most of the cases there was a combination of formal contracts and a broader informal alliance to create advantages for both parties.

Brunes and Lind (2008) describe similar cases where it is very clear that the role of forming the alliance is related to risk reduction and pooling of knowledge. One explicit motive for selling a public building and then renting it back was that major investments were needed and that the local government were afraid of cost overruns.

Co-development between different types of developers is yet another way to combine knowledge and other non-cash resources (Behrens 1990). A joint venture between a large national developer and a smaller local developer can be used to match different resources. For example, a local developer provides with project site selection and local market conditions expertise, contact with local public authorities and private actors, while the
national developer contributes with architects and general contractor arrangements, and also arranges financing with a national bank.

Leinberger (2007) discusses the need for different sources and providers of long-term equity in development finance of walkable, mixed use neighbourhoods, which involve several projects (housing, shopping, school, employment, recreation etc). Leinberger (2007) proposes for instance that professional fees and parking may constitute non-cash sources of equity. Professional fees from architects, lawyers and other professionals can be deferred or even excluded for ownership in the development project.

4.2.3 Alliances related to land ownership

The early stages in the development process have their special risks which create the need for more complex contracts and different types of alliances. The simplest market based co-operations are an option contracts that gives the developer the right to buy land if the necessary permits are given. The price that will be paid for the option can be related to the number of houses that the developer builds and contracts where the risk is split to a higher degree is also possible, e.g. where the land-owner is paid a certain share of the final price.

In Sweden many local government have been large land-owners, and this has opened up the possibility for many formal and informal alliances. Being both land-owner and responsible for planning permits have also strengthened the bargaining power of the municipality. One interesting type of formal risk sharing is land leasing where a market based fee is paid. If the market value in the area goes up then the municipality as a land-owner will get higher revenue. Mandell (2002) analyse this type of contract from an incentive perspective: that the local government keeps the land means that they have an incentive to keep up the local infrastructure and this in turn reduces the risk for the home-owners.

In many municipalities the housing developers know that if they do not produce good enough houses, the possibility to get access to land owned by the municipality in the future is reduced. There are often an informal alliance between the local government and a small number of developers that has produced good areas in the past and that can get permits easier than other developers. Building up such a reputation can also be seen as a way to reduce the future risks concerning access to land.
4.2.4 Final comments on alliances involving the local government

An interesting area of future research is how public procurement rules affect the possibilities to form alliances involving local governments. There is a very fine line between giving advantages to developers that have a good reputation and giving advantages to "well connected" developers. Nyström (2007) discusses how project partnering can be used in combination with public procurement, but more long run and formal alliances seem different to combine with the EU public procurement rules. These rules might also limit other types of public-private partnerships and actually reduce the competitiveness of regions and perhaps also countries if they limit the possibilities of alliances that pool resources and distribute risk in a rational way.

5. Some interesting financial alliances for housing development

5.1 Financial alliances in housing construction – conceptual framework

Essentially, a developer needs financial resources for land acquisition, perhaps after taking an option to buy the land from the land owner (see above), to develop the land and install utilities, and to build homes for sale or rent. Those developers that plan to own and manage new developments also need to seek longer-term or permanent financing in addition to land acquisition and shorter-term construction financing.

For a number of reasons (e.g. credit rationing and other market imperfections), the supply of capital to housing construction at reasonable costs can fall short of the amount needed to meet the level of housing demand. Developers may not be able to raise enough external debt and equity capital to finance land purchases and other construction activities in order to undertake projects with an otherwise expected net positive financial return. Therefore it is interesting to discuss different ways a developer’s need for capital can be reduced, without giving up the initial goals of the project, such as level of quality, size and time to completion.

In the spirit of this article, we present following two alliance strategies a developer can employ in order to reduce the need for capital:
1. By establishing alliances with non-financial actors (e.g. architects, land owners, contractors, brokers, buyers), and
2. By establishing alliances with financial actors (i.e. suppliers of capital).

Both these strategies aim at reducing the amount of money a developer has to invest in a development project, and/or reducing the developer’s need for external capital. Furthermore, risk sharing can many times be considered to be inherent in alliance activities. Indeed, the driving force for establishing alliances such as real estate joint ventures is not to increase profit potential but rather to achieve risk reduction (Behrens, 1990). In both cases the alliance can be either short run related to a specific project or more long run relating to cooperation in several projects over a longer period of time.

5.2 Financial alliances with non-financial actors

In order to reduce the amount of financial capital needed to undertake a project of a certain size and quality, one possibility that a developer may regard is to establish alliances with non-financial actors or suppliers. Such alliances aim at establishing agreements between a developer and its suppliers in which traditional market transactions are exchanged for agreements in which the suppliers contribute with their resources at a below market price level, in exchange for equity-like participation of the completed property. In other words, suppliers may lower the developer’s financial capital requirements of a project by partly, or even completely, substituting conventional compensation with some type of commission or equity-like earnings that are based on cash flows from future sales or letting/leasing of the completed development. Besides lowering the capital required, alliances may facilitate developers’ possibility to acquire highly specialised expertise by ‘creating a commonality of interests via the distributions of equity interests in a venture to a broad range of participants’ (Behrens, 1990: p. 2).

5.2.1 Financial alliances with landowners

An alliance between a developer and a landowner may be manifested in a non-equity or equity joint venture agreement (see e.g. Behrens, 1990; Wilkinson and Reed, 2008; Thomas, 2001). A non-equity joint venture, or simply cooperative agreement, ‘involve the use of carefully defined rules, formulate and contracts to govern the allocation of tasks, costs and revenues’ (Butler and Sohod 1995, p. 160). This type of joint venture may be
suitable for landowners who want to participate in the potential profits of the development project, without retaining full ownership of the land, and for developers who want to reduce the amount of capital required to purchase the land.

Equity joint ventures are formed when two or more distinct economic entities (the parents) combine a portion of their resources to form a separate jointly owned organization (Inkpen and Li 1999). A landowner receives an equity stake in the joint venture by contributing land to the joint venture.

5.2.2 Financial alliances with suppliers of professional services and building contractors

Traditionally, providers of professional services (e.g. suppliers of architectural and engineering design, legal advice, letting services, marketing and brokerage) get income from fixed fees charged to the developer. However, a developer may establish contractual or equity based alliances with professional service providers, in order to reduce capital in different phases of the development process, and to allocate or transfer risks to different actors. Developers may prefer contractual alliance formations in order to limit the number of equity holders in a joint venture company. This line of reasoning also applies to building contractors and subcontractors.

The sharing of risk and rewards can take many forms. On one hand, more simple contractual arrangements may for instance establish that the service providers’ participation in future incomes simply is a percentage of the income above some predetermined threshold level. In this case there is a limited downside risk for the service providers involved in the alliance. On the other, more customized contract arrangements may allocate risks and rewards that are more aligned with which actor that can best control the actions and events that may lead to the risk occurring. For instance, an architect may have the best ability to control the risk associated with the demand for a certain type of design. In this case, the architect may according to the contract carry both upside- and downside risks related to the architectural design. Furthermore, contracts can be designed to fit the risk sharing between a developer and professional firms that sell services that are based on their expert knowledge about local market conditions (e.g. firms providing market analyses and investment appraisals).
A developer may also form a joint venture with another developer. For instance a smaller local developer with good knowledge about the local market may form a joint venture with a large national developer that puts up the necessary financial capital.

5.3 Financial alliances with capital providers – financial partners

A developer may by establishing alliances with different types of financial partners, be able to raise the capital needed to undertake projects. Such financial alliances may involve equity, debt, and hybrid debt-equity solutions such as mezzanine finance. These sources of capital are substitutable and complementary at the same. Furthermore these alternatives can either complement, or substitute, more traditional sources of equity and debt capital. Capital providers may also engage in collaborative activities such as syndications. We therefore briefly present loan and private equity syndication, which involve the practice of co-lending and co-investing respectively. Examples of potential joint venture investor-partners, or money-partners are landowners, banks, insurance companies, private equity funds (e.g. professionally managed venture capital funds that raise equity capital from many investors), other developers, or wealthy persons.

5.3.1 Financial alliances with equity capital partners

Miles et. al. (2000) defines a joint venture partner as “any individual or institution that provides the developer with equity funding during the development period in return for a share of development profits” (p. 48).

The most commonly stated motives for establishing real estate joint ventures are to combine expertise with capital and to share risks (Behrens 1990; Brueggeman and Fisher 2008; Thomas 2001). Here we focus on joint ventures between developers and providers of financial capital, or as in the language of Geltner et. al. (2007), between entrepreneurial investors and money partners. The financial capital may consist of debt, equity, hybrid debt-equity capital, or a combination thereof.

5.3.2 Financial alliances with mezzanine and hybrid debt-equity partners

Equity capital and equity joint ventures are typically considered to be the most expensive form of money, since they require the highest yield. Furthermore, funding with equity dilutes returns to the developer’s original equity. Developers may also feel reluctant to give
away some control of their projects or companies. Therefore, developers who finds it difficult to raise enough debt capital from traditional lenders, may find it attractive to raise capital from lenders who are willing to either bridge the gap between senior debt (e.g. traditional construction loan) and a developer’s own equity (Lonergan, 2007), or from lenders who are willing to exchange a share of regular interest payments with some type of equity participation in the project they finance (consequently decreasing the developers cash outflow during the construction phase).

We can thus clearly see that the traditional and simple senior debt-equity dichotomy of a firm’s capital structure does not justify to the richness of the large number of intermediate securities between senior debt and equity that may be instances of mezzanine finance (cf. Tirole 2006). Mezzanine lending, participating and convertible loans offer an infinite number of possible ways to structure a deal and to meet the specific needs and circumstances (cf. Anderson et al. 2001). The enriched capital structure may also create much more complex relationships among different capital providers, creating another layer of potential risks, pitfalls and tensions between equity, debt, and mezzanine and/or hybrid debt-equity capital providers (see e.g Neuberg, 2002n for a discussion about the need for intercreditor agreements that will set forth the rights and remedies between traditional or senior lenders and mezzanine lenders). While mezzanine debt by definition complements senior debt and equity, hybrid debt-equity solutions such as convertible and participating loans.

Mezzanine debt is typically secured by some type of partnership interest, like ownership shares in the development entity, in case the developer defaults on the mezzanine loan (see e.g. Ling and Archer, 2005; Peiser and Frej 2003). Moreover mezzanine lenders may require some type of “participation interest” or “equity kicker”, like a share of the profits from the sale, and a share of the project’s net operating income (if any) until the project is sold (Miles et al. 2000). Thus Mezzanine financing is usually considered to be a hybrid of debt and equity financing. Finally, since mezzanine debt is inherently more risky than senior debt, such loans typically carry significant higher interest rates but also higher loan fees than conventional construction loans.

In spite of these characteristics of mezzanine debt structures, many developers may still find mezzanine financing to be more attractive than equity financing. For instance the
required rate of return on mezzanine debt, although higher than conventional loan, usually is substantially lower than the required return on equity, which is the most expansive form of capital. Further, some developers may prefer to depend upon an additional lending relationship than to rely on equity partnerships and the inherent fiduciary relationships that arise when partnerships are involved (Miles et. al. 2000).

Yet another potential argument for using mezzanine debt instead of raising more outside equity is that debt does not necessarily decrease or dilute the developer’s position. Note also that a joint venture facing a funding gap may rely on a mezzanine lender in order to fill the gap. It is also a well-known fact that many real estate developers (and real estate investors in general) consider debt financing advantageous since debt can magnify the return on the developer’s equity position through positive financial leverage or gearing. In particular secondary financing (e.g. mezzanine debt) may result in positive financial leverage as long as the marginal after-tax cost of borrowing is less than the after-tax return on the development project.

The practice of lowering the up-front construction costs in exchange for equity-like participation does not need to be characterized as a short- or long-term partnership. However, it is reasonable that those suppliers whose earnings are dependent on the economic success of the project will require more reporting and disclosure of the underlying financial feasibility and market studies. Furthermore, the risk sharing agreement increases the suppliers’ incentive to take an active part in the value creation process, hence increasing the collaborative efforts between the developer and the suppliers.

Iblher and Lucius (2003) conclude that creative and innovative financing solutions like mezzanine financing (but also joint venture and project financing) currently play a minor role in development financing, but that the importance and demand for these types of financial innovations will grow in the near future. Following their spirit we conclude that a growth in the number of financial sector actors that are capable of distributing private equity and mezzanine financing into the development industry should constitute an important step in the right direction.
5.4 Other ways to pool financial resources and share risks

5.4.1 Small capital providers

We recognize that in particular smaller developers engaged in risky, innovative niche development projects probably must fund their projects with a large portion of capital provided by smaller venture capitalists and business angels with a special interest in housing development or development of a certain city. Psilander (2004) argues that Swedish venture capitalist with competence in residential development projects constitute an important but missing part in the industry.

The general venture capital literature typically claim that venture capitalists continuously assess and monitor their investments, and structure contracts to protect them against adverse selection and to mitigate the risk of moral hazard. We find that the Swedish experience of contracting in venture capital reveals that a large part of the contracts between the entrepreneurs and venture capitalists are very similar, hence there are indications of an emerging industry standard, and that this is especially clear when studying distinctive groups, i.e. early vs. late stage investors or public vs. non-public investors (Isaksson et. al. 2004). A similar development for venture and business angel financing may mitigate transaction costs and lower the barrier for developers and venture capitalists to complete financing arrangements. Furthermore, such work can promote the development and marketing of venture capitalist and business angel networks that focus on real estate development finance. Furthermore, such activities also might also increase syndication activities among venture capitalists and business angels.

5.4.2 Venture capital syndications

In a venture capital syndication, two or more venture capital firms come together to take an equity stake in an investment, and therefore closely related to equity joint ventures and strategic alliances, as they involve long term resource pooling by two or more partner firms to achieve shared strategic goals (Wright and Lockett, 2003).

Although financing might be the primary reason for syndications (the scale effect due to capital constrained venture capitalists), syndications frequently occur even when the financing requirements of ventures are low compared to the financial resources of any one venture capitalist (Brander et. al., 2002, Wright and Lockett, 2003). One important reason
for why venture capitalists syndicate investments is to obtain better decisions whether to invest in projects of firms (Lerner, 1994, referred to in Brander et. al., 2002). Brander et. al., (2002) call this the selection hypothesis: ‘There might an advantage to having more than one venture capitalist evaluate a project before it is selected for investments or, in a staged investment setting, before additional investments are made’ (p. 424).

Furthermore, Brander et. al., (2002) highlight that venture capitalists seek syndications in order to pool different skills and information. They call this feature ‘the value-added hypothesis’, which reflects that venture capitalists add value to ventures. See Gompers and Lerner (2004) and Brander et. al., (2002) for other possible reasons for syndications. The features of venture capital syndications indicate that they might be interesting alternative to pool financial resources and manage risks in development projects.

5.4.3 Pre-sold homes and housing partnerships

Developers can, by pre-selling, or forward selling, housing units before completion of projects to would-be home owners, both mitigate risks associated with demand uncertainty and capital constraints (Lai et. al., 2004; Chau et. al. 2007). It might be possible for developers to enter partnerships with wealthy households that purchase a number of dwellings for investment purposes. This is an example of a non-equity joint venture. Since the quality of the pre-sold housing units cannot easily observed by the buyer, some developers may have incentives to cut costs by lowering the quality (Chau et. al. 2007). Based on an empirical study of the forward sales market in Hong-Kong, Chau et. al. argue that information asymmetry problems may be neutralized if a developer provides signal of the quality of its project with the developer’s reputation, above all in a repeated business environment. They conclude that the ‘optimal strategy for developers is to stick to the quality level implied by their reputations’ (p. 324).

Private households may not have the ability or willingness to bear the financial risk and burden of entering presales contract with a developer. Furthermore, many households may be too capital constrained or risk averse to purchase their homes in a traditional way (that is, 100 percent ownership and moderate to high leverage). Caplin et. al., (1997) propose the development of a ‘housing partnership market’ that might open up new financial options for home buyers. The basic idea is that a household take part ownership of the home and sell off an equity share to a financial institution. Such A partnership market
might open up the possibility for institutional investors to diversify their investments into different residential real estate markets.

6. Summing up

Coordination is in reality achieved by a very large number of governance structures that fall between (ideal) markets and (ideal) organizations. Such governance structures, also called hybrid forms, include a vast amount of different strategic alliance formations between organizations, which simultaneously employ the price mechanism and other coordination mechanisms.

The growth of interfirm and strategic alliance activities is considered to be one of the most important trends in industrial organization the last 25-30 years. The literature has found that this growth has been stimulated by a combination of a number of external forces (e.g. globalization of markets and competition, faster technological development, and other forces that increase organizations’ strategic vulnerability) and internal conditions (e.g. organizations’ resource dependency). In fact, already Schumpeter (1942) pointed out that organizational innovations make up one of the driving forces of capitalism:

‘The fundamental impulse that sets and keeps the capitalist engine in motion comes from new customers’ goods, the new markets, the new forms of industrial organization that capitalist enterprise creates’ (p. 83, referred to in Williamsson, 1985).

As with many other industries worldwide, the Swedish housing construction industry evolves as it adapts to external and internal forces that affect economic, social, political and institutional dimensions of the environment that the actors in the housing construction industry live in. The point of departure of this article is the abolition of large public housing construction subsidies in Sweden that has taken place since 1992/93. Today, in order to produce enough dwellings to meet demand, the developers must be able to secure access to necessary resources without public housing construction support.

The intention of this article is to contribute to an increased awareness of potential benefits of different types of strategic alliance activities among the many actors in the housing
construction market, above all as vehicles to pool resources. Based on the large general literature on strategic alliances and interfirm collaboration, we create a frame of references for establishing strategic alliances in the residential development industry.

Alliances may be structured in an infinite number of ways allowing any combination of sharing the risks and rewards through different contractual and company arrangements (cf. Wilkinsson and Reed, 2008). It is only by learning by doing that we can turn alliance opportunities into alliance innovations that may lead to a more efficient supply of new homes.

We have presented a number of interesting non-financial and financial alliances that may be of interest to developers as well as local governments to pool necessary resources to complete successful development projects, and increasing their competitive advantages.

The financial alliances are to solve developer’s needs to solve the problem of financing a project, and sharing risks. The non-financial alliances aim at increasing competitive advantage, learning, and pooling knowledge: what to build, when to build, and where to build in order to increase competitive advantage and attractiveness, to produce a good quality building on time and within budget, focusing on the production process, but alliances can also involve the design process (cf. Wilkinsson and Reed, 2008, pp. 242-243).

We have found that there is no single definition of strategic alliances among academicians and practitioners. But this may not be a problem; in fact, it may only reflect the broad, complex, and evolving nature of inter-firm collaborative activities. A comparison can be made with a similar discussion concerning the definition of economics: Backhouse and Medema (2009) point out that ‘any concise definition of economics is likely to be inadequate. This lack of agreement on a definition does not necessarily pose a problem for the subject […] adhering to a specific definition may constrain the problems that economists believe it is legitimate to tackle and the methods by which they choose to tackle them’ (p. 231). Instead they refer to a comment they attribute to Jacob Viner: ‘Economics is what economists do’. In a similar way, we are inclined to the opinion that strategic alliances are what those that see themselves as alliance partners do.
References:


