

# 11 Why do cooperative arrangements fail?

In Chapter 10, the focus was on the negatives or problems faced by cooperating firms within their cooperative business arrangements. This chapter is concerned with the extreme costs of business cooperation, where problems become so large and unmanageable that firms are forced to abandon a cooperative arrangement.

In the survey, firms were requested to give up to three reasons for abandoning a cooperative arrangement. The reasons listed in the survey question were the same as the problems within cooperative arrangements discussed in the previous chapter. This provides a good opportunity for this chapter to explore the links between the reasons for abandoning cooperative arrangements and problems encountered in existing arrangements.

A total of 165 firms indicated they had at some stage abandoned a cooperative arrangement. Of this number, approximately three-quarters have a current arrangement and the other quarter are no longer involved in business cooperation.

In view of the relatively small number of firms in the population, it is not possible to examine abandonments by reason at the state or metropolitan level. In addition, some of the data for the section relating to firm characteristics have to be treated with caution because of small samples.

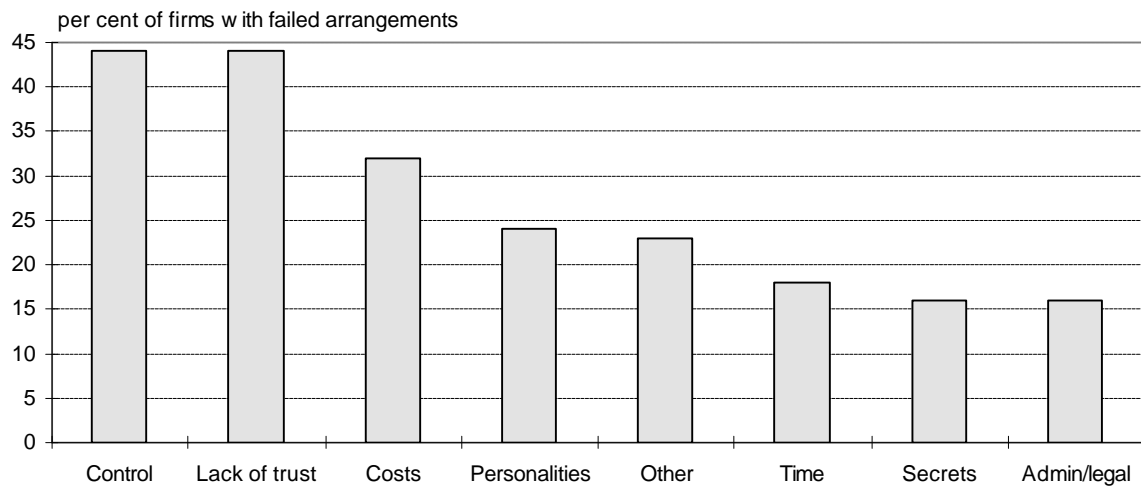
The chapter is structured as follows. Section 11.1 presents an overview of cooperation failure by looking at the major reasons for failure across all industries. Section 11.2 then tests if the reasons for abandoning linkages can be related to particular types of firms. Finally, Section 11.3 summarises the chapter's findings.

## 11.1 Overview of cooperation failure

### 11.1.1 *All industries*

The major contributing factors towards abandoning cooperative business arrangements are shown in Figure 11.1. The two outstanding reasons are loss of control and lack of trust – in both cases, 44 per cent of firms indicated them as major reasons for termination.

The only other notable major reason for cooperation failure is the financial costs of the arrangement (32 per cent of firms). Personality and 'other' reasons were cited by around one quarter of the firms. Finally, disclosure of commercial secrets, administration and time commitments are all relatively unimportant factors.

**Figure 11.1 Reasons for cooperation failure, all industries**

Source: BIE survey

The inability to trust linkage partners sits comfortably with loss of control as a major reason for termination. Both factors relate to uncertainty and uneasiness in dealing with other firms. They suggest that firms used to running their own affairs becoming anxious about matters getting out of hand.

It is interesting to compare and contrast these two major reasons for abandoning linkages with the cooperation problems discussed in Chapter 10. Loss of control and lack of trust were in fact the least important cooperation problems overall (42 per cent of firms). Only 7 per cent of firms indicated they had major or severe problems with these two aspects of cooperation.

So how are these contrasting data to be interpreted? The current cooperative arrangements analysed in this study are apparently successful on the whole and producing a variety of benefits to the firms involved (see Part B). The ‘negatives’ associated with these arrangements, while irritating, are clearly manageable on the whole and not sufficiently troublesome to threaten the viability of the linkages. So while firms do face some difficulties with the control and trust issues, they are apparently acceptable in the context of mutually beneficial cooperation.

Most cooperative business arrangements that ‘fall over’ have probably never established the necessary trust in the first place, or clearly sorted out the appropriate balance of power between the participating firms.

Around 60 per cent of the firms which have abandoned cooperative arrangements are small firms and two-thirds of these are micro firms. Perhaps many of these were first-time cooperators, reluctantly expanding their horizons. Small, privately-owned firms can be expected to be somewhat nervous about sharing aspects of their company’s business. It is not difficult to foresee how matters might easily get out of control.

Whatever the explanation, there is a clear lesson from failed arrangements for firms already involved in or about to embrace business cooperation. This is the need to work hard on both trust and sharing responsibility and never to underestimate their importance (see Box 11.1).

#### **Box 11.1 Surviving the test of time**

*PanBio, a Biomedical firm based in Brisbane, was involved in a cooperative business arrangement in which it manufactured for another company. It wanted to broaden this relationship but the other company did not. This taught PanBio that cooperating firms need to have the same long-term focus, particularly as PanBio's R&D is long term. Trust between cooperating firms is needed to allow confidence to develop.*

*PanBio estimates that about one third of potential cooperative arrangements get to first base and only half of these survive the test of time. Long-run relationships need strong personal commitment from both sides. Agreements allow risk to be shared but some have the potential to produce conflict, especially when they are with a multinational company.*

Source: BIE interview

The additional time involved in managing business cooperation is the *least* important reason for cooperation failure. Again this provides a fascinating contrast to the situation presented by firms within existing cooperative arrangements, where time is by far the most important problem. This suggests that firms will complain dearly about the amount of time chewed up but will put up with the problem indefinitely so long as the arrangement keeps on a sound footing. A shortage of time, it seems, is hardly ever a good enough reason for terminating linkages (although it does of course occur in some cases).

Almost a quarter of the firms that have abandoned business cooperation have done so for a collection of 'other' reasons. The majority of these relate to dissatisfaction with the performance of the cooperative arrangement. However other reasons cited by firms include:

"the other party changed direction";

"loss of brand identity"; and

"lack of commitment and acceptance of responsibilities

The citing of lack of commitment is one of only a few references to this factor. This is interesting when compared with other research stressing the importance of commitment in inter-firm cooperation (Buttery 1993, for example). In addition, NIES officers in all states indicated that they regard the full commitment of participating firms as a vital ingredient for the success of formal business networks.

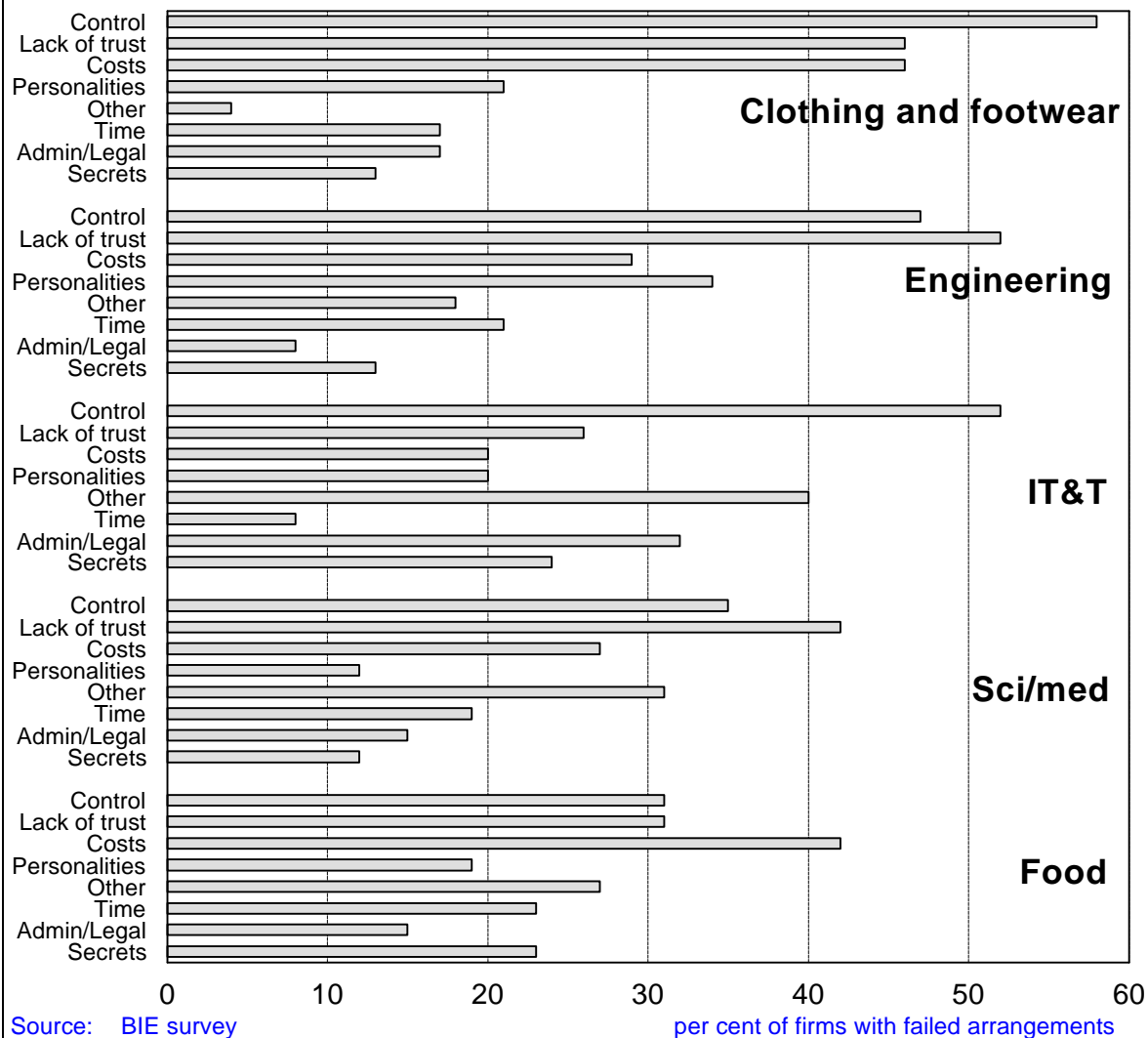
Perhaps lack of commitment spawns other major problems (like weakening trust). It may be that firms attribute linkage failures to these highly visible, if subsidiary problems, instead of identifying the fundamental cause.

## 11.2 Cooperation failure and firm characteristics

### 11.2.1 Industries

The data in this section needs to be examined with caution in view of the relatively small number of firms involved in four of the five industries. The analysis of the data can however point to some possible interpretations and conclusions without being too prescriptive.

**Figure 11.2 Reasons for cooperation failure, by industry**



The survey results suggest considerable variations between the industries (Figure 11.2). For example, there are three different major reasons for abandoning cooperative arrangements. Engineering and Sci/med firms find common ground in agreeing that lack of trust is the biggest problem. Clothing and footwear and IT&T firms emphasise loss of control as the key concern. Food firms, on the other hand, have the financial costs as the clear major cause of business cooperation failure.

Firms in the Food industry are actually the only ones which have a clear relationship between problems within cooperative arrangements and causes of termination. The emphasis Food firms place on financial expense is consistent with the unusually high proportion (58 per cent) experiencing financial problems within current cooperative arrangements (see Chapter 10). Moreover, a high 12 per cent of Food firms indicated they had major or severe financial problems with these linkages. Placing the results for problems and abandonment side-by-side suggests something amiss with the financial costs of operating cooperative arrangements in the Food industry.

Financial expense is also a major concern for Clothing and footwear firms, along with loss of control and lack of trust.

Engineering firms have an unusually high proportion abandoning business cooperation because of personality difficulties, a factor not particularly significant as a problem within their current arrangements. Lack of trust, which is obviously related to impressions about the personnel of partner companies, is the major reason for cooperation failure for firms in the Engineering industry. Overall, the high emphasis placed on trust and personality difficulties tend to set Engineering firms a little apart from other industries.

IT&T firms have quite a spread of reasons for termination. The particularly prominent reasons are loss of control, disclosure of commercial secrets and the administrative/legal burden. The latter is the only factor apparently causing above average concerns to IT&T firms within existing cooperative arrangements and is apparently somewhat of an irritation regarding business cooperation. Perhaps the complexity of contracts relating to intellectual property and software and the sheer pace of change in the industry place undue stress on the people managing the linkages.

The other notable feature of the IT&T industry is the 40 per cent of firms which have abandoned for 'other' reasons. As noted above, these principally relate to the failure of the arrangements to live up to expectations. This high figure for IT&T may reflect the overall importance of linkages to the industry and the vital need to have them working well in order to survive and prosper.

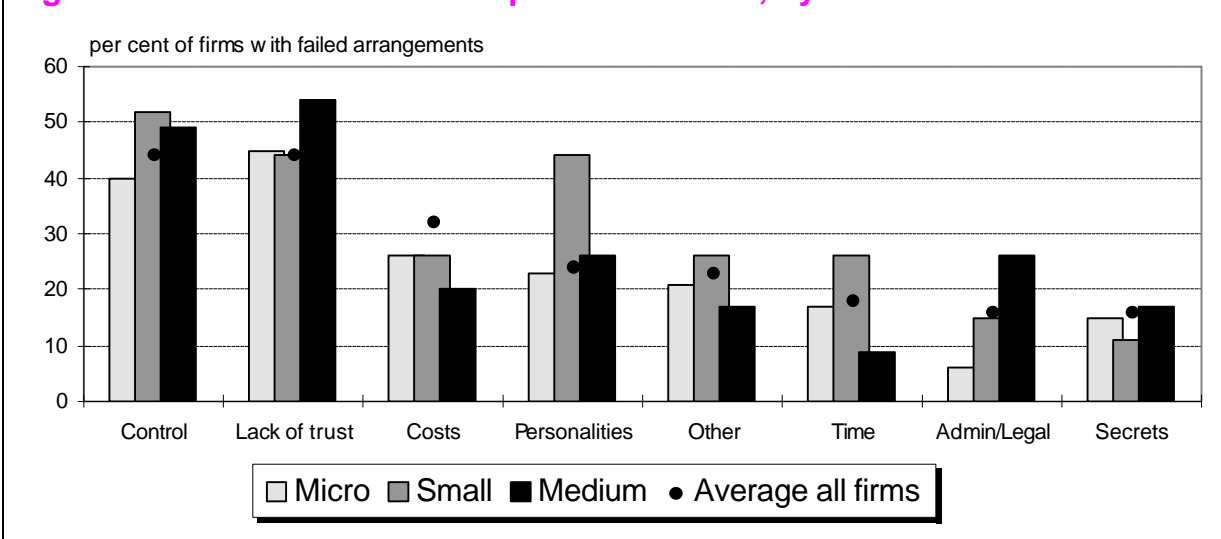
Scientific and medical firms are below average for most reasons. Lack of trust is the most important factor and 'other' reasons are again relatively high – perhaps in part due to a similar explanation as the IT&T industry.

### 11.2.2 Size of firm

Due to the very small number of large-firm survey respondents which have abandoned cooperative arrangements, it is only possible to analyse cooperation failure for micro, small and medium size firms (Figure 11.3).

The two key reasons for cooperation failure, loss of control and lack of trust show some minor variations between the different firms. Interestingly, loss of control is not quite so important to micro firms as to small and medium firms. On the other hand, lack of trust is of greater concern to medium firms than small and micro firms.

**Figure 11.3 Reasons for cooperation failure, by firm size**



Note: (a) Results for 'large' size group not shown due to small sample.  
 (b) Average figure for Costs is higher than the figure for the three firm categories due to missing data.  
 Source: BIE survey

Micro firms are clearly mainly affected by the control and trust issues. Small firms are too, but also have a relatively strong tendency to abandon cooperative arrangements because of personality difficulties (a significant major problem too within their cooperative arrangements). Medium size firms might be slightly more concerned with administration costs than smaller firms – which is supported by data on problems within cooperative arrangements – but lack of trust and loss of control again dominate.

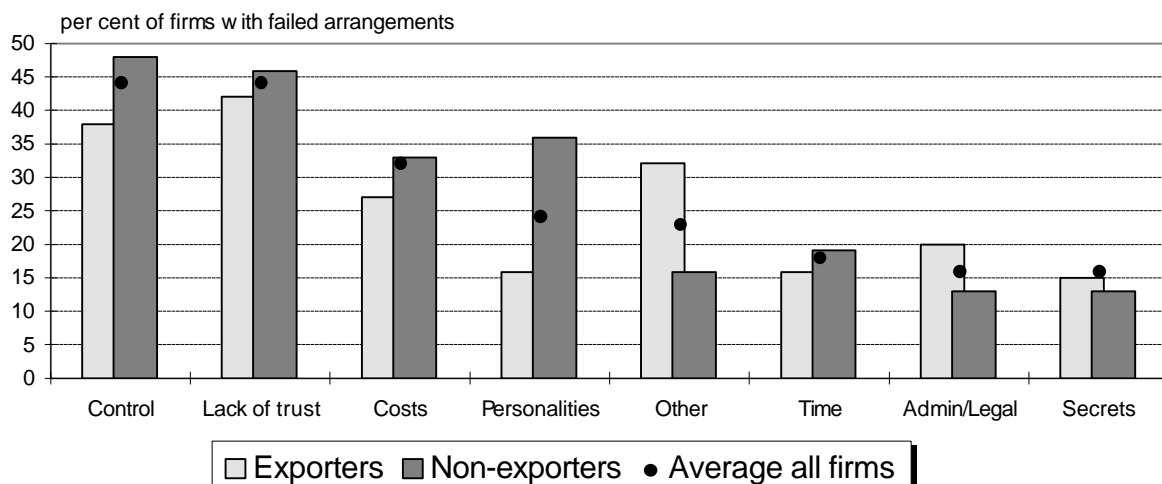
The financial costs involved in commencing and operating a cooperative arrangement might have been expected to be particularly problematical to smaller firms. At the same time, some of the more informal and softer forms of linkage on the cooperation continuum (see Chapter 2) are not especially expensive to set up and manage. Preferred supplier arrangements, for example, need not involve much expense save for some basic administration costs.

It may be the case, therefore, that the larger firms in the sample are responsible for a disproportionate share of the firms terminating for financial reasons. These firms are much more likely to be playing for bigger stakes involving complex contracts and substantial administration and legal expenses<sup>1</sup>.

### 11.2.3 Exporters and non-exporters

Around half the firms in our sample which have abandoned cooperative arrangements are active in export markets. Both exporting and non-exporting firms place a high degree of emphasis on problems of control and trust, and to a lesser extent on the financial costs of cooperation, when giving reasons for 'divorce' (Figure 11.4).

**Figure 11.4 Reasons for cooperation failure by exporters and non-exporters**



Source: BIE survey

<sup>1</sup> This would help explain the average firm figure for Financial Costs in Figure 11.3 being higher than the micro, small and medium firm categories.

The two main points of contrast between the two types of firms are personality difficulties and ‘other’ reasons. For non-exporters, personality problems are the third most important reason for abandoning linkages, whereas they are just about the least important for exporters. The situation is virtually reversed for ‘other’ reasons, which often reflect dissatisfaction with the outcome of cooperative arrangements. This may reflect the fact that exporters have occasionally frustrated ‘great expectations’ about their linkages, whereas non-exporters have weaker aspirations, which are harder to fail.

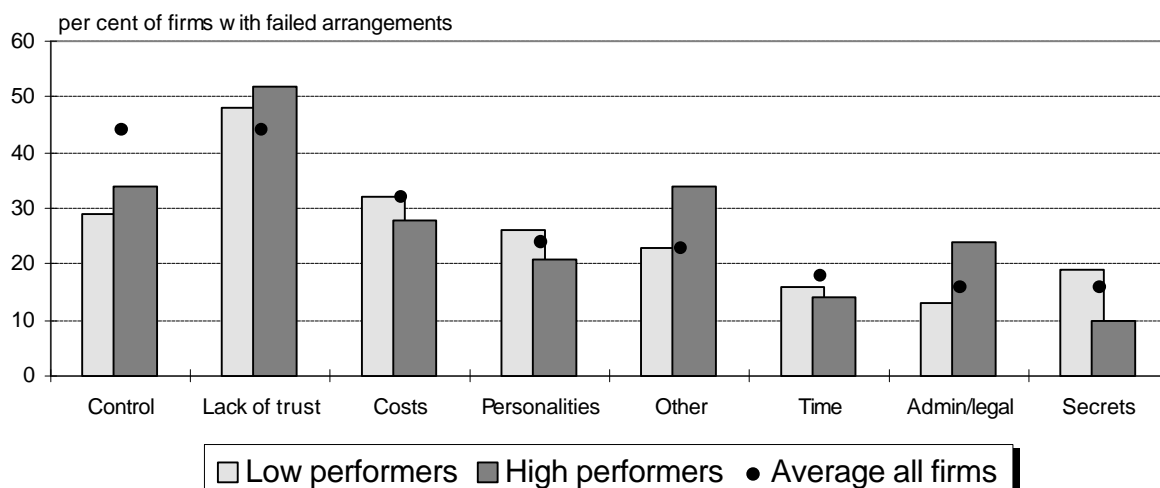
The two most important problems to exporters within cooperative arrangements, relative to firms serving only local markets, are disclosure of commercial secrets and administration (see Chapter 10). Neither of these are significant as reasons for cooperation failure.

### 11.2.4 High and low performance firms

High and low performers have much in common when it comes to abandoning their cooperative arrangements (Figure 11.5). Both have lack of trust as by far the most important reason for failure. This is followed some considerable distance back by loss of control and financial costs (and also ‘other’ reasons in the case of high performers). The proportion of firms citing trust is a little above average for both groups of firms.

The really interesting point is that these firms cite loss of control as a basis for failure much less frequently than the average. Perhaps the high performers have more than a usual tendency to believe they *can* maintain control over partner firms, given their ability to successfully control their own destiny in other spheres. Low growth firms, on the other hand, may have a greater than usual acceptance of some diminution of power in cooperative arrangements as a trade-off for benefits.

**Figure 11.5 Reasons for cooperation failure by high and low performers**



Note: (b) Average figures for Control and Time are higher than the figure for the three firm categories due to missing data.

Source: BIE survey

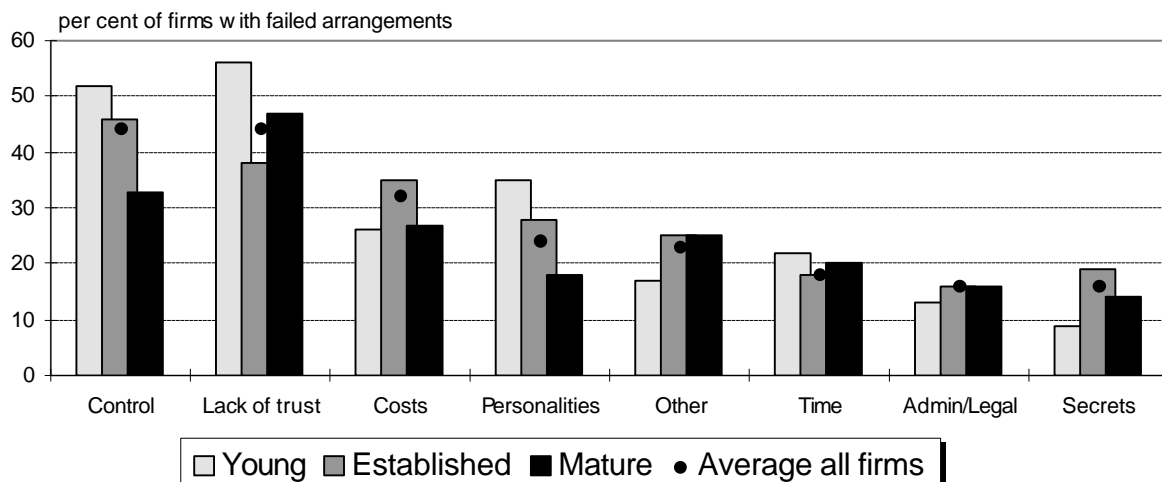
The relatively high proportion of high growth firms citing ‘other’ reasons for cooperation failure is logical, given that the key ‘other’ reason generally relates to dissatisfaction with the performance of the arrangement (see Section 11.1). High performers expect high performance.

Overall though there is little to distinguish the two firm types in their attitude to cooperation failure – from a fairly deep common mistrust of partner firms at one end of the spectrum to the few concerns about time commitments at the other.

### 11.2.5 Age of firm

Reasons for abandonment of cooperative arrangements by age of firm are shown in Figure 11.6. The youngest firms, those 5 years old or less, see loss of control and lack of trust (and also personality difficulties) as the major reasons for linkage failures. Lack of trust is also a ‘major’ cooperation problem for 12 per cent of young firms in current arrangements (see Chapter 10).

**Figure 11.6 Reasons for cooperation failure, by age of firm**



Source: BIE survey

The established firms (6-24 years old) fit in quite closely with the general pattern of reasons for cooperative failure, which is hardly surprising given their predominance in the population. Problems with trust, however, are a little below average and this shows up in the comparisons with young and mature firms (25 years or older).

Mature firms do not have any particularly noteworthy reasons for abandoning linkages, outside loss of control and lack of trust.

### 11.2.6 Other firm characteristics

The type of product, technology content and the level of competition appear to have only a few minor influences on the reasons for cooperation failure.



Loss of control and trust are very similar in degree of importance for all three categories of product types, and this pattern is generally repeated for the other reasons. The only factor significantly different is the financial costs of cooperation. This appears important to firms producing intermediate products (equal first with trust and control), but is of only third and fourth importance to final goods and capital goods firms respectively.

Low-tech companies gave little emphasis to lack of trust as a source of failure. Only 26 per cent said this was a major reason for cooperation failure, compared with 50 per cent for medium-tech firms and 46 per cent for high-tech firms. This may reflect the fact that such firms do not have to protect valuable intellectual property from potential ‘predatory’ partners.

The level of competition a firm faces apparently makes no significant difference in explaining the causes of cooperation failure.

## 11.3 Summary

Business cooperation is not always successful. Sometimes things go wrong with cooperative arrangements and firms are eventually forced to abandon them. Some arrangements are abandoned fairly early in the piece, while others last a considerable time before succumbing to various pressures.

If business cooperation is so beneficial to firms, why do some cooperative arrangements fail? The analysis presented in this chapter has reminded us that businesses or firms are made up of people – and people have expectations about how cooperation should be conducted. They also have expectations about the extent cooperation should be allowed to impinge on their firm’s general business activities.

Lack of trust and the fear of losing control are the two outstanding reasons for cooperation failure. Almost half the firms which have abandoned cooperative arrangements indicated trust and control as the major reasons for termination. The only other notable reason for abandoning an arrangement was its high financial costs.

The inability to trust linkage partners and fear of losing control both relate to uncertainty and uneasiness in dealing with other firms. Some of this may be due to a mismatching of firms or a failure to establish basic communication channels. Around 60 per cent of the firms which have abandoned cooperative arrangements have less than 20 employees, and two-thirds of these are micro firms. Owners of small firms can be expected to be nervous about sharing aspects of their company’s business, and about larger firms exerting undue influence on their firm’s operations.

Clearly, firms need to work hard on trust and partnership responsibilities if cooperation is to be a success – and this may partially explain the high amount of time apparently required to manage *ongoing* cooperative arrangements (see Chapter 10).

Sometimes, of course, the actual performance of cooperative arrangements does not live up to expectations. The anticipated rewards may be too long in arriving or the financial returns are disappointing. High growth firms, exporters and firms in the IT&T industry appear to be the most likely to abandon linkages for performance-related reasons. These relatively ‘high performers’ expect high performance.

The good news about cooperation failure is that it does not appear to be an enduring problem for most firms which have terminated arrangements. There is strong evidence that cooperation failures are predominantly functions of specific arrangements (rather than being linked to particular firm types). Around three-quarters

of the firms which have previously abandoned cooperative arrangements are currently involved in other cooperative arrangements.

This implies that a certain 'cooperation culture' develops in some firms, whereby they see cooperation as a central business strategy and are not diverted by the odd failure. It also reaffirms, of course, the benefits of cooperation. Firms carry on cooperating because they expect to gain a lot more than they lose.