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By René Bakker

Start-ups face many life-and-death choices as they grow. One of the most crucial is how to work with larger partners. On the one hand, the surest way for a start-up to get the resources it needs is to form an alliance with a much bigger and more established company. On the other, interacting with that larger company can be dangerous.

As an example of that possible danger, how do you stop a company 20 times your size from paying too little for your idea – or even stealing it outright? My colleague, Joris Knoben, Professor of Business Economics at Radboud University, and I have given a lot of thought to what we call this “guppy versus whale” problem. We never found the data to study the question empirically, however, until I stumbled onto something I thought might work. While I was doing research at the Australian Centre for Entrepreneurship Research in Brisbane, I happened to run across a book called The Register of Australian Mining. It looked very exotic – we don’t have many diamond and silver mines in the Dutch outback – but more importantly, I could see right off that Joris and I could use this information to answer our guppies-versus-whales question.

As I did more research on the register, I found that it had been published for 31 years. Eventually, I flew out to Perth and persuaded the people who compiled this data to share 10 years of electronic files with us; files we could use to see whether there were organisational reasons that some mining industry “guppies” survived in a sea of mining sharks and whales while most disappeared.

“The meek shall inherit the earth, but not its mineral rights.” J. Paul Getty

Guppies and whales

The Australian mining ecosystem has two important parts: the major mining companies and what they call junior miners. The junior miners are generally start-ups organised around a few key individuals who go out and prospect to find a promising resource.

The major miners, on the other hand, are typically large companies that operate portfolios of extraction projects. The risks of failure are so high that most of the majors no longer look for new mineral deposits themselves – that front-end work is mainly done by the junior miners.

The relationship between the majors and the juniors is highly symbiotic. The days of walking around in the Australian outback and finding a gold nugget at the side of the road or in a riverbed are long gone. To mine minerals now requires considerable capital, technological know-how, and considerable knowledge of how to manage the “green and red tape” of environmental and governmental regulation. Just as the majors look to the juniors to handle the time-consuming and risky work finding deposits, the juniors rely on majors to support the costly and time-consuming process of turning hunches into reality.

Finding the right partner is difficult for both parties. The major miner must choose winners out of a field in which 90 per cent of projects fail. The junior miners need to find partners who will treat them fairly.

Of course, the risks are highest for junior miners. These start-ups may be “muscled out” of a promising asset by a larger company through intimidation, hostile takeovers, or the threat of expensive litigation. Disputes are generally settled in court, where the major miner’s large legal team tends to overwhelm the junior miner’s attorneys. One junior miner executive told us:
As oil tycoon J. Paul Getty once quipped: ‘The meek shall inherit the earth, but not its mineral rights.’

**Who you know**

When we traced the relationships of 915 junior miners and 331 major miners in our 10 years of data, we found that junior miners that were doing well in their partnerships with major miners tended to structure their alliances in a quite typical way: they made sure that their strategic alliances (joint projects) were accompanied by a board interlock – that is, that both the junior miner and the major miner appointed the same individual to both of their boards. We call such partnerships *pluralistic ties*.

When we interviewed mining executives about this phenomenon, we found that three factors explain this behaviour. First, having a member on both boards is likely to facilitate communication and help build trust between the junior miner and the major. Second, alliance partners often have a hard time assessing and monitoring each other’s incentives, capabilities and effort, and a board member with a seat at both tables is better positioned to assess what’s actually going on.

Finally, a pluralistic tie may act as a safeguard against the major miner taking advantage of the junior, because the interlocked board member is generally a more senior person in the industry. We believe having a powerful partner on the board is a strong signal of the start-up’s legitimacy and an important defensive mechanism, as the member is in a position to tell others in the industry about any bad behaviour that goes on.

We had suspected that all this would be the case, but another pattern surprised us: such tie formation is relatively rare. Overall, only 10.1 per cent of juniors formed the kind of pluralistic ties (consisting of a board interlock and an
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not simply due to the formation of board interlocks per se.

We controlled for the number of board interlocks and found it had no statistically significant effect on start-up performance, the latter’s effect size is roughly three times larger. The magnitude of the effect is such that one standard deviation increase in asset growth (our measure of start-up performance) requires a start-up to form 3.4 stand-alone alliances, but only 1.2 pluralistic ties. Importantly, the difference between pluralistic tie formation and stand-alone alliances is not simply due to the formation of board interlocks per se.

We found a second pattern that was even more salient: it turned out that the sequence of tie formation was very important. When the partnership commenced with a board interlock, and the partners only then later formed a strategic alliance, this had the largest positive effect.

Friends first, cash later
For entrepreneurs, this result suggests an important lesson: it’s not only who you know what matters, but when you get to know them. Whether you are looking for gold in the Australian outback or in Silicon Valley, our research suggests it pays to look for strong relationships in the form of pluralistic ties. Really getting to know your partners prior to forming a strategic alliance has many benefits. Venture capitalists too may want to bear this in mind.

This article draws its inspiration from the paper *The guppy and the whale: Relational pluralism and start-ups’ expropriation dilemma in partnership formation*, written by Joris Knoben and René Bakker, and forthcoming in the January 2019 issue of the *Journal of Business Venturing* (Volume 34, Issue 1, Pages 103-121). DOI: https://doi.org/10.1016/j.jbusvent.2018.05.008

Dr René Bakker is Associate Professor of Strategy and Entrepreneurship, Department of Strategic Management and Entrepreneurship, Rotterdam School of Management, Erasmus University. Email bakker@rsm.nl