Strategic Alliances, Innovation Capability, Cost Reduction, Customer Loyalty and Competitive Advantage in B2B Alliances

Soebowo Musa

Swiss German University, Graduate School of Business, Tangerang, Indonesia

soebowomusa@gmail.com

Abstract: Disruptive business environment such as the Covid-19 pandemic and the recent high volatility in commodity prices has changed the way businesses were conducted. The heavy equipment industry is one of many industries affected by such an environment, especially those who are related to the mining industry where the volatility of the commodity prices has a significant impact on their business performance. Alliances are commonly formed by heavy equipment distributors and their customers to create a mutual benefit to sustain their performance. Strategic alliances have attracted substantial attention from industry as well as academia as a way to stay competitive. They mostly focus on the partner-to-partner alliances in serving their customers. Consumer behaviour has changed due to changes in the environment that make firms' strategic focus more on human-centric business approaches. This study looks at the roles of the partner-to-customer alliances, innovation capability, and cost reduction toward customer loyalty and competitive advantage. Data was collected from 335 respondents from the firms that have entered into alliances. This study finds strategic alliances have the highest association with cost reduction, followed by their association with innovation capability. They enhance customer loyalty through innovation capability. Cost reduction is not a lever to develop customer loyalty in the partner-to-customer relationship. The study also confirms that operational efficiencies are necessarily the source of competitive advantage, but strategic alliances are.

Keywords: strategic alliances, innovation capability, cost reduction, customer loyalty, competitive advantage

1. Introduction

The strategic business environment has changed rapidly due to the digital transformation and disruptive innovation in many industrial sectors resulting in the saturation of existing markets and the emergence of new markets in various business sectors (Foroohar, 2018). Digital transformation and the Covid-19 pandemic have changed the landscape of the competitive dynamics for many firms. One of the challenges in digital transformation is that firms need to enhance their collaboration to tap into the digital ecosystem, access resources and skills, and have an effective customer retention strategy. Strategic alliances have become a strategy that attracts scholars as well as business practitioners as a way to sustain competitiveness. Strategic alliances help firms to be competitive through various means, such as enhancing market shares, increasing operational efficiencies, and tapping into new resources or capabilities (Rothaermel & Boeker, 2008).

Green & McCann (2020) indicated strategic alliances bring benefits to firms through sharing resources and expertise, strengthening new market penetration, expanding production capabilities, and building innovation. Strategic alliances are also believed to have a positive effect on the operational efficiencies of firms. Scholars have identified the benefits of strategic alliances in developing a sustainable competitive advantage through better operational efficiencies and enhancing organizational capabilities such as innovation capability (Mowla, 2012; Schweitzer, 2014). Gomes et al., (2016) stated one of the motives for firms entering strategic alliances is access to and transfer of knowledge in building innovation capability. The drivers for entering into strategic alliances are efficiency motives, and competitive motives by securing market power such as sustaining customer loyalty. However, there were also research findings that stated that strategic alliances harm the development of innovation capability due to difficulties in managing unstable characteristics of strategic alliances (Spekman et al., 1996; Wittman, 2007). Strategic alliances are known to enhance such efficiencies (cost reduction) through collaborated efforts in technologies and information exchange between firms. However, other research findings showed that strategic alliances create an unpredictable new cost to the firms putting downward pressure on the operational efficiencies (Das & Rahman, 2010). Kottas & Madas (2018) indicated no evidence of a positive impact of strategic alliances on operational efficiencies. These studies on strategic alliances show that the impact of strategic alliances on organizational outcomes and competitive advantage remains unclear. Under the current condition of digital disruption and transformation, where competitive advantage is becoming rare or shorter, the effectiveness of strategic alliances in creating competitive advantage remains yet to be examined. He et al., (2020) indicated there is a lack of studies focusing on the possible shift in the role of strategic alliances towards firms' outcomes due to the rapid change in the environment and the digital transformation.

Many studies have examined strategic alliances from the perspective of partner-to-partner alliances, but less from the perspective of partner-to-customer alliances (McSweeney-Feld et al., 2010). The study of strategic alliances on partner-to-customer is important because there are differences in the objectives, governance, and structure. Further examination of the relationship between strategic alliances and customer loyalty in the context of partner-to-customer alliances merits consideration. It is also important to examine the impacts of strategic alliances on the organizational outcomes from the perspective of efficiencies and competitive motives concerning customer loyalty as a lever for firm performance, and innovation capability. This study will examine the roles of strategic alliances, innovation capability, and cost reduction toward customer loyalty and competitive advantage in the partner-to-customer alliances. The heavy equipment industry will be the context of this research. The customers were represented by the 35 mining contractors/ companies; while partners were represented by the top 5 heavy equipment distributors whom they have a partnership with. Considering the high volatility and turbulent conditions in the heavy equipment industry, this study expects to provide insight into whether or not the role of strategic alliances has shifted.

2. Theoretical framework and hypotheses

Strategic alliances (SA) are defined as a purposive relationship among firms that stay legally independent to achieve specific common targets, sharing benefits between partners that involve cooperation, resources sharing, knowledge transfer, and improvement of competencies and capabilities (Talebi et al., 2017). Jiang et al. (2016) stated that SA offers an interesting opportunity for learning and knowledge sharing from partners; whereas, Vaidya (2011) indicated that SA potentially gives a cost advantage and reduces potential uncertain risk through cost reduction methods between partners, such as creating a new product, operating new management technique, and implementing new technology to sustain competitive advantage. SA would improve collective capabilities and produce various new ideas and knowledge as the foundation of innovation. On the behavioural aspects of SA, Lin (2013) argues that long-term relationships based on understanding between partners in SA would be based on mutual trust and commitment. Strategic alliance plays an important role in enhancing a partner's loyalty due to coordination, deal, commitment, trust, and interdependency between partners.

Innovation Capability (IC) is defined as the capability to potentially produce or adopt innovations by using internal abilities to allow an organization to have a continuous transformation to have value creation (Weber & Heidenreich, 2018). A firm's activities may involve a process of building innovation capabilities like internal and external R&D, usage of new equipment, technology, improvement process, maximizing external advisory, innovation training, and other activities related to the development of process improvement. IC is one of the firm's capabilities that can generate new knowledge and methods that enhance the firm's competitive advantage. IC was also believed to create better service quality given to customers through products and services evidenced by higher customer retention, and also to yield greater growth and profit for a firm through the operational efficiencies from such IC (Raghuvanshi et al., 2019; Sudolska & Lapinska, 2020). Lam et al., (2021) highlighted strong IC provides firms with the ability to enable employees to convert knowledge into new intellectual assets that could be used to improve existing products, services, processes, technology, and administrative systems, which could provide a secure long-term survival and sustainable development of the firms. Knowledge transfer has a significant relationship with developing the organizational IC. Sun et al., (2021) found SA enhances knowledge sharing between partners, thereby improving IC. Hence, the following hypothesis was made:

> *Hypothesis 1: There is a positive relationship between strategic alliances and innovation capability.*

Cost Reduction (CR) is defined as the process to find out and eliminate waste in a business process to increase profit without negatively impacting the quality of products or services (Yadav et al., 2013). CR can be achieved through running current activities more cheaply by optimizing internal resources or restructuring the business process. Transaction cost theory explains why some firms may be more efficient in governing their economic activities. Such transaction costs arise from the process of a transaction between two parties in the market, and these transaction costs can be reduced through activity outside the market (Williamson, 1975). It is not only concerned with how a firm manages its transaction costs in its business activities, but also how such transaction costs depend on the types of exchange activities between two parties in alliances. Chen & Chen (2003) highlighted the objective of SA is to have a better resource alignment and sharing between partners in leveraging their ability to appropriate the benefits out of the alliances. SA is expected to provide a cost

advantage and mitigate uncertain risk by developing new products, operating new management processes, and applying new technology. Based on such synthesis, the following hypothesis was developed:

> **Hypothesis 2:** *There is a positive relationship between strategic alliances and cost reduction.*

Customer Loyalty (CL) is defined as a deeply held commitment to re-purchase a selected product continuously in the future and produce repetition on the same brand, despite situational influence or marketing efforts that potentially may cause switching behaviour (Oliver, 1999). CL leads to commitment to doing business with the same partner for a long period and becomes a state of mind, a set of attitudes, trust, and appetite. Loyalty can be defined from two dimensions which are attitudinal and behavioural loyalty (Dick & Basu, 1994). Attitudinal loyalty defines customer connection to products, services, brands, or firms, tolerance of price, and intention to purchase. Strong positive attitudinal loyalty results in a protective process toward CL irrespective of the competition, where customers would stick to the existing product and services and deny competitive offers although the competitor's product and services are fairly better. Behavioural loyalty requires repetitive purchases that came from buying orientation involving readiness to accept benefits from a specific entity. Shoemaker & Lewis (1999) indicated an organization needs to pay attention to three functions for building CL - process, communication, and value creation functions. The process function takes into account all activities from both the customer and the service provider's perspectives to have a better business process for both partners. The communication function focuses on how the service provider communicates with its customers to keep track of the customers' favour, needs and preferences resulting in better customer satisfaction that creates CL. It facilitates knowledge transfer between the partners fostering IC. Finally, the value creation function addresses value-added strategies focusing on the long-term relationship between the partners; and value-recovery strategies focusing on the delivery of the services for the relationship between the partners. The objective of value creation is to enhance the perceptions of the customers on the rewards and costs associated with the service transactions provided by the service provider. It infers that value creation enhances operational efficiencies on the part of the customers, which in turn it creates CL. SA facilitates the connectivity across complementary abilities for both partners in the alliances to create new market values without hampering each partner out of its existing competencies. Such connectivity strengthens the partners' relationship resulting in better collaboration where one firm compensates for the other firm's weaknesses. Such collaboration strengthens the loyalty among the partners. Based on the above synthesis, this study advances the following hypotheses:

> **Hypothesis 3:** *There is a positive relationship between strategic alliances and customer loyalty.*
>
> **Hypothesis 4:** *There is a positive relationship between cost reduction and customer loyalty.*
>
> **Hypothesis 5:** *There is a positive relationship between innovation capability and customer loyalty.*

Competitive Advantage (CA) is defined by Barney (1991, p. 102) as a "value-creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy". CA involves the selection of organization resources like organization processes, information, knowledge, and capabilities and the utilization of such resources to create the 'value-creating strategy'. Firms enter SA to obtain the resources needed to enhance and sustain CA. The choice of these resources among other organizational capabilities would determine the sustainability of an organization's CA, where such CA could be fostered through IC (Freije et al., 2021). Hussein et al., (2018) found CL plays a key strategic business in creating sustainable performance. Zhang et al., (2018) indicated CR creates financial efficiency that could be the source of CA. Based on such synthesis, this study advances the following hypotheses:

> **Hypothesis 6:** *There is a positive relationship between strategic alliances and competitive advantage.*
>
> **Hypothesis 7:** *There is a positive relationship between cost reduction and competitive advantage.*
>
> **Hypothesis 8:** *There is a positive relationship between innovation capability and competitive advantage.*
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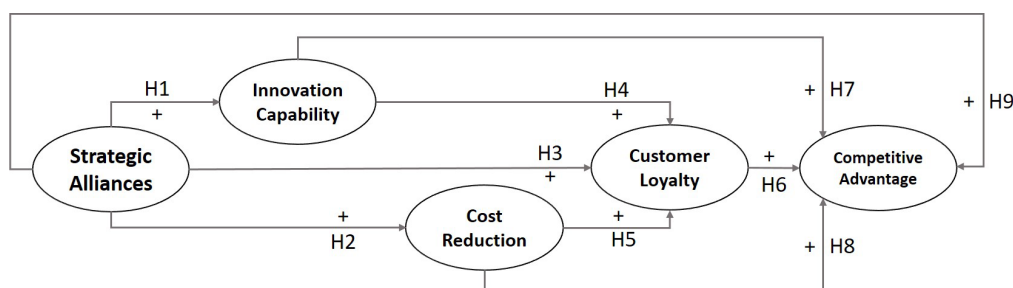> **Hypothesis 9:** *There is a positive relationship between customer loyalty and competitive advantage.*

Figure 1: illustrates the proposed research model in this study

3. Data and methods

3.1 Sample and data collection

This study collected data from a sample based on the two attributes of the firms in the heavy equipment industry - (i) the firms' main business is in the contracting business for the mining industry; and (ii) the firms have engaged in the SA. The data collection was done from December 2021-February 2022 through online self-administered questionnaires distributed to respondents at middle-to-top level positions. The final data comprised 335 usable answers (a response rate of 73%) from employees at the middle level up from 35 firms who have full knowledge of the partnership and day-to-day interaction with their partner's employees. Data analysis was performed using SEM Lisrel 8.8 to test construct validity, reliability, and the goodness of fit indices and the SPSS program was used for the descriptive statistics.

3.2 Measures

All measurements in this study were adapted from the validated and existing measurements used in previous studies and were measured on a 7-point Likert scale, ranging from 1 (strongly disagree) to 7 (strongly agree) for SA, IC, CL, CA, and CR. We conducted Brislin's back-translation into the Indonesian language to ensure the face validity of the survey in Indonesian. A pilot test was conducted based on 25 respondents from targeted firms to assess the face validity of Brislin's back-translation. We performed an outlier test on the data collected. A focus group discussion was then conducted to further refine the wording of the outlier items to make them easy to understand by the respondents. The final questionnaires were then distributed to the targeted respondents.

3.2.1 Independent variables

Strategic alliances are measured with 14 items across the five dimensions of SA, namely trust (SAA) with 2 items, commitment (SAB) with 4 items, communication (SAC) with 3 items, cooperation (SAD) with 3 items, and joint problem-solving (SAE) with 2 items. The SA measurement was adapted from Kwok & Hampson (1996). Sample items for SAA include: "We share commercial and technical information related to projects without the need to protect ourselves"; for SAB: "We actively build trust"; for SAC: "We communicate regularly to compare current performance against expectations"; for SAD: "We co-operate to share risks"; and for SAE: "We feel free to admit and discuss difficulties eve they relate to uncomfortable issues" *Innovation capability* is measured with 6 items. The IC measurement was adapted from Lin (2007). Sample items for IC include: "Our firm looks for new ways of doing things". *Cost reduction* is measured with 5 items. The CR measurement was adapted from Essuman et al. (2020). Sample items for CR include: "Overhead costs incurred by our firm have been very efficient" *Customer loyalty* is measured with 5 items across the two dimensions of CL, namely attitudinal loyalty (CLA) with 2 items, and behavioural loyalty (CLB) with 3 items. The CL measurement was adapted from Lenninkumar (2017). Sample items for CLA include: "We consider our strategic alliance partner as the first choice to buy heavy equipment units and services.", and for CLA: "We say positive things about our strategic alliance partner to other people".

3.2.2 Dependent variables

Competitive advantage – CA is measured with 7 items. The CA measurement was adapted from Fainshmidt et al., (2019). Sample items for CA include: "The firm has better managerial capability than the competitors".

3.2.3 Control variables

This study employs the 4 firm attributes such as size, firm age, the respondent's position and length in strategic alliance with their partner as control variables that might affect the independent variables and the dependent variable.

3.3 Data analysis

The descriptive statistics shown in Table 4.1 were done through SPSS version 25, while the hypotheses testing was done using Lisrel 8.8 SEM with the maximum likelihood estimation method. The measurement model analysis was done to assess the composite reliability (CPR) and validity of the constructs and the average variance extracted (AVE) of each construct. For constructs that have dimensions, we used a higher-order model as prescribed by Crede & Harms (2015).

4. Results

4.1 Descriptive statistics and correlations

All correlations among the constructs in this study are less than 0.60. Therefore, multicollinearity does not pose a threat to the analysis. The variance inflation factor (VIF) analysis (all VIFs ≤ 2.5, Tolerance ≥ 0.20) on the independent variables also suggests the absence of multicollinearity. Table 1 shows the descriptive statistics and correlations among the constructs used in the study.

Table 1: The descriptive statistics and correlations among the constructs used in the study

Descriptive Statistics & Correlations										
No	Variable	Mean	S.D.	Min	Max	1	2	3	4	5
1	SA	6.842	0.285	6.666	6.875	1.000				
2	IC	6.816	0.321	6.669	6.827	0.529**	1.000			
3	CR	6.766	0.380	6.709	6.773	0.419**	0.555**	1.000		
4	CL	6.861	0.283	6.803	6.890	0.478**	0.410**	0.454**	1.000	
5	CA	6.851	0.245	6.699	6.940	0.149**	0.043	0.141**	0.113*	1.000
** Correlation is significant at the 0.01 level (2-tailed); * Correlation is significant at the 0.05 level (2-tailed); N=335										

4.2 Measurement model analysis

All standardized loadings were above 0.30 except for the CA construct, and AVEs for the single-factor model were below the recommended threshold of 0.50. Discriminant validity analysis showed that the SQRT (AVE) of the respective constructs were greater than the inter-correlation coefficients suggesting a good validity. All CPRs and Cronbach's alphas were well above the cut-off point of 0.70 (Fornell & Lacker, 1981) indicating good reliability measures, except for the marginally acceptable CA. The model fit indices showed $\chi 2/dfs$ below the cut-off point of 5.0, RMSEAs below the cut-off point of 0.06, and SRMRs below the cut-off point of ≤ 0.08. GFIs, NNFIs, CFIs, and IFIs are all above the cut-off point of 0.90 (Hu & Bentler, 1999). The results of model fit indices suggest a good fit of the measures. Table 2 shows the results of the measurement model analysis.

Table 2: The results of the measurement model analysis.

Measurement Model Analysis							
	Single Factor Model			Higher-Order Model			
Construct/Variable	Standardized Loadings	CPR	AVE	Standardized Loadings	CPR	AVE	Cronbach's Alpha
SA	0.36-0.65	0.85	0.30	0.65-1.00	0.93	0.76	0.85
	Ave: 0.54			Ave: 0.87			
IC	0.50-0.69	0.78	0.37	-	-	-	0.79
	Ave: 0.61			-			
CR	0.57-0.71	0.80	0.44	-	-	-	0.80
	Ave: 0.66			-			
CL	0.52-0.68	0.73	0.35	0.99-1.00	0.99	0.99	0.73
	Ave: 0.59			Ave: 0.99			
CA	0.20-0.59	0.62	0.20	-	-	-	0.60
	Ave: 0.43			-			

Measurement Model Analysis									
	Single Factor Model				Higher-Order Model				
Model Fit Indices									
	Single Factor Model					Higher-Order Model			
Construct/Variable	SA	IC	CR	CL	CA	SA	IC	CR	CL	CA
χ^2	107.99	8.60	0.00	0.40	17.14	2.94	-	-	0.00	-
df	62.00	7.00	0.00	2.00	13.00	2.00	-	-	0.00	-
χ^2/df	1.74	1.23	0.00	0.20	1.32	0.47	-	-	0.00	-
ρ-value	0.0003	0.283	1.00	0.820	0.193	0.231	-	-	1.00	-
RMSEA	0.047	0.026	0.000	0.000	0.031	0.037	-	-	0.000	-
SRMR	0.04	0.021	0.000	0.006	0.035	0.006	-	-	0.000	-
GFI	0.96	0.99	1.00	1.00	0.99	1.00	-	-	1.00	-
NNFI/TLI	0.97	1.00	1.00	1.00	0.98	1.00	-	-	1.00	-
CFI	0.98	1.00	1.00	1.00	0.98	1.00	-	-	1.00	-
IFI	0.98	1.00	1.00	1.00	0.99	1.00	-	-	1.00	-

4.3 Structural model analysis

The results of the hypotheses testing are presented in Table 3. The supported hypotheses have t-values ranging from 2.15 to 11.29. The overall model has χ2/df=1.23, ρ-value = 0.0158, RMSEA=0.026, SRMR=0.034, GFI=0.94, NNFI=0.99, CFI=1.00, and IFI=1.00 suggesting that the structural model of the study and the data is statistically good fit. Figure 2 illustrates the hypotheses testing results.

Table 3: Illustrates the hypotheses testing result

Hypotheses Testing Results				
No	Hypotheses	t-value	S. Coeff.	Results
1	**H1:** There is a positive relationship between strategic alliances and innovation capability.	8.60	0.89	Supported
2	**H2:** There is a positive relationship between strategic alliances and cost reduction.	11.29	0.80	Supported
3	**H3:** There is a positive relationship between strategic alliances and customer loyalty.	1.80	0.29	Not Supported
4	**H4:** There is a positive relationship between cost reduction and customer loyalty.	-1.30	-0.30	Not Supported
5	**H5:** There is a positive relationship between innovation capability and customer loyalty.	2.21	0.73	Supported
6	**H6:** There is a positive relationship between strategic alliances and competitive advantage.	2.15	0.51	Supported
7	**H7:** There is a positive relationship between cost reduction and competitive advantage.	0.93	0.30	Not Supported
8	**H8:** There is a positive relationship between innovation capability and competitive advantage.	-0.93	-0.45	Not Supported
9	**H9:** There is a positive relationship between customer loyalty and competitive advantage.	-0.84	-0.11	Not Supported
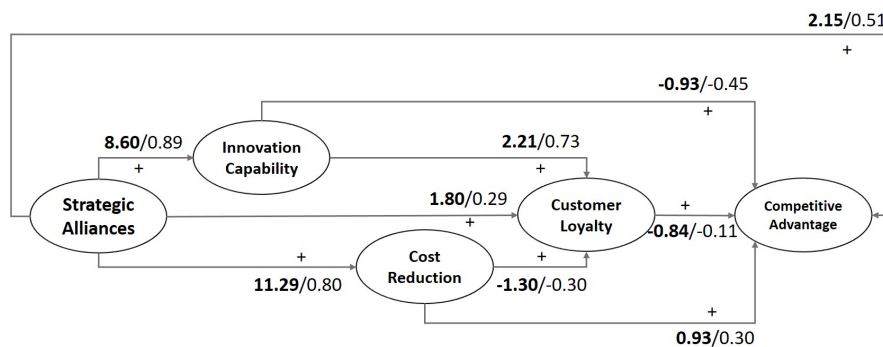
t-value/structural coefficient: Chi-Square=246.46, df=201, ρ-value=0.01584, RMSEA=0.026

Figure 2: Hypotheses testing results

5. Discussion

This study examines the roles of SA, IC, and CR towards CL and CA in the partner-to-customer alliances. The study found associations between SA and IC, CR, and CA, where SA has the greatest association with a t-value of 11.29 with CR compared to IC with a t-value of 8.60, and CA with a t-value of 2.15. The study showed IC has an association with CL with a t-value of 2.21. Such finding infers for partner-to-customer alliances, the key driver in developing CL comes from IC. The study confirms partners' commitment to SA would be perceived as highly substantial when the existence of non-financial contributions present like human resources and technical know-how that could enhance their capabilities. Such commitment is the key driver in establishing CL. No direct associations between SA to CL, and CR to CL because the relationships are fully mediated through IC. During a disruptive environment, customers value more the partner's ability to enhance their capabilities in dealing with challenges rather than merely on cost reduction to create CL. The high association between SA and CR can be explained by the transaction costs theory whereby firms enter into alliances to have resource exchange or sharing that improves their operational efficiencies (Gorovaia & Windsperger, 2018). From the perspective of resource-based view theory, the study confirms SA capitalizes on the strategic implications through the development of organizational capabilities evidenced by a positive relationship with CA. The study found no associations between CR to CA, and IC to CA because of the direct relationship between SA and CA. Furthermore, the study confirms Porter's (1996) view stating that operational efficiency is not a sufficient condition to create CA, particularly in a rapid change of business environment.

Our study enriches the literature on several issues. First, the study clarifies the role of SA in the partner-to-customer relationship showing high association in creating operational efficiencies for the customers. The study also shows operational efficiencies created in partner-to-customer alliances are not necessarily creating CL. From the resource-based view perspective, SA has an indirect relationship with CL mediated by IC. The study also shows that operational efficiencies are not the source of CA, while SA can directly foster CA. Furthermore, our study provides some important implications for partner-to-customer alliances. First, the key success factor in creating CL through SA is by fostering IC. Second, CR is an important outcome for SA, to achieve operational efficiencies. However, CR will not create loyalty or CA. The high t-value between SA and CR indicates the creation of operational efficiencies could be the short-term objective in SA while developing organizational capabilities could be the long-term objective of SA. Finally, the study indicates that developing CA in the partner-to-customer alliances is more driven directly by how SA is structured to enhance CA.

6. Conclusion

This study provides insights on the importance of the strategic alliance between partner-to-customers to enhance innovation capability and competitive advantage for the customers to create customer loyalty. Moreover, the study indicates that operational efficiency in the form of cost reduction is not a sufficient condition to create customer loyalty and competitive advantage, particularly in a rapid change in a business environment. This study has several limitations. First, the data was based on cross-sectional data. Hence, the results of the study may not be able to highlight the causality among the constructs before, during and/or after the Covid-19 pandemic. Future research could explore the research using the same research model longitudinal research. Second, the study only covered the firms in heavy equipment that have entered into partner-to-customer alliances with a distributor of heavy equipment. Therefore, the data collected from these firms may not represent other SA in different industries. Future research merits consideration to examine more diverse industries. Last, this study was conducted in Indonesia, the findings of the study may be affected by the country's demographic. Hence, future research could explore multi countries' studies.

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