

# Uncertainty, Risk, and Strategic Alliances

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## Conversation Ecosystem



- Let us frame our business activities as a series of **performance-driven actions** defined by engagement **rules** under risk and uncertainty as conceived by the **thinking** of business' leaders
- We argue that performance emanates from a thinking framework that determines which actions to take

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## Reframing: Successful organizations . . .

- Define, articulate and live a vision of the future they choose to create
- Know and listen to their customers, and respond to what they hear
- Create a culture in which their employees can achieve their personal excellence
- **Demonstrate the value in interdependence**
- Seek to continuously improve everything they do . . . forever

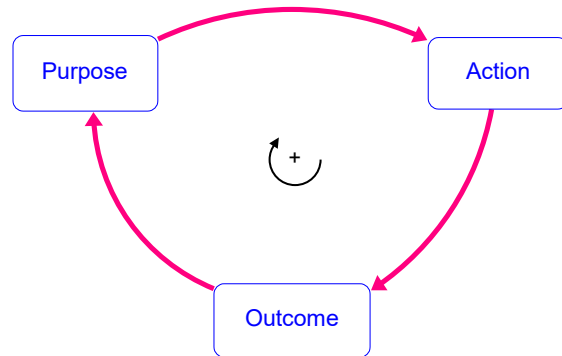
## Implementing Statement

We will continuously create **value innovation** for our chosen customers in ways that enable them to produce and grow their **superior performance**

Our chosen **customers will reward us** with our own superior performance, helping make the **competition irrelevant**

# Purpose-Driven Performance

- PepsiCo's vision is to deliver top-tier financial performance over the long term by integrating sustainability into our business strategy, leaving a positive imprint on society and the environment.
- They call this vision Performance with Purpose
- Purpose drives thinking, which determines action, which produces results/outcomes, which are the evidence of the actions and the thinking
- These results reinforce the purpose and sharpens the thinking to improve actions and enhance outcomes
- Those outcomes are always measurable and **mission relevant**



# Risk vs Uncertainty

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Risk is the probability of occurrence of an event

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Risks can be transferred through insurance

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Uncertainty describes epistemic situations involving imperfect or unknown information

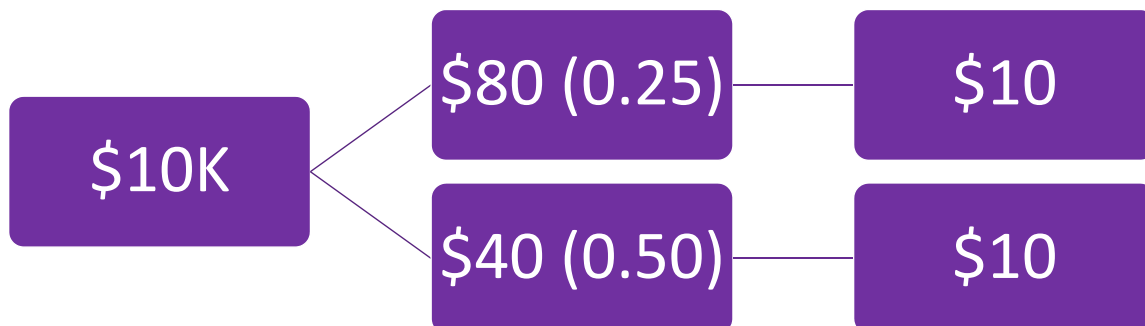
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But there is no insurance for uncertainty

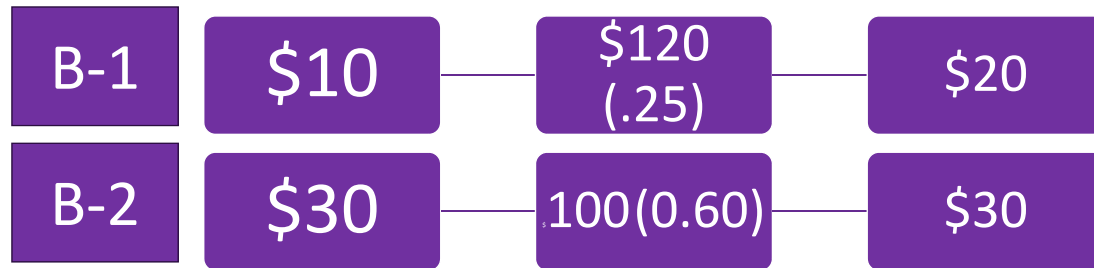
## An Illustrative Exercise

- Two investments (A & B) each with two options
  - Option A-1: Invest \$10K and expect a 25% probability of yielding \$80K in 5 years
  - Option A-2: Invest \$10K and expect a 50% chance of yielding \$40K in 5 years
  - Option B-1: Invest \$10K and expect a 30% probability of yielding \$120 K in 5 years
  - Option B-2: Invest \$20K and expect a 60% chance of yielding \$100K in 5 years

## Outcome Flow



## Outcome Flow



## Risk, Probability, and Uncertainty

- Would the expected outcomes actually occur **for me**?
  - Yes, there is a 25% chance that we will make \$80K but what will happen with the 75% chance alternative occurs?
  - What are the professional, reputational, and other costs if it doesn't work?
- What else are you thinking?

## Risk, Probability, and Uncertainty

- The options under both experiments are risky outcomes with known payout and probability of those outcomes, hence our ability to estimate the expected return,  $E(R)$ , and the expected profit,  $E(\pi)$
- If you were not indifferent between A-1 and A-2, you are in good company
- And if you did not choose B-2 over B-1, you are not alone
- You are not irrational, you're human
- You are human...let us dance to that

## Risk, Probability, and Uncertainty

- Humans do not work probabilities
- Their realities are more complex than the simplified expected outcomes model suggests
- What are some of the factors you thought about while considering the options?

## Risk, Probability, and Uncertainty

- We distinguish between the population estimate of risky events and uncertainty
- The 25% chance of getting \$80K from the \$10K investment is, technically calculated from watching similar investments across many industries over many years
- But you know you could roll a dice and get the same number over and over again

## Risk, Uncertainty, and Strategic Thinking

- But in the limit (i.e., very many times), we will move towards the estimated probability
- But humans don't live on a geologic time scale; we don't usually get a do-over
- Brings us to the concept of individual and population statistics

## Risk, Uncertainty, and Strategic Thinking

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At the population level (numerous replications by many different people)

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At the individual level, there is only one chance per event

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There it happens or it does not (50/50)

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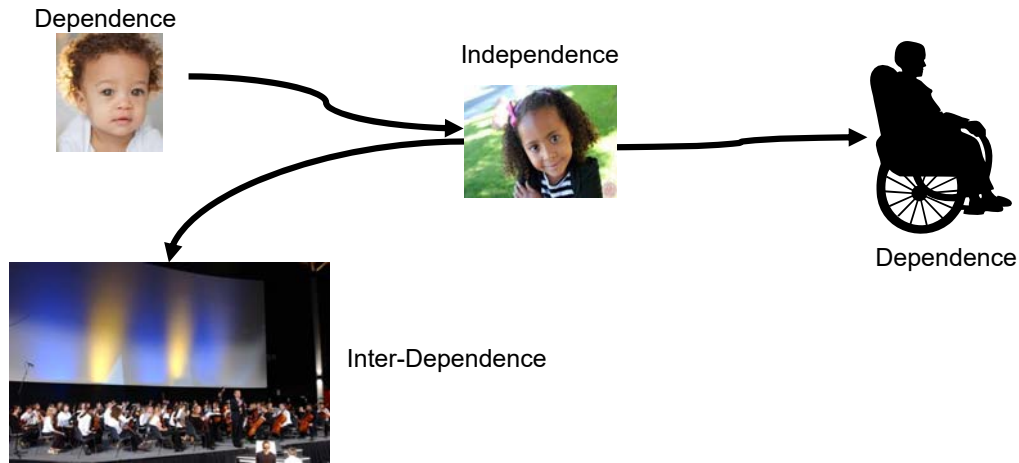
Bottomline: The probability of the outcome is not enough to motivate us to act

## Risk, Uncertainty, and Strategic Thinking

- How do we manage the inadequacy of information?
- Create flexibility that allows us to be agile and resilient
- Strategic alliances facilitate this strategy
- But we can only succeed at it if we are willing to move into an inter-dependent mindset and mode of operation



# Rights of Passage: Where Are We?



# What is Strategic Alliance?

- An arrangement in which two or more independent organizations,
  - Recognizing their need for each other,
  - Identify specific strategic objectives which they attain by
  - Mutually controlling decision-making processes and
  - Sharing associated risks and benefits



## Expected Strategic Alliances Outcomes

- Strategic alliances must aim at the minimum at Pareto Efficient Outcomes:
  - Partners are no worse off than they were prior to the alliance
  - At least one partner is better off than without the alliance
  - All partners are better off than without the alliance
- The ultimate expected outcome is Pareto Optimal
  - Where there is no other arrangement that will make every partner at least as well off and at least one partner strictly better off with the alliance

## Superiority of Strategic Alliances

- Advantages over spot market transactions
  - Reduction in transaction costs
  - Search, negotiation, pricing, quality & quantity uncertainty risk
- Advantages over integration
  - Reduction/elimination of agency costs
  - Information asymmetry, monitoring, enforcement, bonding
- Overall advantage
  - Learning and a greater appreciation of the system

## Rationale for Strategic Alliances

- Co-option
  - Turning current and potential competitors into allies
  - Bringing firms with complementary products and services together to enhance product/service value
- Co-specialization
  - Synergistic value creation resulting from combining previously separate resources — skills, brands, tangible assets
  - Melding differentiated skill sets and other resources to create embeddedness – enhancing total partner sustained competitive advantage

## Rationale for Strategic Alliances

- Learning & Internalization of New Skills
  - Creating strategic core competencies (cannot be purchased on the open market)
  - Provides new resources that are difficult to copy
  - Leverage learning into other business areas
  - Source of sustained competitive advantage
- Fluidity & Uncertainty of Competition
  - Today's partners are tomorrow's competitors

## Final words

- Strategic alliances are not a panacea for risk management
- They can be expensive alternatives to integration
- But when well thought-out, they can provide significant leverage in enhancing performance