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Strategic Alliances

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1. Definition of strategic alliances

Strategic alliances are agreements between companies (partners) to reach objectives of a common interest. Alliances are among the various options which companies can use to achieve their goals; they are based on cooperation between companies. The description “strategic” limits the field to alliances that are important to the partners and have broad horizons¹.

- Using a broad interpretation, strategic alliances are agreements between companies that remain independent and are often in competition. In practice, they would be all relationships between companies, with these exceptions: a) transactions (acquisitions, sales, loans) based on short-term contracts (while a transaction from a multi-year agreement between a supplier and buyer could be an alliance); b) agreements related to activities that are not important, or not strategic for the partners, for example a multi-year agreement for a service provided (outsourcing).

With this interpretation, the spectrum is wide. It goes from a sub-supplier contract to franchising and licensing; from R&D partnership contracts to joint venture and consortium investments, to participation in capital stock.

- According to a more restrictive interpretation, strategic alliances would be limited to long-term agreements based on the conferral of resources and participation in capital stock. Agreements based on contracts would not be considered alliances.

Whatever the definition, alliances have some distinctive characteristics².

- Two or more organizations (business units or companies) make an agreement to achieve objectives of a common interest considered important, while remaining independent with respect to the alliance. If A and B create an alliance C, A and B remain independent both between themselves and with respect to C.

1 According to Mockler (1998), strategic alliances are “agreements that are important to the partners, created to achieve common interests”

2 Mockler (1998), p. 2

- The partners share both the advantages and control of the management of the alliance for its entire duration. As we will see, this is the most difficult problem.
- The partners contribute, using their own resources and capabilities, to the development of one or more areas of the alliance (important for them). This could be technology, marketing, production, R&D or other areas.

Alliances which are now called “strategic” are not new.

Westinghouse Electric and Mitsubishi were allied for seventy years. Dow Chemical and Corning for fifty years. The alliance between Ford and Mazda dates back to 1931, when Toyo Corg Kogyo (Mazda’s predecessor) asked for help to build a three-wheeled vehicle in Japan.

What is new is the proliferation of alliances and the range of activities they embrace. They reflect a turbulent economy. They are an attempt to give stability to the environment. Factors of this turbulence are as noted: market globalization; technological innovations that break down barriers between sectors; and ever-intensifying competition.

- CALTEX. This is a classic example of an alliance, dating back to 1936. Standard Oil of California – later Socal, now Chevron – had the distributors to take advantage of the petrol deposits in Bahrain, but did not have access to refineries able to process crude oil with heavy sulfur content that was being extracted from the ground. Texaco, on the other hand, had an extensive distribution network in Asia and Africa, but had no oil wells in the Middle East. They decided to create an alliance. Caltex produces over one million barrels per day and distributes to more than 50 countries.

Alliances yield better results under certain conditions.

- 1) When each partner recognizes the need to have access to capabilities and competencies it cannot develop internally.
- 2) When a gradual approach is preferable in accessing resources, capabilities and competencies. Uncertainties about the future evolution of demand and technology often advise flexibility. The alliance can provide this.
- 3) When the acquisition of another company is not a possibility in achieving particular development goals.

It is a fairly common belief that the management of an alliance must have qualities different at least in part from those of the parent company (the partners). The reason is simple. The management of a strategic alliance is profoundly different from that of a company that acts independently.

2. Why alliances are more common now

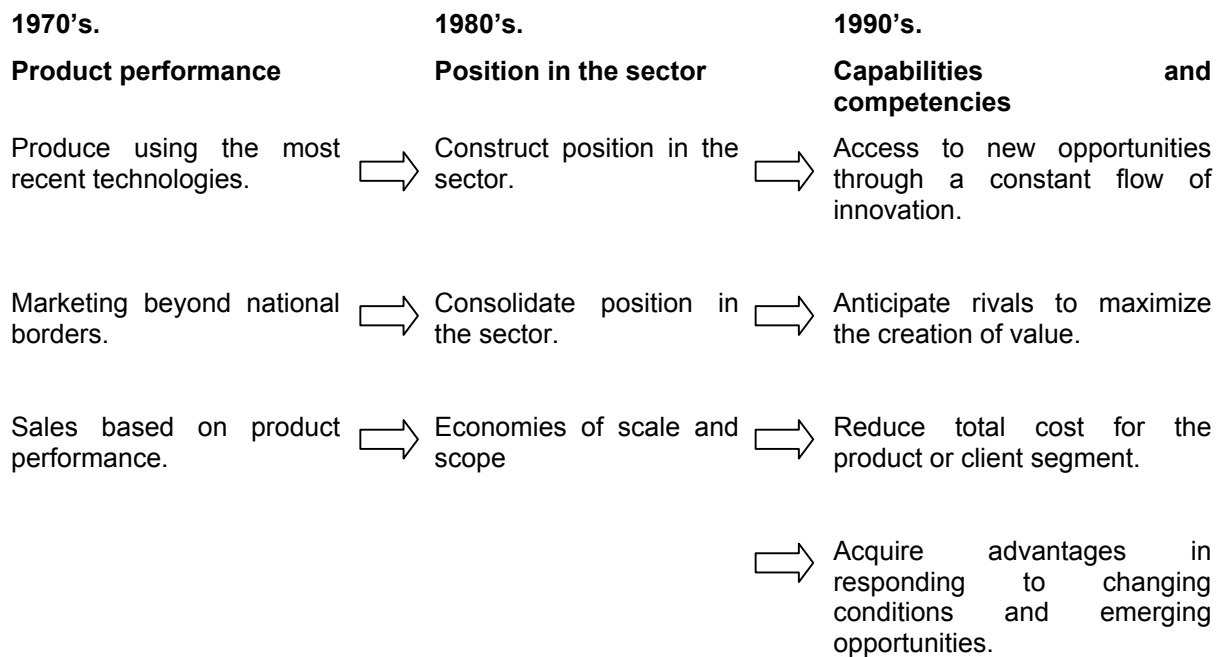
The drive to create alliances has evolved quickly over the last few decades.

- In the 70’s, the main factor was the performance of the product. Alliances aimed to acquire the best raw material, the lowest costs, the most recent technology and improved market penetration internationally, but the mainstay was the product.
- In the 80’s, the main objective became consolidation of the company’s position in the sector, using alliances to build economies of scale and scope. In this period there was

a true explosion of alliances. The one between Boeing and a consortium of Japanese companies to build the fuselage of the passenger

- transport version of the 767; the alliance between Eastman Kodak and Canon, which allowed Canon to produce a line of photocopiers sold under the Kodak brand; an agreement between Toshiba and Motorola to combine their respective technologies in order to produce microprocessors.
- In the 90's – according to Harbison and Pekar (1998) – collapsing barriers between many geographical markets and the blurring of borders between sectors brought the development of capabilities and competencies to the center of attention. It was no longer enough to defend one's position in the market. It became necessary to anticipate one's rivals through a constant flow of innovations giving recurrent competitive advantage.

Fig.1- Evolution of factors leading to alliances



Source: adapted from Harbison and Pekar (1998)

It is easy to predict that various factors will contribute to the diffusion of alliances in the coming years as well.

- Acceleration of the rhythms of technological innovation and shortening of product life cycles.
- The convergence of technologies and the “permeability” of borders between sectors and

between markets.³

- Progress in telecommunications.
- Strong improvements in R&D costs, new product launches, tools and systems.
- The collapse of many barriers to competition, on account of deregulation, privatization and globalization.
- The interest of governments in attracting foreign capital and technologies without ceding control of local companies to foreigners.

3. Goals of alliances

Alliances include a wide variety of goals which companies are completely or partially precluded from achieving when confronting competition on their own.

Setting new global standards. Entering into an alliance can be the best way to establish standards of technology in the sector.

- **PHILIPS-SONY.** In the late 80's, Philips was in essence pushed out the VCR market, when Japanese producers managed to impose their standards. To avoid new defeats, Philips created various alliances with Japanese rivals to assure technological compatibility among European and Japanese products.

The compact disc (CD) was designed with a global standard by virtue of a series of alliances:

- 1) between Philips and Sony, which not only contributed to the planning of the CD and sound reproduction, but with its presence in the alliance dissuaded other Japanese producers from seeking alternative solutions;
- 2) to spread usage of the CD and the standard, Philips ceded the production licensing in exchange for modest royalties;
- 3) Philips and DuPont made a 50-50 joint venture to produce and sell optics components for the audio-video market;
- 4) Philips and Sony jointly launched the mini-CD.

Confronting competition. When a high-volume producer decides to attack a new geographic market, defense is difficult if it does not have comparable size. Alliance between companies is a response which has often led to positive results. It is equally valid to attempt an attack on a leader that has consolidated its own positions.

- **CLARK-VOLVO** In the earth-mover sector, neither ClarkEquipment nor Volvo had enough production volume (the former in the United States, the latter in Europe) to take on the global leaders Caterpillar and Komatsu. In the mid-80's they decided to create an alliance.

Overcoming protectionist barriers. Alliances can allow companies to avoid controls on importation and overcome barriers to commercial penetration. For example, in Japan many

³ Convergence among sectors must be intended correctly. For example, microchips are a base technology for two sectors: computers and telecommunications. There was a convergence in technology, but the two businesses remained quite different.

companies have established that the best and fastest way to achieve success in the market is to make an alliance with a local company. In fact, the distribution system is controlled by a tightly-woven network of producers, distributors and importers. Only an alliance with one of these can open the road to the final buyer.

Alliances can also be a way to respect the bonds posted by the “host” country regarding value-added local content and participation in the capital of local businesses.

Dividing risks. For certain projects, risks of failure are high, and even higher when investments are elevated.

CFM International. The alliance (50-50 joint venture) between General Electric and Snecma was made to plan, develop and produce a new airplane propeller. Over ten years of R&D work and more than two billion dollars were necessary to sell the first engine.

Economy of scale. There are many alliances designed to divide fixed costs of production and distribution, seeking to improve volume. The alliances between airlines to manage reservation systems (Computer Reservation Systems) jointly are among the most notable examples.

- COVISINT. Every year, Ford, General Motors and Daimler Benz buy component parts and services together for \$250 billion. The auto companies give strategic importance to economies on the acquisition side. Covisint – that is, the synthesis of collaboration, vision and integrity – is a B-to-B that at first integrated exchanges of parts and services made within Ford and GM and then – after the entry of Daimler Benz – connected over 50 thousand potential suppliers.

Through a common platform, participants in the alliance aim to develop and standardize online transactions. According to the authors of COVISINT, with the complete realization of the network, planning of a new car model could decrease from 40 to 15 months.

- NESTLE'-HAAGEN DAZS. When in the summer of 1999 Nestlè and Haagen-Dazs (part of the Diageo group) announced an alliance for production and marketing in the United States (not the rest of the world), many were shocked.

In the past, Nestlè had rarely made alliances with the competition. The only notable exception was made to enter into a new product line: breakfast cereals. A joint venture with General Mills was formed called Cereal Partners Worldwide.

In the United States, Nestlè sought to build critical mass in the ice cream sector and a way to reduce costs by operating its plants in California and Maryland at full capacity.

“We believe we can grow better together than separately” said a Diageo spokesperson. Nestlè would contribute its frozen dessert technology, while Haagen Dazs would contribute to distribution through the network of points of sale with its name. (Beck E., “Nestlè, Haagen Dazs to create venture”, Wall Street Journal, 20-21 August 1999).

Access to a market segment. In mature segments, a company often wants to develop in a market segment where it is not present through an agreement with another company.

- SMART. An alliance was created between Daimler-Benz and the Swiss microelectronics company SMH. “Smart-ville” was inaugurated in October 1997, in Lorena, not far from the German border.

Access to a geographic market. A strategic alliance is often a way to enter a market that is protected by (national) tariff and other barriers, or dominated by another company with particular competitive advantages.

- **MOTOROLA-TOSHIBA.** For a long time, Motorola encountered serious obstacles to entering the cellular phone market in Japan. In the mid 80's, it publicly declared the existence of commercial barriers (state protection). The shift happened in 1987 when an agreement was made with Toshiba to produce microprocessors. Toshiba contributed access to the distribution network (difficult to penetrate for a foreign company) and its existing relationships with the governing authorities. Motorola was authorized to operate in Japan and also obtained a radio frequency for its own mobile communications system. (Economist, "Asia Beckons", May 30, 1992).

Access to technology. Convergence among technologies is the origin of many alliances. It is increasingly more frequent that companies need to appeal to their competition in different sectors if they want to realize a product line.

- **GENERAL INSTRUMENTS, MICROSOFT, INTEL.** In the "information gateway" alliance, General Electric brought its experience and market share in converter boxes; Microsoft contributed its software and Intel its microprocessors.

Uniting forces. Some projects are too complex, with costs that are too high, to be managed by a single company (military supplier contracts, civil infrastructure construction).

- **BOEING, GENERAL DYNAMICS, LOCKEED.** In the early 90's, these companies united forces to win a bid put forth by the Pentagon for the construction of a tactical combat destroyer. It was the biggest contract awarded by the American government (proceeds of \$5 billion per year).

Bridging a gap. If a company does not have the resources or capabilities necessary to develop a particular strategy, an alliance with one or more companies is the most logical solution. Making an alliance to gain access to resources and capabilities that are lacking internally is perhaps the most frequent motive leading a company to seek partners.

- **THOMPSON-JVC.** Thompson lacked the product technologies and production process needed to sell VCRs in a highly fragmented European market. It found these in JVC. For its part, JVC did not have knowledge of the European market or relationships with the distribution system necessary to enter this market.

"Anticipating a play". The advantages and risks of pioneering are significant. In many sectors, the first company to enter the market with a new product achieves advantages that are difficult for the competition to overcome. The company is the first along the experience curve. It gets the best positions for distribution. It invests initial profit margins in the production process, distancing itself further from the competition.

The strategic alliance can have the scope of utilizing the pioneering experience of one of the partners. If this experience is brought to the alliance, it confers the advantages on the other partners as well.

- **ALCATEL-FUJITSU.** The two groups, one French and the other Japanese, made a joint venture in order to develop the equipment for the third generation of cellular telephone. The alliance happened when operators in the sector started to invest in new networks to transmit wireless Internet services.

Alcatel is not one of the leaders in the sector, with less than 10% of the global market of equipment for cellular phones. Fujitsu is even smaller, but it has an advantageous position: close supplier relationships with NTT DoCoMo, the Japanese company that dominates the local cellular phone market and plans to launch the next generation of wireless service in April 2001. These relationships would give Fujitsu experience that Alcatel plans to use next in Europe.

One step towards acquisition. In addition to giving reciprocal advantages, an alliance can be one step towards the acquisition of one partner by the other.

- NESTLÉ'-HAAGEN DAZS. After the announcement of the alliance, some analysts commented that Nestlé would have preferred to acquire Haagen Dazs, but Diageo considered the business strategic to a portfolio that included the fast food chain Burger King, Smirnoff vodka and various brands of whisky including Johnnie Walker Scotch.

They suggested that Nestlé was probably using a long-term relationship with Haagen Dazs as the prelude to a possible acquisition in case Diageo had decided to agree to it.

- NO LACK OF CRITICS. Some critics sustain that alliances created by European and American companies with Japanese ones have given the latter low cost access to western markets and technology.

Reich and Markin (1986), for example, claim that the alliances of the 1980's were part of a deliberate strategy (also sustained by MITI) aimed at developing new technologies in Japan and selling products in the US, both with the assistance of the American companies. ⁴

4. Types of alliance

It is useful to distinguish among types of alliance in order to understand various characteristics and make choices. But every alliance is different and has its own story. It adapts its needs to specific situations.

After deciding to form an alliance and with whom, the best form of collaboration needs to be established.

There are numerous distinctions to be made. Three of these merit examination for their ability to illustrate the advantages and disadvantages of alliances and thus make the choice based on the different strategic needs of the partners :

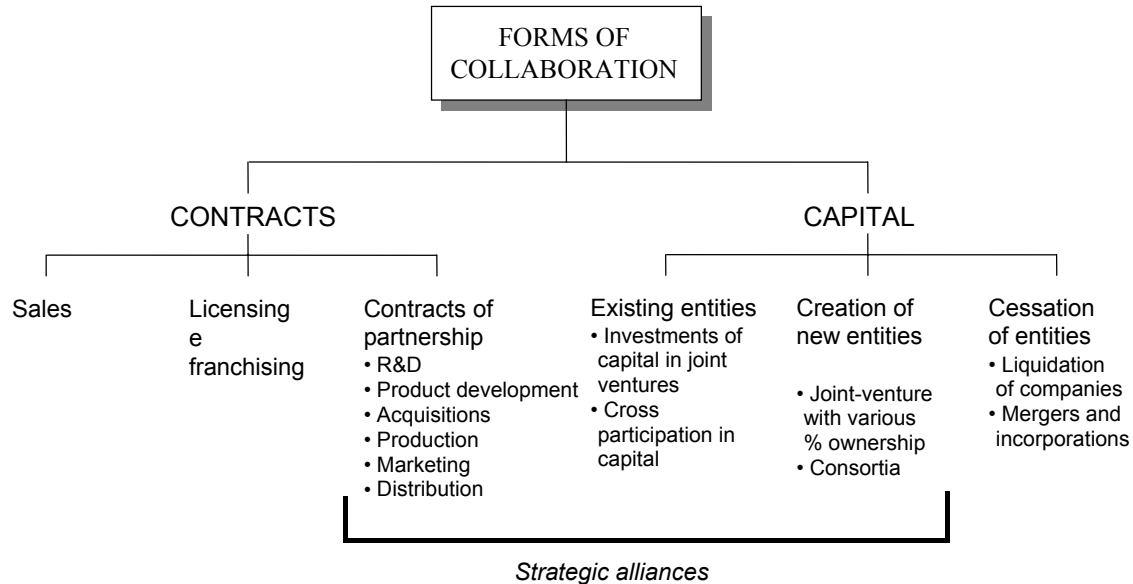
- 1) alliances based on contracts as opposed to those based on ownership of capital;
- 2) relationships between the degree of involvement of the partners in the alliance and ownership of capital;
- 3) management of the resources conferred in the alliance, their separability and the risk of other partners appropriating these resources.

4.1 Contracts/ownership of capital

⁴ Reich R., Mankin E., "Joint Ventures with Japan Give Away our Future", Harvard Business Review, March-April 1986, pp. 78-79

One of the most prevalent and effective distinctions (regarding problem management) is that between alliances based on contracts and alliances based on ownership of capital.⁵

Fig.2 – Forms of collaboration



Source: Mockler (1999)

Using this interpretation, strategic alliances would be contracts of partnership, investments in the capital of already existing organizations and investments for the creation of new organizations (joint ventures and consortia).

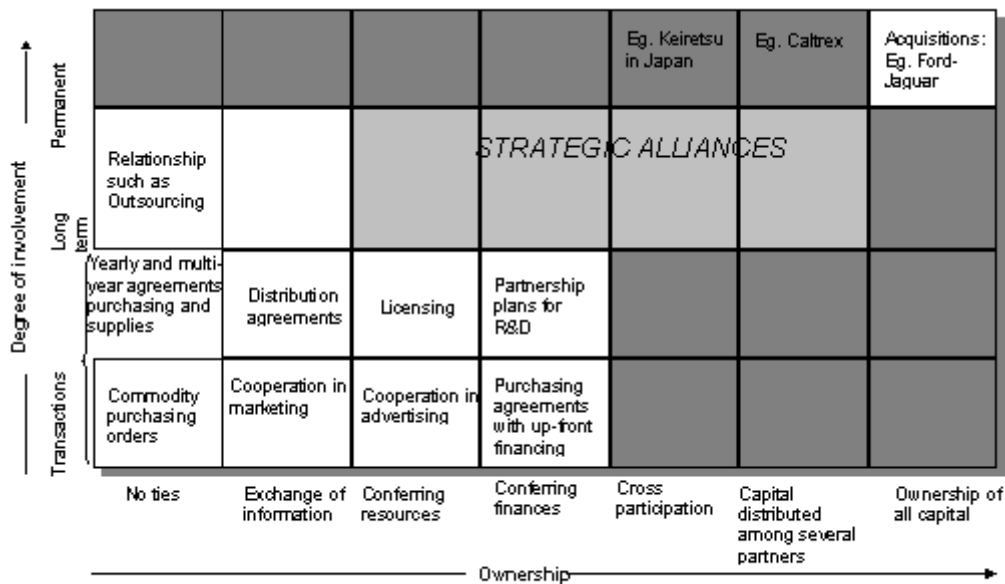
To clarify this concept of alliance, it is useful to look at what an alliance is not (if this interpretation is accepted).

- Mergers and acquisitions are not considered strategic alliances, in that they involve two or more entities that do not remain independent.
- For the same reason, the acquisition of control of a company's total capital by another company is excluded in discussion of an alliance.
- Whether a joint venture is or is not a strategic alliance depends on the features of the agreement. To be a strategic alliance, the agreement must be important for the partners. It is not a strategic alliance if it simply represents a tool to update
- periodically the database for a market or system of suppliers. It can be strategic if it concerns an agreement to distribute products in a market where penetration by a foreign company is difficult.
- Similarly, sharing technology in exchange for royalties is not strictly speaking a

⁵ Mockler (1999)

strategic alliance, unless it deals with “core competencies.” All the more reason a franchising contract is not considered a strategic alliance.⁶

Fig. 3 – The spectrum of agreements



Source: adapted from Harbison and Pekar (1998)

4.2 Involvement/ownership of capital

Others interpret the concept of alliance more restrictively. Harbison and Pekar (1998), for example, distinguish relationships between companies by two criteria. On one side, the degree of involvement, which ranges from a simple transaction (sale) to the long term and a permanent relationship (for example a cartel or keiretsu). On the other side is ownership of capital, which goes from no ties between the partners at all to total control of the capital by one or more of the partners (e.g. the 100% acquisition of Jaguar by Ford).

The two authors cited limit strategic alliances to long-term agreements based on conferring resources and financing and on stock participation (including cross participation). They do not consider relationships based on transactions regulated by contracts, such as agreements on marketing collaboration or the cooperation between distribution and licensing to be strategic alliances.

They exclude (on the grounds of their permanence) cartels, which aim to restrict competition and fix price structures, and keiretsu, which aim to give stability to the vertical structure of service and product suppliers. They also exclude joint ventures based on the ownership of capital.

⁶ In practice, the use of expressions like “partnership” or “letter of intent” must be made very carefully, as they carry a precise meaning from a legal point of view. Informal use of these expressions can raise unwanted obligations.

4.3 Resource management, separability, risk that a partner will appropriate resources

We have already discussed how strategic alliances are based on a wide variety of agreements. On one hand there are extremely formalized alliances based on contracts and the control of capital; on the other are alliances based on informal agreements between organizations, without any control of property.

The reasoning at the base of these different forms of alliance is varied, but more often than not involves the nature of resources (assets) involved in the alliance. “Resources” is a broad concept, ranging from the availability of financial resources to the availability of plants, from access to a market to intellectual property and the availability of professional capabilities (skills). A classification of strategic alliances and the motives at their origin is based on the weight given to: 1) the management of resources; 2) separability of the resources; 3) the risk that one partner will appropriate the key resources.

- Asset management: the extent to which the assets (resources) can be managed jointly.
- Asset separability: the extent to which it is possible to separate the assets (resources) between the partners.
- Asset appropriation possibility: the extent to which a risk exists that one of the partners involved could “appropriate” the assets (resources).

The following chart is the synthesis of the principal types of alliance, based on the concept of resources and illustrates the different factors that can affect the structure of these alliances. It also demonstrates how the same factors can affect the decision to acquire another company or create an alliance instead.

Fig. 4 – Types of strategic alliances

Types of strategic alliances and the reasons they are the basis of their constitutions

	Weak relationships (in the market)	Relationships based on contracts	Formalized relationships based on ownership of capital	Formalized integrations
FORMS OF ALLIANCE	<ul style="list-style-type: none"> • Networks • Temporary alliances 	<ul style="list-style-type: none"> • Sub-supplier • Licensing and franchising 	<ul style="list-style-type: none"> • Consortia • Joint venture 	<ul style="list-style-type: none"> • Mergers and acquisitions
FACTORS THAT INFLUENCE				
Asset management	<ul style="list-style-type: none"> • Resources that do not have to be managed jointly 	<ul style="list-style-type: none"> • Resources that can be isolated 	<ul style="list-style-type: none"> • Resources that must be managed jointly 	
Asset separability	<ul style="list-style-type: none"> • Resources that cannot be separated 	<ul style="list-style-type: none"> • Resources that can be separated 		<ul style="list-style-type: none"> • Resources that can not be separated
Asset appropriability	<ul style="list-style-type: none"> • High risk that one or more parties could appropriate resources 		<ul style="list-style-type: none"> • Low risk of appropriation of resources 	
			<ul style="list-style-type: none"> • High risk of appropriation of resources 	

Source: adapted from Gupta A, Singh H., "The governance of synergy: the R&D coordination versus external strategic alliances," Academy of management Annual Conference, Miami FL, 1991

4.4 Types of alliance

Alliances assume many different configurations.

Joint ventures. These are the results of agreements based on which the partner companies remain independent and decide to create a new organization that is legally distinct. The share of participation in capital can be 50/50, 49/51, 30/70. Most joint ventures limit collaboration to specific functions. For example, only R&D, not product development and distribution. Joint ventures that cover all possible functions of a company are rare.

- **EASTERN EUROPE.** In two different periods, joint ventures were the preferred tool of operations in the economies of Eastern Europe.

During the Cold War they were the only means of being present in these markets. The political regimes did not admit foreign property of means of production. As a consequence, the only possibility was a joint venture between the western company and a local organization. Western participation was almost always as a minority.

In the early 90's and beyond, the joint venture has represented the best way to set up collaborations between western companies and Eastern European ones. The former supplied technology and financial means, the latter supplied low-cost labor, entry into the markets and production facilities (which almost always needed modernization).

Consortia. These involve two or more organizations, both public and private. Their objective is a particular initiative or a particular project. The most significant examples are in construction or large infrastructure, like the Channel Tunnel, or aerospace construction, like the European Airbus consortium.

- **AIRBUS INDUSTRIES.** It was founded in 1969 by the governments of Great Britain, France, Germany and Spain. At the beginning it was a consortium for the marketing of the airplanes of the four partners: Aerospatiale, Daimler Benz Aerospace, British Aerospace and Costruccioni Aeronauticas.

Contract of partnership in specific functions. One or more companies decide to collaborate in one or more functions, such as marketing, R&D, production, distribution, or other functions, without starting a new, legally distinct entity. The partners set contracts or make formal agreements among themselves. They remain independent. Often, they are competitors.

Ownership of capital. The alliance can be based on stock participation of one or more of the partners by other partners.

Networks. These are agreements in which two or more organizations collaborate without formal relationships, but through mechanisms that provide reciprocal advantages. "Code sharing" agreements among airlines can be considered networks. These are agreements through which passengers can fly with one ticket, using several airline partners.

Franchising. This is an agreement in which a company (franchiser) allows another (franchisee) the right to sell its products or services. An exclusive franchise is when the agreement is made with a single company; a non-exclusive franchise when it is made with a number of companies. A franchising contract is set for a specific period of time. The franchisee pays a royalty to the franchiser for the buying rights. The most notable examples are Coca Cola and McDonald's. In these cases, the franchisee carries out a specific activity such as production, distribution or sales, while the franchiser is responsible for the brand, marketing, and often the training. In the fast food sector, and in clothing distribution, franchises are quite common: Burger King, Kentucky Fried Chicken, Tie Rack, Dyno-Rod.

Franchising is a type of alliance that offers advantages to both parties. The franchiser is offered the possibility of quickly developing sales over a wide territory, often worldwide,

without having to invest serious resources. There can also be advantages of entrepreneurial motivation of the franchisee, who prefers to operate under the brand name of a large organization. All generally have to contribute an initial investment in tangible activities, therefore having a personal interest in the success of the initiative.

The franchisee can gain the advantage of acquiring sales methods from the franchiser's technical assistance, specialized equipment and global advertising campaigns.

Licensing. This is an agreement in which a company allows another (exclusive licensing) or multiple others (non-exclusive licensing) the right to use its technology, distribution network or to manufacture its products. Licensing is based on a contract, generally stipulated for a specific period of time, in which the licensee pays a fixed amount and/or a royalty or fee for the rights that are ceded to it.

For an innovative company with limited resources, licensing offers the possibility of presence in multiple markets and recuperating investment capital quickly. The risk is that the company, ceding its own know-how to current or potential competitors (for a long period), therefore loses control over its core technology.

To address this risk, and to widen the collaboration in the technology field, the companies can decide to collaborate exchanging expertise or technology. They create a cross-licensing agreement that brings a certain expertise from A to B and licenses another expertise complementary to the first from B to A.

- **MOTOROLA-TOSHIBA.** The two companies made a cross-licensing alliance. Motorola ceded part of its microprocessor technology to Toshiba. In exchange, Toshiba allowed Motorola part of its memory chip technology.

4.5 Alliances for specific functions

For each partner, the alliance is a means to overcoming a weakness. Each wants to bolster its own capabilities, in technology, finance, marketing, etc., to ally itself with partners that are strong where it is weak.

Many alliances deal with specific functions. Two or more companies decide to cooperate in one or more functions: R&D, marketing, production, distribution, etc.

Research and Development. This is a collaboration for the development of new products and technologies. The alliance is generally limited to research. The partners then develop the production and distribution on their own. R&D alliances are an important strategic option when the costs for researching innovations are high and when shortening the life cycle of products creates pressure to be among the pioneers of product innovation and the production process, which also greatly increases risk factors.

The alliance also offers the advantages of having access to work groups with elevated professional skills, avoiding duplication of costs and accelerating the introduction of the product to the market.

Generally, this type of alliance is limited to a specific project or market segment. It almost always involves only one aspect of technology.

The organization of alliances is quite varied. Sometimes the partners carry out the research in their own laboratories or with their own equipment, then exchange information and personnel

(Philips-Siemens), or they develop distinct branches of the R&D process (Tanabe-Glaxo) or one part of the product (Philips Du Pont Optical).

Production. The advantages of an alliance in production are mainly in the economy of scale and the possibility of absorbing excesses in operational capacity during periods of declining demand.

Distribution. This is one of the most common and oldest forms of alliance. It gives a company the possibility of broadening its range of products and services offered on the market, adding the products and services of another company to its own. The greatest successes happen when the alliance is made for products that are compatible or complementary, so that they can be sold as part of a coherent line.

Alliances for distribution are often integrated with other alliances. For example, in exchange for an agreement to combine production capacity, one of the partners offers the other or others its own distribution structures (logistics, channels, relationships with individual distributors and distribution chains).

5. Best practices: a way to build alliances

If a company chooses alliances as a means to develop strategies, it is a common conviction that in order to obtain good results, there needs to be a method. It is considered risky to tackle alliances on a case-by-case basis; it is preferable to set up a line of conduct with the goal of accumulating experience. Much research has been done to identify the best practices that should represent a common denominator for each approach to the problem.

Best practices vary from one sector to another. The following list summarizes the principal paths that a future partner should take towards an alliance.

- 1) Place the alliance project within the long-term strategies of the company.
- 2) Define the specific goals of the alliance.
- 3) Choose the partners.
- 4) Evaluate what to offer and what to receive in exchange.
- 5) Define the opportunities.
- 6) Evaluate the impact on stakeholders.
- 7) Evaluate the negotiation capabilities.
- 8) Plan the integration.
- 9) Create the alliance.

5.1 Placing the alliance project within the long-term strategies of the company

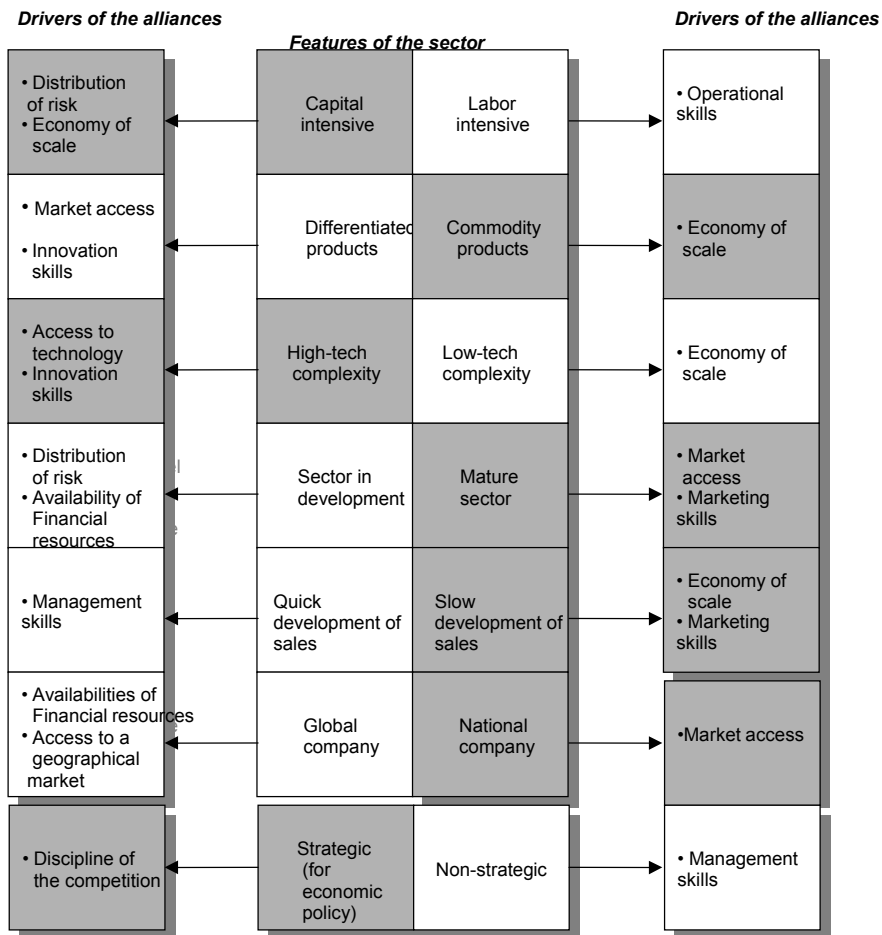
Strategic alliances answer various long-term strategies of a company. Not only the decision of whether or not to choose a strategic alliance, but also what type of alliance to choose depends on these strategies, the sector, the competitive position in the market, and the specific objectives the company wishes to achieve.

It is logical to place the goals of a strategic alliance within the framework of the long-term strategies of a company, but this is easier said than done. Unforeseen needs or opportunities in the long-term plans can arise. In addition, an alliance is rarely transplanted into a long-term strategy exactly the way the company hopes it will be.

There are, however, some uniform issues that are worthy of mention. They concern: 1) features of the sector; 2) the strategies adopted in a specific market; 3) the organizational culture.

Fig. 5 – Types of drivers

Drivers originating from features of the sector using telecommunications as the example



■ Features of the telecommunicationm sector

Features of the sector. There is a correlation evident between the features (drivers) of the sector and the use of strategic alliance. There is no doubt that the strategies of the electronics sector are different from those in passenger airplane transport. Each sector has its own drivers.

- TOSHIBA. Sato, CEO of Toshiba, sustains that strategic alliances, in particular the joint venture, are an irreplaceable component of the strategy of a high-tech electronics company with global ambition. “The times when an individual company could dominate with a single

technology or business are over. Technology has made so much progress and the marketplace is so complex that companies are prevented from reaching the top alone”.⁷

Among Toshiba’s primary alliances were those with Motorola (for D-RAM), IBM (computer flat screens), Ericsson (cellular phone equipment), Sun Microsystems (portable workstations), Apple Computer (television multimedia players), and Time Warner (development of interactive technologies for cable TV).

- **AIRLINES.** Strategic alliances in air transport are numerous, and their popularity is growing. They have a much different form than in the manufacturing sector. Why? First of all, the demand for transport of passengers and goods is increasing significantly. Secondly, the intervention of state authorities is strong (landing rights, flight paths, prices, ownership of capital). Most of all, the method of competition influences strategies: hub and spoke, or point-to-point routes? Finally, promotion and ticket sales which are entrusted at a growing rate to electronic means and the serious investment of capital to build or update the fleets.

The nature of the sector, in particular the fact that the plants are “mobile,” gives alliances based on shared code, marketing, terminals and airports and reservation systems. There are many alliances in this sector, but there are also many divorces.

The strategies adopted in a specific market. A gap emerges between what a company would like to do (goals to achieve) and what it can do realistically (available resources and capabilities) when comparing the threats and opportunities in the environment with the company’s strengths and weaknesses. The gap can be bridged by the alliance. For example, in order to compete on a global scale (as a long term strategy) and at the same time maintain its independence, the company must make alliances to develop R&D and

technology in partnership, together with others to use facilities, produce components and assemble products.

Often when a company intends to sell in a country as a way to develop, an alliance is the only alternative to overcome protectionist barriers.

The organizational culture. Why do some companies make alliances more than others, in the same sector and in the presence of the same competitive conditions? The experiences accumulated in the past, the orientation of the leaders and also the organizational structure create a culture that can be more or less inclined to make alliances.

- **MOTOROLA.** In the past twenty years, Motorola has made wide use of strategic alliances to confront the limitations of its own resources. Having put two strategies on the horizon: to compete in the global market and to compete in businesses that use semiconductors, Motorola (as an example) licensed its technologies to NEC and Hitachi in Japan, made a joint venture with Toshiba and entered into a consortium, Iridium Japan, with Sony, Mitsui and Mitsubishi, and created a subsidiary with 100% control of capital: Nippon Motorola.

5.2 Defining specific objectives of the alliance

The research of Booz Allen & Hamilton mentioned above identified the objectives of the alliance as one essential requisite for success. This is particularly valid when the partners are

⁷ Schlender B., “How Toshiba Make Alliance Work”, Fortune, October 4, 1993, pp. 116-120

also competitors. There is no doubt that a plan is necessary. Dissent lies in how to construct it, in that the path to an alliance is only in part definable a priori.

Three things are necessary for the success of the alliance through definition of objectives.

1) As for any strategy, the objective must be compared with the company's available resources and capabilities and with those that could be used. The alliance should bridge the gap of existing resources and capabilities to achieve the objectives. It is evident, though, that it is not always the case that this gap can be bridged with an alliance.

2) A clear consensus (internal) on why the company cannot reach particular goals on its own and why it must seek an alliance with an external organization rather than internal development or an acquisition.

Some questions identify the core essence. Does the project have the support of top management? Do the advantages of the alliance benefit the entire organization or only part of it?

3) Knowing where the alliance generates advantages within the chain of value and clarifying why each partner cannot develop these advantages internally.

Harbison and Pekar (1998) advise particular attention to the responses to some questions. Are we creating new competitors? What does the alliance mean for the future of our company? Does it change our competitive position in other business arenas?

5.3 Choosing partners

After deciding to go ahead with the alliance, the next step is to decide with whom to make it. The criteria for this choice are also quite varied according to the needs and past experiences of the individual partners.

TAKING THE INITIATIVE. Choosing partners is one of the most difficult steps. Booz, Allen & Hamilton suggest an active participation in the selection, the identification and the approach to potential partners, rather than waiting for others to take the initiative.

One factor that must be examined carefully is the history of the partner on the subject of alliances.

- Booz, Allen & Hamilton also recommend identification of the drivers of the alliance (the expected benefits) for the various partners. The drivers can be complementary, but not cover everything necessary for the success of the alliance. Some can overlap (several partners contribute to the same area with analogous resources, capabilities and competencies); some can be completely lacking.

Planning the expectations, knowing those of the partners and incorporating them into the company's own plan for the alliance contribute to building trust among the collaborators. It also helps partially to anticipate the behavior of the partner in subsequent negotiations.

The chart that follows is an example of a situation in which the partners are complementary in many drivers of the alliance, but do not cover them all (blank spaces).

THE PROFILE. According to Hill and Jones (1999), the right partner in an alliance must have three principal features.

- 1) The partner must have the resources and capabilities to help the company achieve its strategic goals, whether access to a market or allocation of costs and risk in launching new products. It must bring to the alliance what is missing from the others and which they are seeking.
- 2) The partner must share its long-term goals for the alliance. Failure is inevitable if the goals are divergent.
- 3) The partner must not use the alliance to appropriate know-how, relationships with clients or suppliers or technology without making contributions of equal strategic weight. Alliances are longer lasting and better when they are considered between partners with a reputation for correctness.

Garr (2000) points out that when Gerstner decided to acquire Lotus Development in a hostile manner, at a time when it was allied with IBM, the primary concern was: “what will they say to our partners in other alliances?” The fear was that the reputation as a trustworthy partner would be shaken, and it would be more difficult to find allies in the future.

THE THREE Cs. According to Business International (1992), instead of turning to a long list of criteria to measure the potential of candidates for integration, it is preferable to bring it all down to three requisites, the three Cs: Compatibility, Capability, Commitment).

Compatibility. It is easier to establish whether compatibility exists by looking at previous alliances. Many strategic alliances are made up of partners who already have ties between them: supplier-client relationships or licensor-licensee. Experience says whether the partners can cooperate; personal ties are already established. Each one knows the capabilities, values, culture and management style of the other.

Building relationships with known partners reduces one type of risk, but runs another: giving up the ability to select better partners for new alliances.

Capability. Generally one partner seeks in another the capabilities that contribute to strengthening an alliance. It looks for a complement. One partner can cover a geographic area, another a different one; one partner technology, the other distribution.

Commitment. The partner can be compatible, with complementary capabilities, but it must also believe in the alliance. It must commit. Business International (1987) suggests two tests to verify commitment: 1) do the core businesses coincide? 2) What difficulties would the partner have if it decided to pull out? What risks would it run if it ignored the agreement?

5.4 Evaluating what to offer and what to receive in exchange

Each partner must evaluate which capabilities are critical to the alliance. What the appropriate position is with respect to them. What advantages to expect. It should also evaluate what advantages of the alliance are expected by the various partners. What the company can offer to the others and what it can expect from them.

5.5 Defining the opportunities

Knowing the value of the opportunities that can be achieved with the alliance is an essential guide in negotiation and subsequent management of the alliance itself. Beyond the opportunities it is also necessary to examine the possible threats.

Often alliances change the landscape of competition. They can then elicit reactions from the competitors, the authorities that discipline competition, and governments. The evaluation must therefore be repeated periodically. It is possible – especially in the case of intervention by public authorities – that the alliance has to be renegotiated on a different basis than originally decided.

5.6 Evaluating impact on the stakeholders

Given that the creation of value for the shareholders is a priority goal and given that the strategic alliance is generally very visible, the management must consider the realistic reaction of shareholders when evaluating the pros and cons of the project.

When announcing the already decided or possible alliance, investors can react by making an evaluation of the agreement that could translate into a variation of value of the stock on the Market. The benefit of this variation is difficult to predict. Various other factors can also impact on the listing.

The evaluation should not be limited to reaction of the investors, clients, suppliers and employees, but it should also include reaction of the government, the local community, the banking system, unions and, not least of all, the authority that regulates competition. The question is: how will they react to the alliance?

Alliances often change the landscape of competition, rewrite the way of competing, initiating reactions of rivals and antitrust authorities. There are many cases of announced alliances, which are later dissolved or changed in structure following antitrust intervention.

From the research of Khanna and Anand, results were obtained that Wall Street reacts differently according to the sector and type of alliance. The results show that the highest evaluations (the progress of the listings) go to licensing agreements. Joint ventures result in less enthusiasm.

5.7 Evaluating negotiating capabilities

There are vast writings on the subject of negotiation processes. According to Booz, Allen & Hamilton, the ability to negotiate, in particular for alliances, is the result of a process that mainly includes the following steps.

- Defining on which resources and capabilities the alliance depends.
- Protecting the core resources of the company and showing the potential partner what they are and why they are protected (in order to avoid losing exclusive ownership).
- Studying the negotiating style of the potential partner and the results of its previous alliances.
- Establishing why the other is available to negotiate and what goals it has in mind.
- What resources and capabilities the other partner can realistically bring to the alliance.

- There are ample writings on negotiation. Regarding alliances in particular, the suggestions that emerge from analysis of publications on the subject are

concentrated on the make-up of the negotiation team. Business International suggests: a) a scrupulous, detailed program; b) simulating what could happen at the negotiation table; c) determining in advance not only the economic results of the alliance, but the target of all transactions; d) not to underestimate the symptoms that reveal the interest of the partners in the alliance to be insufficient or modest during the course of planning.

Many executives who have participated in alliance negotiations suggest not hesitating to abandon the project if serious difficulties are already emerging during the initial phases.

5.8 Planning the integration

Integration deals with two aspects in particular: current management and the choice of top management. Both of these aspects will be subsequently examined.

Agreements should foresee the (not rare) eventuality that external conditions could evolve in a different way than anticipated, so much so as to change the landscape of expected advantages and the contributions planned by the partners.

This can be an increase in the price of raw material or a strong oscillation in the exchange rate. A form of protection should be identified and agreed upon for each type of risk.

For example, a band of variation could be identified for fluctuations in the exchange rate within which each partner tolerates disadvantages or keeps the advantages (tolerates losses and enjoys benefits). Beyond this band of variation, profits and losses can be divided among the partners.

In order to give stability to the alliance, a common suggestion is for the parties to commit for no less than five years. This should give the alliance a sense of stability and a mission able to direct both partners.

Reciprocity of advantages and obligations should be verified. Too often a partner believes it has access to technology, plans, production processes and gives in exchange less than what it receives.

Another suggestion relates to the so-called “divorce clause.”

Withdrawal should not be without consequence. Making withdrawal difficult has a great advantage: it reduces conflicts and pushes the partners towards the agreement, for long-term choices as well.

The business plan should in particular:

- a) establish how to choose and remunerate executives;
- b) organize activities and functions (R&D, production, planning, etc.);
- c) define accounting procedures to determine benefits and dividends to be distributed;
- d) define procedures to resolve conflicts;
- e) define relationships between the alliance and the parent company.

5.9 Creating the alliance

Management, organization and control are the three processes upon which the creation of the alliance project is based. The three processes together follow from the chosen form of alliance.

The pages that follow are dedicated to management and control. Two directions prevail regarding the organization: 1) a flexible, agile structure; 2) a structure designed with the features of the alliance in mind and not as a function of the needs of the partners.

Whatever the form of the alliance adopted, some principles apply.

- Each company has its own goals that dictate the role of the alliance.
- Depending on the intended markets and the strategies to be adopted in these markets, the company chooses whether to make an alliance, what type to make and with which partners.
- The role of the alliance changes as internal and external conditions evolve.
- The relationship between the partners is quite dynamic. An alliance can begin as a licensing agreement and then evolve into a joint venture or stock participation.

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