PARTNERSHIPS FOR PROFIT

Structuring and Managing Strategic Alliances

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Preface

SUDDENLY, the business world is undergoing massive, fundamental change. At the same time as global competition is raising the standards for quality, innovation, productivity, and customer value—those golden keys to success—the scope of what a firm can do alone is shrinking.

As a manager, you probably already know that quality improvements require close cooperation with suppliers, and customer value comes from close ties to users. Now, think more broadly.

In a world bursting with new technology, how much more innovative can you be if you reach out to share others' developments? Why limit productivity advances to what your firm can do alone? Why not become even more efficient, for example, by adapting others' know-how or building a larger-scale plant with a partner? More generally, why not seek excellence by focusing on those things your firm does best and work with others in areas where they excel? Can you afford to lose such opportunities?

Clearly, there is little doubt regarding the answers. In all industries, in every nation, firms have gained real power through cooperation. Around the world, the number of such efforts has risen by orders of magnitude within the past decade. We have entered the age of strategic alliances.

The sudden prominence of alliances is a dramatic change from just a few years ago. They will be far more important in the years ahead. This phenomenon raises vital questions reaching well beyond most managers' experience:

- What is driving the change? Is it here to stay?
- How should alliances affect strategic thinking?

- How can a firm benefit from alliances without being hurt?
- Is there a way to cooperate safely with a competitor?
- When should different kinds of alliances (such as risk-sharing contracts or joint ventures) be used? How should they be designed and managed?
- How can a firm work with other business and national cultures?
- What management practices does a firm need to support alliances?

To answer these questions this book builds on the experiences of some of the most successful strategic alliances and alliance practitioners in the world. It describes alliances that make diapers, cars, office copiers, jet engines, software, pharmaceuticals, trucks, alcohol, computer chips, health tests, telephone switches, and optical fiber; and others that distribute magazines, carry passengers, perform research, share technology, bottle soft drinks, lobby governments, auction vehicles, and create ads.

The illustrations include alliances of Apple Computer, Asahi Glass, Baxter Travenol, Bloomingdale's, Boeing, British Aerospace, Cadbury Schweppes, Ciba-Geigy, Coca-Cola, Corning, Digital Equipment, Dow Chemical, L. M. Ericsson, Fiat, Ford Motor, Fuji Xerox, General Electric, Glaxo, Harris, Hercules, Hitachi, IBM, Intel, Johnson & Johnson, Kawasaki Heavy Industries, Komatsu, Martin Marietta, Matsushita, Mazda, McDonald's, McKesson, Mitsubishi Heavy Industries, National Semiconductor, New York Times, Nippon Steel, Northern Telecom, Ogilvy & Mather, N.V. Philips, Pilkington, Rockwell, Rolls-Royce, Samsung, Siemens, SNECMA, Sony, Sumitomo Bank, Texas Instruments, Thorn-EMI, Toyota, and Volkswagen, plus many other Asian, European, and U.S. firms.

Successful companies that shared their experiences for this book have had few guidelines for strategic alliances. Like other accomplished pioneers, their good fortune today comes from intuition, intelligence, some luck, an early start, and a solid ability to learn from experience. That they have not translated their mastery into formal guidelines is probably because, having learned by doing, they absorbed key lessons implicitly.

Beyond that, each firm's experience is limited to alliances that have met its particular needs. Further, separate units in the same firms use alliances in different forms, for different reasons, and manage them differently. The practice of strategic alliances is thus fragmented and uncodified.

Consider that for one kind of alliance—the joint venture—there are seven distinct starting and operating conditions, and three basic ownership and governance arrangements (see Chapter 9). Each combination has unique implications for design and management.

Companies with less background in alliances thus have to experiment on their own. Unfortunately, studies of alliances cite high failure rates.[1] Even some widely acclaimed alliances, such as General Motors' and Toyota's NUMMI joint venture in California, are not the successes that have been reported, when we look at them carefully (see Chapter 4). With the rapid global growth of strategic alliances, one ought to do better.

My own thinking about strategic alliances has taken shape over the past twenty years as I have been increasingly drawn to help plan, advise on, work in, teach about, and sometimes manage alliances around the world. These experiences began in the late 1960s. By the early 1980s it was clear that a new—possibly important—trend was building.

To better understand its breadth and thrust, I assigned "cooperation in business" to a research seminar I was teaching at the University of Pennsylvania's Wharton School. We uncovered a surprisingly large number of what are now called strategic alliances. Most significantly, their number was growing rapidly from year to year. At the same time, executives I knew and visited in major firms at home and abroad also saw cooperation as becoming more important.

Yet there were no guidelines for how two or more firms—with different objectives and cultures—could work together to strengthen each, while remaining independent. Those observations, plus the documented high failure rates, led to my decision to write this book.

The core of this book is built from about three dozen case studies I wrote on a selected set of alliances. These were picked from a broad literature survey done over five years to expand the original work at Wharton. Cases were chosen with one criterion: An alliance must have produced (for a product or service) or become (for a business) an important factor in its industry.

This led to a list of about eighty alliances, which was then narrowed to include experiences broadly representative of major business dimensions: high- and low-technology, global giants and local enterprises, manufacturing and services, consumer and industrial goods, domestic and international.

Most cases were developed from on-site interviews with several people, on both sides of an alliance, plus material from internal documents that were shared with me. In total, more than a hundred executives from some forty U.S., European, and Asian firms participated, with about five hundred interview hours in all. The cases turned out to be extensive. Many run to fifty pages. Completed cases were approved by the respective firms.

As you read through the chapters you will find that many firms were willing to share their good and bad experiences. Surely this is a sign of strength.

To fill out my research, the case studies were complemented by several hundred descriptions of strategic alliances culled from the business press.

To understand what it takes to build and support effective alliances, I also spent considerable time over about two years with a wide range of mid-level and senior executives inside Corning Incorporated, Ford Motor Company, and two other major firms, which I do not identify. Corning and Ford are widely regarded as exceptionally well-managed firms, and each has been an industry leader in the use of alliances. In fact one-half of Corning's corporate earnings come from joint ventures. The unnamed firms' experiences were generally poor, and the contrasts were useful.

In the process of writing individual cases one difference between success and failure became evident. Executives with successful experiences kept redirecting our interviews to how people on both sides of their alliances had built strong relationships. For them, strategic gain was the motivation for alliances, yet strategy was an intellectual construct that worked or didn't depending on relationships.

For me, the direct evidence of close relationships was also strong. In separate interviews people on both sides of successful alliances described in the same way the issues, the arguments they had had with each other, and how they were resolved. Different firms always have different views. Good relationships make it possible to see a partner's perspective, to be sure one's own concerns are heard, and to work things out.

This crucial feature was underscored during my interviews on less successful (by their own measure) alliances. It often seemed as though people on each side were not talking about the same experiences, and by their own account didn't know each other well.

One other observation was particularly significant to me. It was clear from my research that regardless of nationality, industry, or purpose, a successful alliance requires the same basic ingredients.

Contents

An Introduction to Strategic Alliances

IN a strategic alliance firms cooperate out of mutual need and share the risks to reach a common objective. Without a mutual need companies may have the same objective, but each can get there on its own. If they don't share significant risks they can't expect mutual commitments. Firms will share risks only if they need each other to reach the same objective.

Strategic alliances provide access to far more resources than any single firm owns or could buy. This can greatly expand its ability to create new products, reduce costs, bring in new technologies, penetrate other markets, preempt competitors, reach the scale needed to survive in world markets, and generate more cash to invest in core skills.

The way Dow Chemical and Personal Care (not the real name) introduced a radically new kind of diaper is instructive. Personal Care, a large consumer products firm, asked Dow to develop a highly absorbent polymer that would make diapers thin and dry.

To create the product, Personal Care needed Dow's technical expertise and Dow needed Personal Care's marketing strength. The firms faced major risks, which they shared. It wasn't clear that buyers would change their practices. Diapers had always been promoted as "the thicker the better." Personal Care had to make major investments in new designs, materials, facilities, and advertising. To make the new polymer, Dow had to build an expensive, reliable plant in record time. The firms' shared risks and mutual dependence fostered a high level of cooperation, which led to an important new product for each.

Shared Objectives Set the Stage

It may seem unnecessary to tell prospective partners they must first agree on what they want to achieve. The point is vital, however, because every firm has its own objectives. Some are of such long standing that they have become tacitly understood and are rarely stated. Moreover, one party will often make the assumption that another's expectations are what it would like them to be.

Azusa Tomiura, a Nippon Steel executive, tells of a machinery manufacturer that proposed a joint research effort on a novel rolling mill it had conceived. Nippon realized the mill might produce a product it was considering. Yet the machinery firm would consider the research done when a practical mill was developed, while for Nippon Steel the R&D would be complete only when its new product was realized. With different objectives, there was no hope for a successful alliance.[1]

When we fail to surface our hopes and presumptions, we set the stage for later conflict. Further, without making compromises in our separate objectives, we can't join to reach a more powerful result.

Take the experience of Fiat and Ford. These firms have become highly successful alliance practitioners, but not without some early missteps. In the mid-1980s the two spent many months planning a European joint venture that would have given them 25 percent of the market—almost twice the share of their nearest competitor. At a time when European auto firms were facing major changes, the expected efficiencies would give the firms important added strengths. Yet until the end of their discussions, each assumed the other would eventually be willing to yield control. The deal came apart when the differences finally surfaced.

Mutual Need Builds Commitment

When a relationship builds on mutual need, it helps the partners win internal support and move beyond the thicket of day-to-day problem-solving, partially conflicting interests, and contrasting cultures. It also cools arguments that one firm must dominate to succeed or could have done as well alone.

In the early 1970s General Electric and France's SNECMA, which manufactures jet engines for the Mirage fighter, formed a joint venture to build a new class of commercial aircraft engines. GE had most of the technical skills but could not afford to develop and produce the engines by itself. GE also had poor access to the growing European commercial aircraft market. SNECMA had related technical know-how, good European market contacts, and financial depth, but no commercial experience. Together, both companies had the needed technical, marketing, and financial resources neither could assemble alone.

At first there was considerable resistance. People in each firm tried to undermine the venture. SNECMA employees questioned GE's experience—it was a relative newcomer to this market. Skeptics in GE feared creating a new competitor. Senior executives in both firms had to use their authority to overcome internal resistance.

As the venture progressed, both sides came to respect each other's contribution and recognize their mutual dependence. These growing bonds supported the close cooperation needed for joint development, manufacturing, and marketing. Today the firms' teamwork is based on widespread mutual respect and a deep belief that they will need each other for a long time to come. Their joint venture, CFM International, makes the best-selling commercial jet engine in the world.

An alliance lasts as long as mutual need exists. As soon as one partner's value erodes, the other has reason to take over or to leave.

This happened in a British communications equipment joint venture between Thorn-EMI, the large electronics and entertainment firm, and Sweden's L. M. Ericsson. Thorn provided market access, and Ericsson contributed the technology. Together they won major orders over foreign competition. After the British market was opened to outsiders, the value of Thorn's marketing declined, while the venture remained dependent on Ericsson's technology. Thus even though Thorn held a majority stake, effective control shifted to Ericsson, which eventually bought Thorn's share.[2]

Continued mutual need—buttressed by each firm's efforts to keep it this way—has been a hallmark of CFM International. The original CFMI product was largely a straightforward extension of GE and SNECMA abilities. However, major technological improvements have been crucial to staying competitive in the hotly contested aircraft engine market.

Thus while GE has been the leading industry innovator, SNECMA has developed strong technologies that are now going into CFM products. In some areas, SNECMA technology has become equal to or better than GE's. Moreover, GE and SNECMA continue to need each other to win customer acceptance in different markets around the world, and to share the risks of their large investments.

Risk-Sharing Completes the Bond

If one firm has nothing to lose while its partner is highly exposed, it has no compelling reason to go the extra mile for the sake of a shared objective. With more at risk, the partner will hold back or withdraw.

This pattern has been evident in many sectors, including the American auto industry. U.S. auto makers have, until recently, used annual supply contracts that emphasized lowest cost. This produced uncertainties about future commitments that kept suppliers from making longer-term investments. The incremental, risk-averse practice severely inhibited the development of new product and process technologies by suppliers, substantially weakening the whole industry.[3]

Risk-sharing creates a powerful incentive to cooperate for mutual gain in all kinds of settings. You may not think of franchising as a form of alliance, and often it is not, because many arrangements place much of the burden on franchisees.

But consider McDonald's—the most successful restaurant chain in the world. More than most other chains, McDonald's profits depend on its franchisees' success. As in other chains, McDonald's owner-operators must buy from common suppliers for uniformity. Unlike others, McDonald's rejects the usual practice of taking a markup on supplies. If individual restaurants make money, everyone does well. The practice stimulates McDonald's to work even harder for its franchisees.[4]

We often cooperate out of mutual need. But we have tended to take the risks separately or to use our economic power to force them on others. This hurts both of us when it sacrifices mutual opportunities, or if we will need each other's strengths in the future. In a successful alliance shared risks, like mutual need, foster stronger commitments.

Alliances Depend on Relationships

The risks in an alliance include how effectively firms will work together. Like a marriage, this can't be predicted with certainty at the start. Successful cooperation hinges on mutual trust and understanding, which develop only with effort, over time. When one company is engaged in a new activity with an unfamiliar firm, the quality of the relationship may be the riskiest part of their alliance.

Consider what might be needed to distribute a partner's product with your own, or to service its equipment in your territory. These activities may involve little investment risk if you are using excess capacity to