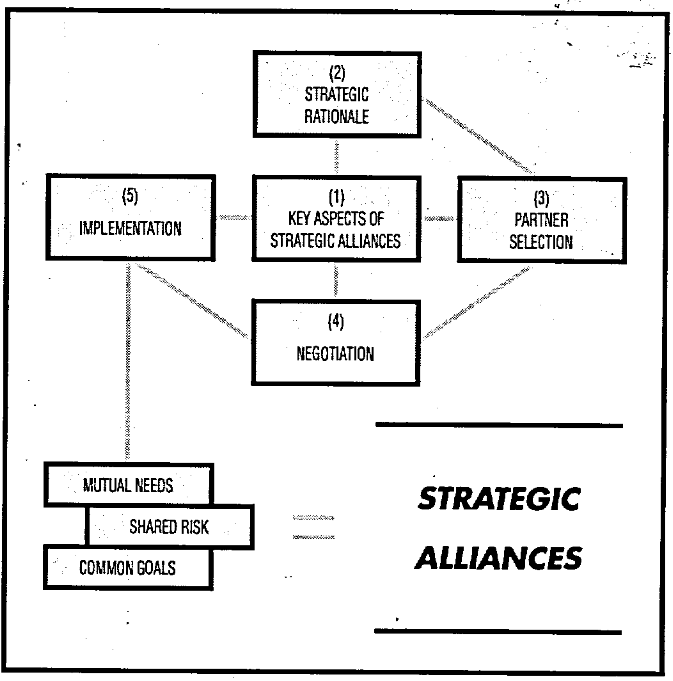
BUILDING SUCCESSFUL STRATEGIC ALLIANCES



Canada

Department of Foreign Affairs and International Trade

Ministère des Affaires étrangères et du Commerce international

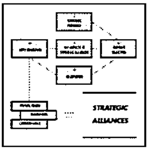


Table of Contents

Introduction 1

Alliances: A Key Corporate Development Tool 1

Building Successful Strategic Alliances 3

Developing A Strategic Rationale For The Alliance 4

Selecting The Right Partner 7

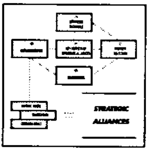
Partner Due Diligence 10
- The Partner's Agenda 10
- Personal Chemistry 12
- Internal Commitment 12
- Champions 13

Negotiating The Alliance 14
- The Negotiating Team 14
- The Negotiating Process 16
- The Alliance Agreement 16
- Benchmarks 18
- Control 20
- Conflict Resolution 20

Implementing The Partnership 21
- Managing Size Differences 21
- Communicating 22
- Protecting Key Assets 22
- Managing Change 22
- Establishing A Learning Process 23
- Ensuring Deliverables 23
- Selecting A Manager 24

Conclusion 24

Selected Reading 26



Introduction

This booklet is designed as a companion piece to the Government of Canada video on strategic alliances. The purpose of both tools is to introduce companies to the concept of strategic alliances and to help managers, particularly those of small and medium-sized companies, develop alliances and use them successfully. Both the video and this booklet are organized around four key aspects of a strategic alliance: **strategic rationale, partner selection, negotiation and implementation.** Together, the video and booklet highlight some of the key issues executives should consider in each of these areas. The booklet draws out many of the points raised in the video and provides a number of checklists relevant to forming and managing alliances.

The booklet is by no means an exhaustive treatment of the subject. A brief bibliography is appended for those who want greater detail on any of the issues raised here.

Alliances: A Key Corporate Development Tool

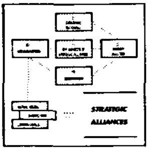
The last decade has witnessed a dramatic increase in the number of strategic alliances. This has touched virtually every aspect of global industry: from large to small companies, from sunrise to sunset industries, and from manufacturing to services. Today, collaboration with both friends and enemies is a key consideration in almost every company's competitive strategy.

The pervasiveness of corporate alliances is profoundly affecting the contemporary corporate landscape. Industry structure in industries such as automobiles, aerospace, computers, telecommunications and biotechnology is now defined by complex networks of companies. Corporate structure, once based on vertical integration, increasingly involves linkages with numerous external partners across a variety of different functional areas.

The growing importance of alliances is also reshaping the nature of competition and competitive advantage. Today, competitive abilities are increasingly based on the leveraging of internal capabilities through relationships with others.

The drive to form alliances is fueled by a diverse set of pressures. These include:

- the enormously high cost of technology development and commercialization, e.g., $1 billion for new telephone switching devices, $7 billion for the next generation of passenger aircraft, $230 million for new drugs
- the recognition that products costing hundreds of millions of dollars to develop may have life spans of less than two years, e.g., current estimates of the life cycle of the average computer range from 8 to 18 months
- growing technology fusion as evidence by products bridging previously unrelated technologies and skills, e.g., the personal communications device, multimedia



- dramatic shifts in market structures in Europe, Asia and North America and the liberalization of markets in Eastern Europe, Latin America and China
- the increased importance of product standards as a source of competitive advantage and the importance of establishing these standards quickly in the face of intense competition

In the current business environment, speed, responsiveness, flexibility and geographic reach are key determinants of success. Strategic alliances can offer companies opportunities to develop new products and enter new markets more quickly and at a lower capital cost than investing directly or by acquisition. At the same time, they can limit the strain on companies' managerial, financial and technological capabilities.

There are many definitions of what constitutes a strategic alliance. Perhaps one of the most useful and most widely recognized is offered by Jordan Lewis in his book *Partnerships for Profit*.

> A strategic alliance is a formal and mutually agreed commercial collaboration between companies. The partners *pool*, *exchange* or *integrate* specific business resources for mutual gain. Yet the partners remain separate businesses.[1]

COMPETITIVE ADVANTAGE THROUGH ALLIANCES

Strategic alliances can be used to:

- accelerate R&D activity and reduce R&D costs
- develop new businesses
- share risks and resources
- create new ideas and products
- shorten lead times
- access new markets
- facilitate standardization
- build credibility

This definition highlights the various methods of collaboration. By stipulating that the partners remain separate business entities, it also differentiates the nature of the activity from mergers and acquisitions. According to Lewis, the dominant characteristics of a strategic alliance are mutual need, shared risks and a common objective.

Strategic alliances can cover a wide spectrum of activity along a firm's value chain. They can also take a number of different forms ranging from relatively simple contractual arrangements through to full-blown joint ventures, depending on the needs and strategies of the companies involved. Alliances typically include some combination of technology and/or product

[1] LEWIS, Jordan. *Partnerships for Profit, Structuring Alliances*, New York Free Press, 1990, p. 11.

FORMS OF COOPERATION

<table>
<tr><th>Product design</th><th>Purchasing</th><th>Production</th><th>Marketing</th><th>Distribution</th></tr>
<tr><td rowspan="3">Research contract</td><td rowspan="6">Joint purchases</td><td>Engineering contract</td><td rowspan="3">Trademark licence</td><td rowspan="6">Distribution agreements</td></tr>
<tr><td>Subcontracting</td></tr>
<tr><td rowspan="2">Joint manufacturing agreement</td></tr>
<tr><td rowspan="3">Joint research</td><td rowspan="2">Co-marketing</td></tr>
<tr><td>Know-how communication contract</td></tr>
<tr><td>Patent licence</td><td>Co-promotion</td></tr>
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licences, R&D manufacturing, marketing or distribution agreement, and can involve equity or equity options.

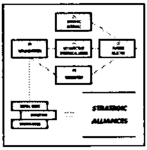
Despite the rapid growth of strategic alliances over the last decade, success for many companies has remained elusive. Many firms have come to recognize that alliances are not easy to form and manage, nor are they necessarily a viable strategic option for all firms. They can severely challenge the managerial abilities and resources of even the most experienced companies.

Moreover, while alliances offer companies tremendous opportunities to extend their capabilities and market reach, these opportunities do not come without some serious downside risks — including the loss of competitiveness. Hence, they must be approached with care and substantial preparation. Despite these caveats, it is increasingly evident that the recipe for corporate competitive success in the 1990s involves the ability to form and manage alliances, and that companies that develop capabilities in this area will find themselves ahead of the game.

Building Successful Srategic Alliances

The partnering process has four major dimensions. These are:

- developing the strategic rationale for the partnership
- selecting the right partner



THE PARTNERING PROCESS

Strategic rationale

- Establish corporate objectives and aspirations.
- Establish strategic targets by market segment.
- Analyze industry fundamentals and key success factors influencing competitive position in your target areas.
- Evaluate your competences in context of objectives and resources required to be successful.
- Identify capability gaps.
- Examine possible alternatives for achieving strategic needs in the context of your organizational and financial capability.
- Decide on most viable option.
- Set clear goals for the proposed option.
- Communicate strategic rationale and objectives of option to line managers.

Partner selection

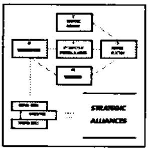
- Establish a screening criteria based on your strategic needs.
- Develop an extensive list of candidates starting with companies with whom you already do business.
- Rank the candidates.
- Contact those who meet your criteria.
- Begin conducting due diligence on your best prospects.
- Set up initial meeting and undertake 'discussions' with companies who express serious interest.

- negotiating the alliance
- implementing the partnership

Careful attention needs to be paid to each of these to give the alliance the proper foundation for success.

Developing a Strategic Rationale for the Alliance

Perhaps the most important factor in determining the success or failure of an alliance is whether it is strategically sound in the first place. Because alliances are less formal and tend to involve less financial commitment than new subsidiaries or acquisitions, sometimes companies tend to treat them as expedient rather than strategic ventures. Examples abound of ventures that have been formed on impulse or for purely opportunistic reasons. While they may involve less in the way of resource commitments, poorly planned alliances can have serious consequences, including a loss of competitive advantage. When it comes to strategic planning for a new venture, most shortcuts turn out to be dead ends.



THE PARTNERING PROCESS

Negotiation	Implementation
• Put together a negotiating team. • Establish your bargaining position. • Begin negotiations. • Develop non-binding letter of intent. • Formalize the alliance agreement.	• Set out detailed implementation goals and timetable. • Put venture management in place. • Monitor alliance progress and market and competitor response.

The rationale for a strategic alliance needs to be firmly grounded in a clear strategic understanding of a company's current capabilities and those it will need in the future to be successful. This means using some sort of strategic planning process that can establish objectives and evaluate alternatives. This process should be highly market sensitive rather than rigidly bureaucratic.

The decision to pursue an alliance begins with a clear statement of your strategic objective, i.e., what you are trying to accomplish – your competitive objectives and moves to an evaluation of resources and capabilities and the ways of meeting your objective. The outcome of the process should be an understanding of the specific goal that you are trying to achieve, the timeframe in which you need to achieve the goal, the specific capabilities you already have, and those you will be required to develop.

The objective of this exercise is the development of a realistic appraisal of what resources are required to meet the company's long-term strategic goals, i.e., what capabilities will give you a competitive advantage in three to five years. These capabilities might include credibility, geographical presence, distribution, technology and money. More and more today, capabilities also include knowledge.

An understanding of the gap between what you might be able to accomplish internally and what you need will ultimately help you to develop the profile of the best partner and to begin to establish criteria for rating partnership opportunities, if this is the option you choose. An understanding of your capabilities is also valuable in helping you define what you have to offer a potential partner.

Finally, the process should involve an evaluation of your various alternatives and the pros and cons of each. In many cases, a strategic alliance may not be the most appropriate vehicle for meeting your strategic needs. For example, a recent study by McKinsey & Company Inc. found alliances worked best for companies entering new geographic markets and related industries, whereas acquisitions were likely to be more effective in core businesses or existing geographic markets. Moreover, the study also found that using an alliance to hide a weakness as opposed to leveraging a strength was rarely a successful strategy.[2]

Before you decide that an alliance is your preferred route, you must also clearly understand the potential costs involved in pursuing this option. You must consider technology transfer, coordination and management costs. These can be particularly high in international alliances. Potential costs might also include reduction of control, reduction of flexibility in optimizing global production and marketing efforts, lost opportunity costs and the danger of creating or strengthening a competitor.

In the end, it is important to recognize that alliances are a second-best alternative. They make most sense when other internal options are not viable or when it would be foolish to go it alone. Today, however, both of these conditions are more the rule than the exception.

If you choose to pursue an alliance, the more narrowly scoped or focused the alliance, the more likely it is to be successful. Narrowly scoped alliances are those built around a specific product, country, technology or product. Broad-based alliances, on the other hand, seldom seem to work and tend to flounder on conflicting objectives and a poor management foundation.

Before taking the next step, i.e., searching for a partner, you should begin building internal consensus and overcoming opposition (i.e. the N.I.H. syndrome) within

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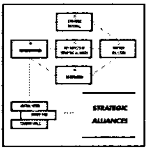
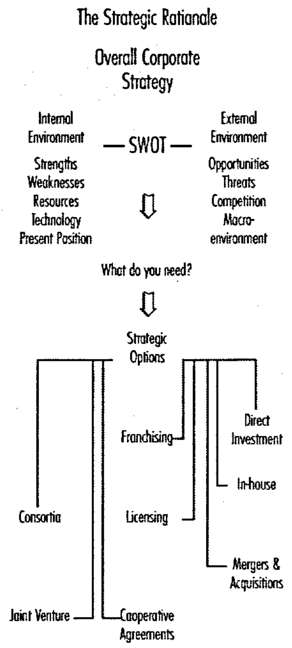
[2] BLEEKE, Joel and David ERNST. *"The Way to Win in Cross Border Alliances"*, in the *Harvard Business Review*, Nov.-Dec. 1991, p. 127.





Source: SRI

your firm to the possibility of a partnership. The strategic rationale and objectives of the proposed alliance should be communicated to line managers and staff, and all should be aware of the importance of the proposed relationship.

Selecting the Right Partner

Along with unfocused strategic objectives, poor partner selection ranks high among the reasons for alliance failure. Hence, this is another area where you should not be looking for shortcuts.

One of the first rules in undertaking a partner search is to be willing to commit the time and resources to select and analyze partners. Depending on the scope and complexity of the alliance, you may be looking at a couple of months to a couple of years to put the deal together. The GM-Toyota joint venture, for example, was almost two years in the making. Moreover, if you are looking for more than one partner, you may be looking at a lengthy period to get all your deals together.

It almost always takes longer than predicted to find the right partner. To be realistic and avoid disappointments, you may want to double your initial time estimate. If you think you can put together a deal quickly, you are probably letting hope substitute for good judgment. There will always be more problems than you anticipated and more issues to be worked through than you thought. Furthermore, it is likely that there is more than one right partner. It is worth taking the time early in the game to determine who would best meet your strategic needs.

Small companies seeking partners are often prone to panic as they find themselves running out of money and time in their partner search. In their eagerness to close a deal, there is a temptation to rush to sign a contract with any company that expresses interest, whether or not it fits the partner profile. This is almost always a mistake. If you haven't done your homework and checked out your options carefully, partnering with the wrong company could be a disaster. Being willing isn't a sufficient consideration — a partner has to fit your strategic needs.[3]

Small companies can also be overwhelmed when approached by a large company to form a partnership. The reputation and image of the large company or the thrill of being approached can often cause the small company to neglect the necessary partner evaluation and to ignore their own strategic objectives.

Once companies have decided on their partnering objectives and want to start searching for a partner, executives must decide how many partners to approach. One method is to start with your partner profile screening criteria, develop a long list of prospects, then rank the list and concentrate on a manageable number of the best prospects.

Generally, among the first potential partners to be considered are distributors, suppliers and customers in the industry for the proposed venture, particularly firms with which your company has formerly had a good relationship. Beyond this, there are numerous sources that can be consulted in your search.

Some of these include:

- business networks
- industry associations
- External Affairs and International Trade Canada and its embassies and consulates abroad
- the embassies and consulates of other governments
- foreign trade offices, e.g., Jetro
- regional and municipal economic development authorities
- trading houses
- investment bankers
- business directories and databases
- business reporters and editors in your target territory
- domestic and foreign venture capital groups

Venture capital companies that focus on your industry can be a particularly useful source of partner information as they may have potential partners in their portfolios and may also be willing to participate financially in the partnership. Overall, the explosion of partnership interest in recent years is reflected in the number of information sources and databases on partnering opportunities. Governments at all levels are increasingly active in profiling companies interested in partnerships.

3 BOTKIN, James W. and Jana B. MATTHEWS. *Winning Combinations: The Coming Wave of Entrepreneurial Partnerships Between Large and Small Companies*, John Wiley and Sons, Inc., New York, 1992, p. 116.

A CHECKLIST FOR PARTNER SELECTION

- ✔ Know clearly what you need from a partnership and whether the partner really has it.
- ✔ Take time to understand your partner's real strengths and weaknesses. Don't be fooled by superficial similarities.
- ✔ Make an effort to understand why the partner wants to do the deal.
- ✔ Understand the potential partner's organizational and management structure, decision-making process, financial capabilities, dividend and re-investment strategies, employment policies, compensation programs and hiring strategies, profit and growth orientation, and financial and accounting practices in terms of compatibility with yours.
- ✔ Assess your company and the proposed relationship from your partner's perspective. Is it a good deal for both of you?
- ✔ Pay close attention to the differences and similarities between your corporate culture and your partner's.
- ✔ Be aware of the partner's relationship (political or ownership) with the host government.
- ✔ Take time to understand the business culture in which a potential foreign partner operates.
- ✔ Know where the partner is situated in its industry, i.e., leader or follower.
- ✔ Understand the possible competitive aspects of the partnership — are you strengthening or creating a competitor?
- ✔ Look at your partner's track record. Has it lived up to previous partnership commitments? Has it litigated against former partners? Is there a history of patent and trademark infringements, health and safety violations or labour unrest?
- ✔ Know how close the alliance is to the core business or product of the partner.
- ✔ Be aware of the partner's other alliances and understand the importance of the proposed venture within the partner's corporate portfolio.
- ✔ Make sure there is policy and operating level commitment in both companies.
- ✔ Seek to identify champions and potential champions in the partner's company.
- ✔ Understand the influence of the partner's parent on its operations.

Partner Due Diligence

No matter how simple the alliance being contemplated, companies should pay attention to adequately evaluating their potential partners' capabilities and suitability for the arrangement. Making partnership decisions based on superficial similarities or apparent compatibilities has frequently been a fatal mistake. Don't rush into a deal simply because the partner meets your minimum technical requirements.

Potential partners should be assessed with implementation in mind. First of all you should be looking at a partner who has what you don't have and vice versa. Having identical strengths is not a good basis for a partnership. You should also be looking for technical complementarity and strategic and cultural fit. Hence, your due diligence should involve taking a close look at the potential partner's technical, financial and managerial capabilities and organizational complementarity. The right partner is one who brings the resources required to make the venture a success and who is similar enough in terms of organization and outlook to make the arrangement work.

In the ideal business environment, only company-specific factors would need to be evaluated in the screening process. However, particularly when searching for a partner in a foreign market, there are numerous political, economic, legal and cultural factors related to the specific market that need to be carefully assessed before a deal should be signed. These include:

- the attitude of the foreign country toward investment, its treatment of intellectual property and its political stability
- prospects of expropriation
- the relationship between the potential partner and the host government or domestic political groups
- local currency stability
- restrictions on capital repatriation and remittances
- the bureaucratic and regulatory environment
- prevalence of corruption
- labour unrest

It is extremely important in foreign markets, particularly in developing country markets, to understand the broader sociopolitical environment in which the partner operates.

Successful partnerships benefit both parties. Don't assume, however, that your partner is as diligent in its due diligence as you are. Try to look at your own company and, if necessary, its broader environment from the perspective of your partner — do you provide a good fit for it?

In vetting a potential partner, there are four broad areas that merit particularly close attention.

- **The Partner's Agenda**

While it may be extremely difficult to get at some of the hidden agendas that potential partners bring to the table, it is important

SHORTCUTS DON'T WORK[4]

One frequently cited example of a partnership where detailed partner due diligence was neglected is the alliance between Joseph E. Seagram and Sons and Kirin Brewery Co. for the manufacture and distribution of spirits in Japan. On the surface, this seemed to be a perfect match. Seagram, one of the world's great distillers, wanted to enter the promising Japanese market. Kirin wanted to link up with a reputable and well-known foreign company with complementary products. Both partners made a broad assessment of the strategic match and decided there was sufficient complementarity to warrant the venture. Unfortunately, it became apparent shortly after the venture was established that they should have paid more attention to a detailed analysis of the market and the development of a business plan during the formation stage. Problems quickly arose including sales well below forecasted levels. The major reason for this was that spirits proved to be difficult to market through Kirin's existing distribution network for beers. Sales improved only after a separate distribution plan was developed. Today the venture is highly profitable, but a bit more of a detailed analysis of partner capabilities might have saved both parties substantial time and money.

to try to develop an insight into the real reason why the partner wants to do the deal. Collaboration can be just another competitive tactic.

Therefore, understand what benefits the partner seeks to derive from the partnership. Will these be at your expense, i.e., are you going to create a competitor or strengthen a competitor?

For example, there are numerous examples of small companies signing away marketing rights to corporations that just sat on their innovative product. Eventually, the small company realized that the partner had obtained exclusive rights to mothball products it saw as competition for its current business line.

Large firms also, on occasion, enter into partnerships as insurance or as a means of hedging their bets, and may not be interested or fully committed to having them succeed quickly. Other partnerships have been entered into for preemptive reasons, i.e., to immobilize or temporarily prevent a partner from entering into a partnership with another firm. A little homework can frequently prevent unhappy outcomes.

[4] LORANGE, Peter and Johan ROOS. *Strategic Alliances: Formation, Implementation and Evolution*, Blackwell Publishers, Cambridge, 1992, p. 51.

CHARACTERISTICS OF THE RIGHT PARTNER

- complementarity of technical skills and resources
- mutual need
- financial capability
- relative size
- a compatible view of strategy and objectives
- complementary operating policies
- compatible management teams
- trustworthy and committed
- low risk of becoming a competitor

Given the proliferation of alliances in recent years, it is also likely that the potential partner may be engaged in numerous other partnerships. Your assessment should involve an evaluation of the potential partner's other alliances. You should determine, for example, whether the prospective partner is allied with any of your competitors, and whether it is in an area in which you are vulnerable. If so, you should ensure very early in the game that there are mechanisms in place to prevent shared proprietary data from leaking to competitors. You should also understand whether the other alliances limit the prospects of expanding your relationship in the future.

Next to proper due diligence, the best way to deal with hidden agendas and uncertainties is giving the partnership a clear focus and visible boundaries in terms of duration and scope. Also, be wary of exclusivity or tying your fate to a single partner.

- **Personal Chemistry**

No matter how good the eventual deal or agreement, it is the people involved on both sides that will make or break the partnership. If the relationship part doesn't work, neither will the business part. Therefore, good personal chemistry between key decision makers and a sense of cultural compatibility 'our kind of people' are an important part of the recipe for success. While there are no hard and fast rules for determining personal chemistry, it is extremely important to try to get a good sense of the people with whom you could be working. For example, William Norris, the President of Central Data, frequently went fishing with potential partners to get a sense of their character and compatibility. Time spent getting to know the key people in the potential partner's firm to see how you relate to them is time well invested. Japanese companies, for example, tend to emphasize this aspect in looking at potential partners and spend considerable time sizing up the partner and its team in the pre- and early negotiation phase.

- **Internal Commitment**

The commitment of operational level staff in both companies will be central to the effective implementation of the partnership. Look for such commitment in a potential partner. Companies must sell the venture to their own operating staff and ensure that equal support is present in the partner firm. Particularly important are mid-level personnel, who may inherit direct responsibility for carrying out the provisions of the contract. Partnerships can be extremely difficult to implement at the middle-management level where parochial interests can derail mutual interests. The Not Invented Here (NIH) syndrome has caused many corporate relationships to fail. If sufficient efforts and incentives are in place up front to bring these middle managers on board, their energy will go into supporting the partnership, as opposed to undermining it.

- **Champions**

Having well-positioned champions in both organizations will also be critical to the partnership. A champion is someone who believes in the idea and strives to get it accepted and implemented by the rest of the organization. Small companies looking to form partnerships with large corporations need champions who can steer the partnership project through the bureaucracy of the corporation and who will be credible when defending its merits. In identifying or cultivating champions, small companies should recognize that champions can quickly disappear in large companies. Fast trackers, who often play a champion role, frequently move right out of the picture and beyond their role as champion as they head up the corporate ladder.

The smaller partner should look for every opportunity to multiply the network of corporate champions in the firm. At the same time, large companies should look to develop effective contacts with small company partners beyond the founder and president.

One way to multiply these inter-relationships is to involve a range of players in the eventual negotiations to ensure that the lineup of champions will be several layers deep. An alliance between two companies will be reinforced by multiple alliances among the people in each company. Multiple relationships provide a continuity even when one of the champions of the partnership is promoted to another position or retires. The more numerous the organizational ties, the more secure and the greater the commitment among the personnel of both firms.[5]

In summary, start early, develop a list of possible partners, rank the list, contact those who fit the profile and are interested, and carry out several types of due diligence examinations before getting too far in the process. Pay particular attention to the potential partner's agenda and the personal aspects of the proposed relationship. Use all your contacts in your network of colleagues, clients, suppliers and associates in your industry to develop leads. Don't rush. If you focus too soon on a single prospect, you might be closing yourself off from other possible partners. Finally, there is no one right partner, so

[5] BOTKIN, James W. and Jana B. MATTHEWS. *Ibid.*, p. 137.

don't conclude that you have failed after the first promising negotiations fall through.[6]

Negotiating the Alliance

Alliance negotiations can provide an interesting challenge to companies used to the adversarial, position-maximizing negotiation involved in most types of business contracts and in making sales. Negotiating a partnership is largely a process of defining mutual interest, establishing trust and developing a problem-solving attitude, while at the same time establishing a business plan for the proposed enterprise. The negotiation process should be used to get a better perspective of the other side's personality, goals, capabilities and weaknesses, to clarify mutual goals, and to establish the business and operational framework for the venture.

In the negotiation phase, companies should pay particular attention to the composition of the negotiating team, the process of reaching an agreement and the nature of the ultimate agreement.

- **The Negotiating Team**

There is no simple formula for how to conduct strategic alliance negotiations or who should be involved. Negotiations will likely occur at several different levels in the two organizations.

Experience has demonstrated the importance of involving both senior managers, preferably CEOs (although this may be difficult in partnerships between small firms and large multinationals), and middle managers. Discussions between CEOs or senior managers should be focused on issues related to strategic and financial fit. Moreover, CEO involvement and visible commitment to the venture at this early stage provides important cueing for middle management and staff. The involvement of middle managers should focus on operational fit and the day-to-day issues related to implementing the venture. As mentioned earlier, for the venture to be implemented quickly, as many key players as possible should be sold on the venture early in the process.

Overall, the involvement of senior and operational management in the negotiations should be seen as the vehicle for building a level of trust and collaborative attitude between the parties — things that can't be written into the legal agreement.

In some cases, particularly when dealing in a foreign business culture, it is useful to involve specialized consultants to assist in the negotiations. Consultants knowledgable in the culture and business practices of the foreign environment and who have credibility and contacts in the area of your proposed venture can sometimes be of enormous benefit to you in both better understanding the potential deal and in facilitating it. However, it is always best to

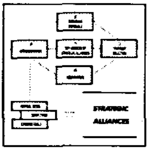
[6] BOTKIN, James W. and Jana B. MATTHEWS. *Ibid.*, p. 127.

NEGOTIATING YOUR ALLIANCE

- ✔ Be clear about your strategic agenda before you begin the process.
- ✔ Know your bargaining strength.
- ✔ Know what you are prepared to trade off and what you are not — know what constitutes a deal breaker for you.
- ✔ Involve both senior management and those who are going to manage the alliance in the negotiations.
- ✔ Negotiate as equals — don't be intimidated by organizations that are much larger than yours.
- ✔ For international alliances, have someone on your team that speaks both languages.
- ✔ Explore and define your mutual interests and benefits together.
- ✔ Don't rush to the deal — take a hard look at your partner and the deal at each stage in the process.
- ✔ Use the negotiation process to build understanding and commitment.
- ✔ Avoid coercive tactics and be prepared to give as well as take.
- ✔ Ensure there are appropriate measures in place, e.g., patents and confidentiality agreements, to protect any proprietary information that is disclosed.
- ✔ Balance the unveiling of capabilities and information with what your partner unveils.
- ✔ Use a non-binding letter of intent to work toward a clear understanding of objectives, rights, responsibilities and implementation.
- ✔ Work toward a clear picture of what the short and medium-term will look like for the venture.
- ✔ Ensure there is a clear understanding of areas of competition and cooperation.
- ✔ Ensure the legal agreement supports the business concept of the alliance.
- ✔ Leave room in your agreement for growth and change.
- ✔ Before inking the deal, make sure you have had an objective look at it. Don't be afraid to walk away.

avoid reliance on the consultant to put the deal together. If you don't have sufficient resources inside the company to make the business judgments leading up to the deal, you are unlikely to have the resources to make the deal work.

Many companies have also found it handy to have a 'contrarian' on their team. This is someone who can counter the tendency for "group-think", and cut through some of the ego involvement that takes place in these kinds of negotiations. It is someone



who can challenge assumptions and take a close look at details and potential problems, and ensure negotiators are realistic and objective in assessing the potential deal.

Although the presence of this type of person on your team may occasionally ruffle the feathers of other members, it may also result in a much better deal or the avoidance of a bad one.

Legal and tax professionals have a very important role to play in putting a partnership together. However, their role is largely behind the scenes. It is best to avoid involving your legal counsel as a negotiating agent. This may encourage the other side to do the same and move the negotiations from a search for mutual understanding and benefit to an adversarial process. In some foreign cultures having legal counsel at the negotiating table may also be interpreted as a sign of mistrust. The role of the negotiations is to establish the business framework for the alliance. Once both parties have agreed in principle on how they want the partnership to proceed, legal counsel should be brought in to draw up a sound document to protect both parties and provide the partnership a solid foundation. Tax advisors can help structure the deal for maximum financial benefit.

- **The Negotiation Process**

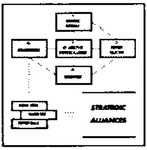
The first few meetings between the parties should be used to identify mutual interest and to build consensus about the basic strategy of the alliance. There should be no pressure to conclude a deal. Spelling out mutual benefits can also help negotiators uncover unrealistic expectations. The early negotiations should allow the parties to get to know each other, clarify expected benefits and identify shared goals.

Before proceeding to serious negotiations involving the disclosure of proprietary data, you must ensure that your competitive advantage is adequately protected. Any technology to be disclosed should be patented. Confidentiality agreements should also be signed to cover sensitive information to preclude the prospective partner from using the negotiations to exploit the disclosed information in a competitive manner.

Once the mutual benefits and general objectives have been set out, the concepts of the venture can begin to be transferred to a non-binding statement of intent. This document is used to move the negotiations beyond the initial conceptual stages to an operational stage where the alliance starts to have a clear description. This document should be drafted mutually by the key players of both parties. A good letter of intent will greatly facilitate the drafting of a binding legal agreement.

- **The Alliance Agreement**

Very informal alliances often do not require binding agreements. Rather, the partners maintain individual control over their specific areas of responsibility and share the results jointly. Most arrangements, however, are cemented by some sort of contractual agreement.



ELEMENTS OF STATEMENT OF INTENT

Purpose of the alliance

Scope of activity

Key objective and responsibilities

Method for decision making

Resource commitments

Assumption of risk and division of rewards

Rights and exclusions

Proposed structure of the alliance or venture

The complexity of an agreement will be related to the proposed scope and structure of the venture.[7]

In alliances requiring a legal agreement, partners should strive for a well-written agreement that sets out the purpose, terms, durations, warranties, obligations and other key understandings on which the relationship is based. The agreement should be designed to reinforce the business objectives of the partnership and, at the same time, protect the partners. Some of the best agreements, while setting out clearly articulated ground rules, also leave a lot of contingency room for the relationship to grow and deal with changes.

The following issues should be clearly addressed in a strategic alliance legal agreement:

- contribution of parties
- performance objectives and review process
- implementation plan and speed
- roles and responsibilities
- procedures for adapting to change
- provisions for expansion of activity
- conflict resolution procedures
- provisions for termination
- control (in the case of joint venture)

Companies that have never worked together before may wish to consider a less formal alliance as a first step in the collaborative process. It may be wise to have a narrowly focused agreement to work together on a small project. This allows the partners to see how the two companies interact and establish mutual trust on which to base a broader partnership. Terminating a small alliance that is not working is much easier than trying to disentangle from a large one.

In general, companies should strive in the initial partnership agreement for simplicity in mission and goals. Rather than a complicated contract with multiple goals, it is better to start with simple goals and clearly articulated outcomes and measures of achievement. If all goes well, the partnership can expand down the road. Moreover, simple, well-defined goals on both

[7] For a detailed discussion see LYNCH, Robert Porter. *The Practical Guide to Joint Ventures and Strategic Alliances,* John Wiley and Sons, Inc., New York, 1989, Chapter 9.

sides will make it easier to assess whether the partnership is achieving its intended purpose and help to prevent conflicts between the parties. If your partner is not capable of agreeing to this level of clarity, you may want to reconsider the venture.[8]

Some aspects of the alliance agreement that merit particular attention are the establishment of performance objectives/ benchmarks, the allocation of control and the establishment of conflict resolution procedures.

- **Benchmarks**

Successful partnerships require regular and frequent care and attention. Periodic reviews based on prespecified benchmarks allow both parties to assess progress and identify problem areas. They also help manage expectations and enable partners to make any necessary adjustments early rather than wait until deviations become substantial and the alarm bells ring. Benchmarks can also be used to manage infusions of capital and technology transfer in ways that protects partner interests. And they can be used to further cement the relationship. Some companies build trust and enthusiasm by moving from simple to more complex interdependencies throughout a series of easily achievable milestones or stages.

A good relationship and a well-conceived agreement makes provisions for changing circumstances and the possibility that the alliance will need to be terminated. Relationships can outlive their usefulness even when they have a mutually productive and beneficial history. The direction of companies change. New management may have a different vision for the corporation. The founder of the small company may decide it's time to sell out and do something different.

An extremely important benchmark in any agreement concerns provisions for renewal and termination. Termination should include agreement on the allocation of rights and assets emerging from the alliance. One way to avoid dashed expectations is to spell out, in the contract, the terms and conditions for continuation of the relationship. Put in writing the outcomes that must be achieved for the partnership to continue and list things that can lead to the termination of the arrangement. A requirement that the principals meet at least every year, review progress, agree on future plans and goals for the collaboration, and revise terms and conditions for renewal and termination as needed, is also a useful way to ensure the relationship continues to benefit both parties. If there are phases or stages in the contract, the collaboration agreement needs to specify what they are.[9]

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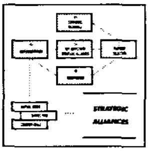
8 BOTKIN, James W. and Jana B. MATTHEWS. *Ibid.*, p. 130.

9 BOTKIN, James W. and Jana B. MATTHEWS. *Ibid.*, p. 132.



SOME KEY ISSUES TO BE NEGOTIATED[10]

KEY TECHNOLOGY ISSUES

Partners need to resolve:

- Questions of ownership of technologies developed by the alliance
- The rights to use and market:
  - technologies to be developed
  - technologies from outside sources
  - core technologies
- Division of royalties if a partner markets technology or products based on technology developed by the alliance
- Ownership and rights to use improvements in the technology
- Decision-making procedures concerning products based on new technology
- Legal rights involved if a third party infringes on technology developed by the partnership

IMPORTANT MARKETING ISSUES

Key issues to address are:

- Who decides what the product will be?
- Who designs the product?
- Who chooses the product name?
- Will you share advertising or marketing campaigns?
- Who decides on improvements or new additions to the product line?
- Who is responsible for warranty obligations?
- Who is responsible if a customer is injured?
- What happens if the product infringes on the intellectual property rights of someone else?
- What happens to marketing rights if the partnership ends?

STRUCTURING A JOINT VENTURE

Some issues to consider:

- How will the management and board of directors of the joint venture be chosen?
- Will the joint venture rely on its own staff or on service contracts from the partners for financial, management or technical services?
- What happens if the joint venture needs additional capital?
- How will the joint venture decide whether to expand into new businesses?
- What will happen if one of the partners wants to sell its interest in the venture?
- How will a decision to liquidate the joint venture be made?
- How will ownership of the joint venture's technology and other assets be divided if the venture is liquidated?

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10 This table is developed from MYERS, Marlee. *"Strategic Partnerships"*, *Pittsburgh High Technology Journal*, May 1989: 1-2.

- **Control**

In joint venture agreements, control will likely be a key issue. It is also a subject that is far too complex to be treated here in any detail. A detailed discussion of the control issue is provided in the Investment Canada publication *Growing Together: Exploring the Joint Venture Option in Canada*.

The resolution of the control issue should result in a decision-making structure that is efficient, collaborative and synergistic. Control should be a business decision first and a legal decision second.

Ownership and control should be treated as separate issues. Careful consideration should be given to 50/50 ownership whenever possible. A 50/50 joint venture has great psychological value for the parties involved and helps to ensure that both parties are fully committed to the venture. A recent study by McKinsey and Company Inc. found that joint ventures in which ownership was split 50/50 had success rates superior to those in which financial holdings were unequally divided.[11]

Even with 50/50 ownership, however, one partner should be clearly responsible for ultimate management control. In some cases, partners can agree to maintain control over specific functions of the venture that are critically important to them. It is noteworthy that the McKinsey and Company Inc. study also found no instances of a successful joint venture where management control was shared evenly between the owners.

- **Conflict Resolution**

Strategic alliances often involve partners with different cultures, capabilities, and in some cases ultimate objectives. A certain amount of conflict, therefore, is inevitable.

A moderate degree of conflict in an alliance can be quite healthy and a stimulus to creativity and improved performance. The key is to have a process in place that will keep conflicts from getting out of hand and causing serious disruption to the venture. Hence, companies should strive to reach some agreement how conflicts between the parties are to be handled once the venture is operational.

As a first step, partners should look at mitigating potential conflicts structurally or managerially. Where a high degree of conflict is anticipated, it may be best to start with a highly focused alliance and a simple structure and build the relationship, working to find solutions to potential conflicts before attempting a more complex arrangement.

Having a mutually agreed upon and consistent set of management principles for the venture also helps. Many of the conflicts that arise during alliances are the results of misunderstandings or unclear or misread signals between the partners. Clearly defined and widely understood management principles and well defined responsibilities can help avoid some of the problems.

[11] BLEEKE, Joel and David ERNST (1991), page 128.

In the end, some formal method for resolving disputes will be necessary and should be outlined as part of the agreement. This mechanism should be consistent with the nature of the venture and the resources of the partners. It can range from having a designated mediator independent of the partners to the establishment of an arbitration board consisting of people in each partner company who have dispute resolution experience and who are not involved in the conflict.

Implementing the Partnership

Once the agreement is signed by the two parties, the real work begins. Success or failure depends on the day-to-day operating practices, i.e., what you do after the contract is signed, the news release is issued and the euphoria wears off. No matter how good the agreement and how clearly defined the goals and responsibilities, success will be achieved only through careful and attentive management of the venture.

Unfortunately the implementation stage of an alliance is often referred to as the 'Cinderella' phase. Several studies have shown that partners forming an alliance put a great deal of effort into all the details of negotiating the agreement but tend to pay very little attention to how the venture is to be managed. Hence, the post-transaction phase (i.e., what happens on Monday morning), has been the Achilles heel of many alliances.

The first thing that partners have to do in establishing an environment for the implementation of their alliance is to be realistic about their expectations. Unless partners have substantial experience in managing alliances, care should be taken to avoid trying to implement the partnership too quickly.

Managing a strategic alliance can be one of the most interesting and challenging opportunities that a manager may have in his or her career. It can also be one of the most frustrating. The management of the venture is really the management of a relationship: it requires the same nurturing, care, attention, trust and respect as human relationships. Often, it involves the same kinds of ups and downs.

- **Managing Size Differences**

To be successful, partnerships between companies of substantially different sizes frequently require the fostering of a special environment. Although the partnership may be between a small company and a particular business unit or division of a large company, as opposed to the company as a 'large' whole, the differences in bureaucratic cultures and operational practices may still stifle the venture. To ensure a smooth relationship in these types of ventures, the larger partner should consider stepping outside its traditional hierarchy to create task forces or horizontal teams with some decision-making capability to relate to the smaller partner. Other techniques to address the size-asymmetry problem include regularly scheduled meetings between the partners to ensure mutual understanding and speedy decision making. Perhaps the most effective approach is to provide the venture with as much autonomy as needed in its specific area of activity, whenever possible.

- **Communicating**

Frequent and effective communications are a key factor in successfully implementing strategic alliances. Communication is an area fraught with problems, particularly when language or cultural differences are involved.

Partners should ensure that liaison points and communications procedures and lines are in place between each other as well as inside each company. They should also ensure that they respond promptly to communications from the other partner. Communication involves sharing impending problems as well as reporting good news. Consideration should be given to linking partners electronically by establishing an electronic mail or phone mail system. If a large partner already has one, it should make sure the small partner becomes a part of it. Partners might also set up regular, scheduled times for telephone calls or teleconferences for status reporting. In some cases, an overseas subsidiary of the foreign partner in the host country can serve as a key communications vehicle.

- **Protecting Key Assets**

Partners need to ensure that knowledge that doesn't need to be involved in the relationship is protected both formally and organizationally. Formal protection is achieved through patents and the terms and conditions of the agreement. Organizational protection involves:

- monitoring information flow
- isolating project teams from the rest of the company
- setting up Chinese walls
- educating employees about the type of information they can share
- establishing a gatekeeper or project manager for information exchange

When considering what knowledge needs to be protected, don't think only of patents and formulas. Knowledge that you take for granted, e.g., management or organizational skills, may be extremely valuable to a competitor and could do serious damage to your company if inadvertently divulged.

- **Managing Change**

A critical aspect of alliance management involves being able to manage change. Numerous studies have shown that successful alliances undergo dramatic changes in their first few years as a result of changing economic conditions, new competitors, new technologies, changes in partner goals, changes in capabilities and circumstances, and the loss of the key managers. Managing a partnership means paying close attention to internal and external changes that can affect the venture.

It also means that alliance management involves a continuous process of negotiating and reaching agreement on the nature and value of partnership. Any ideas about rigid planning and control should be tempered by the reality of the alliance's

AN IMPLEMENTATION CHECKLIST

- ✔ Start with clearly defined goals and objectives.
- ✔ Set out an implementation plan for the first 100 days — the who, what and when to get the venture going.
- ✔ Ensure that the required resources and people are available to the venture.
- ✔ Choose an experienced manager.
- ✔ Be realistic about how long it will take to see some returns and the limitations of the venture.
- ✔ Set up clear lines and procedures for vertical and horizontal communication.
- ✔ Be clear about how and where the two companies link together.
- ✔ Ensure the roles and responsibilities of different organizational levels are clearly understood.
- ✔ Avoid sharing core competencies with the partner unless absolutely essential to the venture.
- ✔ Establish internal and external barriers to prevent the leakage of core skills to the partner.
- ✔ Ensure all the parties involved know their responsibilities and accountability.
- ✔ Ensure and maintain top level commitment.
- ✔ Pay close attention to the monitoring of milestones and checkpoints.
- ✔ Think strategically but deliver short-term results to maintain enthusiasm and momentum.
- ✔ Encourage a learning environment in your company to internalize necessary skills and avoid dependency.
- ✔ Pay close attention to the response of competitors to your venture.
- ✔ Be flexible.

competitive environment. Partners who are unwilling to change or be flexible are unlikely to enjoy much success from their alliance.

- **Establishing a Learning Process**

Learning is the key to extracting value from a partnership. Alliances can and should be used as an opportunity to learn and internalize the capabilities that your company needs to be successful in the longer term. However, this will not happen by osmosis. Rather, it involves the creation of special procedures and attitudes to ensure that what needs to be learned is absorbed and used. In most cases, managers must change their core operations and traditional organizations so that they will be open to learning from alliance partners.

- **Ensuring Deliverables**

Without losing their focus on the long-term strategic objectives of the alliance, managers should ensure that there is a continuous stream of short-term deliverables or achievements. These do not have to be significant achievements, small things will do. This will demonstrate activity and progress, build confidence in the venture and keep enthusiasm high for the partnership at both operational and senior management levels.

- **Selecting a Manager**

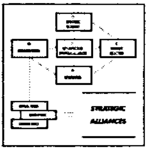
In the end, there is no substitute for good, experienced managers. If the venture is a critical one for the partners, they should seek to provide the best managers possible. The best manager for an alliance is one who possesses excellent integrative skills and the ability to manage diverse perspectives and a wide array of specialist capabilities. Experience operating in a collaborative environment is clearly a plus.

Conclusion

Strategic alliances occupy an increasingly prominent role in the competitive strategies of today's companies. The ability to form and manage alliances and to reap the benefits that they can create will be a key to surviving the intense and dynamic competitive environment of the next decade. To be successful, alliances require great care in preparation and implementation. Taking shortcuts can result either in

GUIDELINES FOR ALLIANCE SUCCESS

1. Start with clearly defined goals and objectives — the more narrowly focused, the better.
2. Evaluate each potential partner carefully in terms of technical and organizational complementarity, personal chemistry and other relationships.
3. Take the time to understand the business environment in which a potential foreign partner operates.
4. Ensure that there is commitment at both the senior and operating level to the proposed venture.
5. Use the negotiation process to foster understanding, commitment and a problem-solving attitude as a foundation for the venture.
6. Make sure that there are measures in place to protect your company secrets both during the negotiations and the implementation of the partnership.
7. Stay flexible. Recognize that circumstances and markets change — your agreement may have to change, possibly more than once.
8. Ensure that your agreement has clearly defined milestones and checkpoints, and agree on reviews and measures for termination.
9. Place a priority on communication and on putting in place whatever measures are required to ensure that partners talk to each other frequently.
10. Whenever possible, provide the venture with an experienced alliance manager.
11. Look for short-term deliverables to build trust and maintain enthusiasm and commitment.
12. Create an environment in your company to internalize the skills you need from the partnership and to avoid 'alliance dependences'.



a loss of time and money or, in some cases, a loss of key skills and competencies.

Although there is no single recipe for success, the material provided in the video and this booklet should provide you with a basic foundation for considering the alliance option for your business.

Selected Reading

The following books and articles are provided for those who would like more detailed information on strategic alliances.

- **Books/Brochures**

Joseph L. Badaracco Jr. 1991: *The Knowledge Link: How Firms Compete Through Strategic Alliances*, Boston, Harvard Business School Press.

Joel Bleeke and David Ernst 1993: *Collaborating to Compete: Using Strategic Alliances and Acquisitions in the Global Marketplace*, New York, John Wiley and Sons, Inc.

James W. Botkin and Jana B. Matthews 1992: *Winning Combinations: The Coming Wave of Entrepreneurial Partnerships Between Large and Small Companies*, New York, John Wiley and Sons, Inc.

Timothy M. Collins and Thomas L. Doorley 1991: *Teaming Up for the 90s: A Guide to International Joint Ventures and Strategic Alliances,* Business Homewood, Illinois, One Irwin.

Richard P. Cosma and John E. McDermott 1991: *International Joint Ventures: The Legal and Tax Issues*, London, The Eurostudy Publishing Company.

John L. Graham and Yostuhiro Sano 1989: *Smart Bargaining: Doing Business with the Japanese*, New York, Harper Business.

Donald W. Hendon and Rebecca Angeles Hendon 1990: *World Class Negotiating: Deal Making in the Global Marketplace*, New York, John Wiley and Sons, Inc.

Investment Canada, 1991: *Growing Together. Exploring the Joint Venture Option in Canada,* Ottawa, Investment Canada.

Jordan Lewis 1990: *Partnerships for Profit, Structuring Alliances*, New York Free Press.

Robert Porter Lynch 1989: *The Practical Guide to Joint Ventures and Strategic Alliances*, New York, John Wiley and Sons, Inc.

Peter Lorange and Johan Roos 1992: *Strategic Alliances: Formation, Implementation and Evolution*, Cambridge, Blackwell Publishers.

David E. Raphael 1993: Designing *Strategic Alliances: Guidelines for Managers,* Menlo Park, SRI International.

David E. Raphael 1993: *Managing and Growing Strategic Alliances: Guidelines for Managers,* Menlo Park, SRI International.

- **Articles**

Joel Bleeke and David Ernst 1991: "The Way to Win in Cross Border Alliances", *Harvard Business Review*, November – December , 127-135.

Christopher Bronder and Rudalf Pritzi 1992: "Developing Strategic Alliances: A Conceptual Framework for Successful Cooperation", *European Management Review*, December, 412-421.

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David Lee and John W. Slocum Jr. 1992: "Global Strategy Competence – Building and Strategic Alliances", *California Management Review*, Fall, 81-97.

Peter Lorange and Johan Roos 1991: *"Why Some Strategic Alliances Succeed and Other Fail"*, Journal of Business Strategy, 25-30.

Michel Robert, "The Do's and Don'ts of Strategic Alliances", *The Journal of Business Strategy*, 50-53.

Kenichi Ohmae 1989: "The Global Logic of Strategic Alliances", *Harvard Business Review*, March-April, 143-154.