

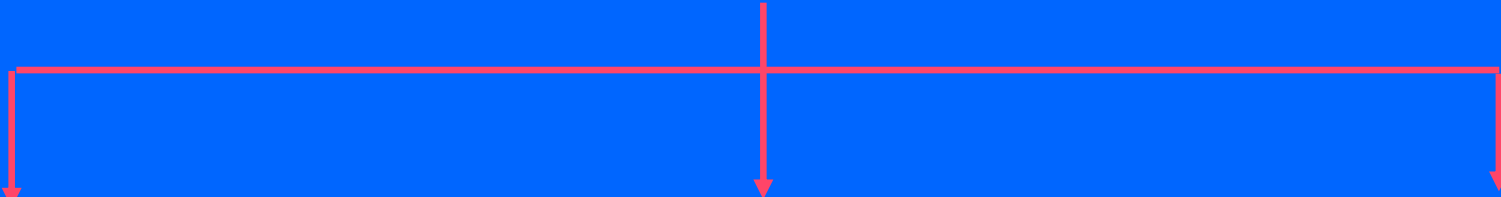
BUILDING CAPABILITIES THROUGH ALLIANCES

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ENVIRONMENT
international
technological



STRATEGY
choice



INDUSTRY
competition

ORGANIZATION
competence

→ **STRUCTURE**

ALLIANCES
stability



PERFORMANCE
financial
stakeholder

The New Competitive Environment

- Higher rates of market change
- High rates of capital expenditure
- Increased need to fuel revenues through innovation
- Need to show continued increases in earnings to create shareholder value



A NEW ORDER
OF
COMPETITION?

Strategic Alliances

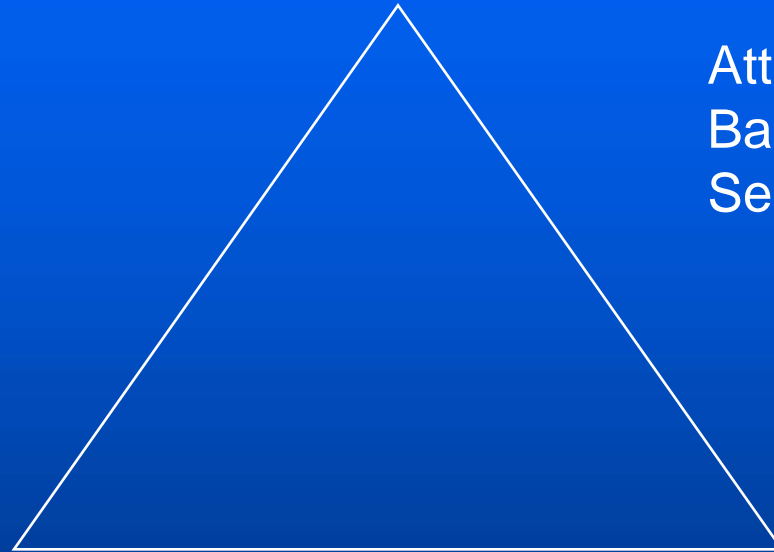
- **A strategic alliance is a cooperative arrangement between two or more organizations designed to achieve a shared strategic goal**
- **There are two general types of alliances: equity-based and non-equity-based**
- **Equity-based alliances include minority stock investments, joint ventures and at the extreme end, majority investments**
- **Non-equity based alliances tend to be governed primarily by a contractual arrangement that specifies the responsibilities of each party, the mode of operation of the alliance, and considerations involved in expansion or termination**

Key Questions

- Is alliance the most appropriate mode to achieve joint strategic goals?
- Is this the best partner? Cooperative and competitive issues.
- What is an appropriate deal structure? Equity/non? Duration? Exit Clauses?
- What is the experience base of the people identifying, negotiating and managing the alliance?
- What would the reaction of the investment community to this transaction? Why?

ALLIANCES AND COMPETITIVE ADVANTAGE

POSITION IN INDUSTRY



Attractiveness
Barriers to entry
Segmentation

NEUTRALIZING COMPETITION

Competitor Capabilities
Nature of Competitive Game
Forming new alliances

LEVERAGING CAPABILITIES

Skills
Resources
Learning
Alliances for complementarity

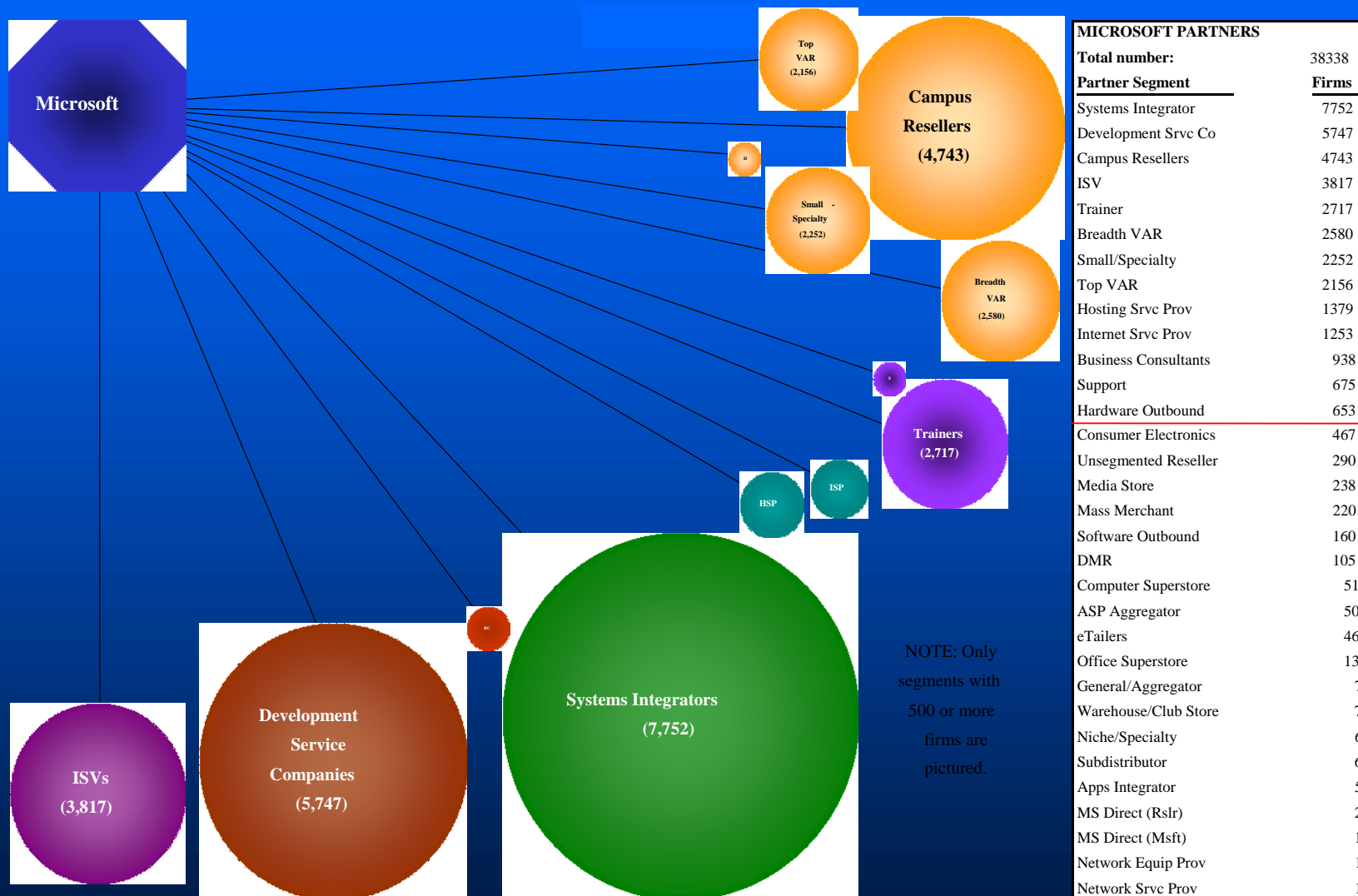
Why Are Alliance Portfolios Interesting?

- Phenomenon
 - Over time and across business contingencies, multiple alliances are created by firms
 - There are potential interdependencies between alliances, and between alliances and wholly owned businesses
- Perspectives
 - Options view: alliances can be seen as different types of real options
 - Relational view and relational capability: factors differentiating effective and ineffective alliance portfolio development
 - Networks: how different parts of alliance portfolios can serve different functions in a network

Critical Examples of Alliance Portfolios

- Millennium Pharmaceuticals in its early stages:
 - Using early alliances to do contract research
 - Later alliances to trade new drug discovery platforms for capital. While partners got targets for new drugs, Millennium as a new organization got capital and retained the knowledge spillovers to other product domains
- Strategic Ecosystems

Business ecosystems based on alliance networks are very common today



Source: Iansiti 2003

Objectives of Alliances

- **Risk/reward sharing**
Ex: Aerospace joint ventures
- **Market entry or extension**
Ex: Orls-Tianjin joint venture in China;
P&G - Papelera (CMPC) in disposable diapers
- **Sharing technological and innovative activities**
Ex: Alliances for joint research and development in biotechnology
- **Respond to regulatory constraints**
Ex: joint venture in Indonesia for local production of automobiles, consumer electronics

Cooperation and Competition: Different Mindsets

	Cooperation	Competition
Strategic Goals	Maximize joint strategic objectives	Maximize individual strategic objectives
Proprietary resources	Manage shared resources	Develop and protect
Organizational Control	Through coordination and control processes	Through hierarchy and internal control

Organizational Realities Of Alliances

- Building trust
(Accommodate the needs of the other side)
- Cultural clashes
(Find ways to work with multiple styles)
- Conflict over asymmetric investments
(Create an investment plan for each side)
- ‘Temporary arrangement’ with no long term plan
(Ensure that alliances are formed more pro-actively)
- Performance ambiguity
(Link alliance performance to mutually agreed strategic milestones)
- No parent firm support
(Create an alliance management infrastructure)

Pitfalls of Alliances

- McKinsey study: 2/3 of alliances have serious problems in the first two years
- Cross cultural conflict
- Changes in industry or environment
- Poor organizational linkage between partners
- Poor strategic analysis (Bain study)

Longevity of Alliances

- McKinsey study finds that alliances are at extensive risk in the first two years
- Wharton study finds that there are high risks of termination or dissolution in years five or six -- need to have process in place to manage
- About 30 percent of technology alliances are terminated by buyout, 40 % because they achieved their objectives, and 30 % are dissolved: implies that outcomes are heterogeneous

Research on Alliance Effectiveness

- Success is explained by investments in relational capital, arising from mutual respect, trust and knowledge assets
- Another factor driving success is conflict resolution mechanisms: emphasis on speed, operational and close to source
- Equity levels in the alliance are not correlated with success
- Prior experience is an important driver of alliance success. This can be greatly increased by knowledge management and the alliance function in the firm

THE FORMATION PROCESS

INITIAL PHASE

STAKEHOLDER
BLESSING

political

analytical

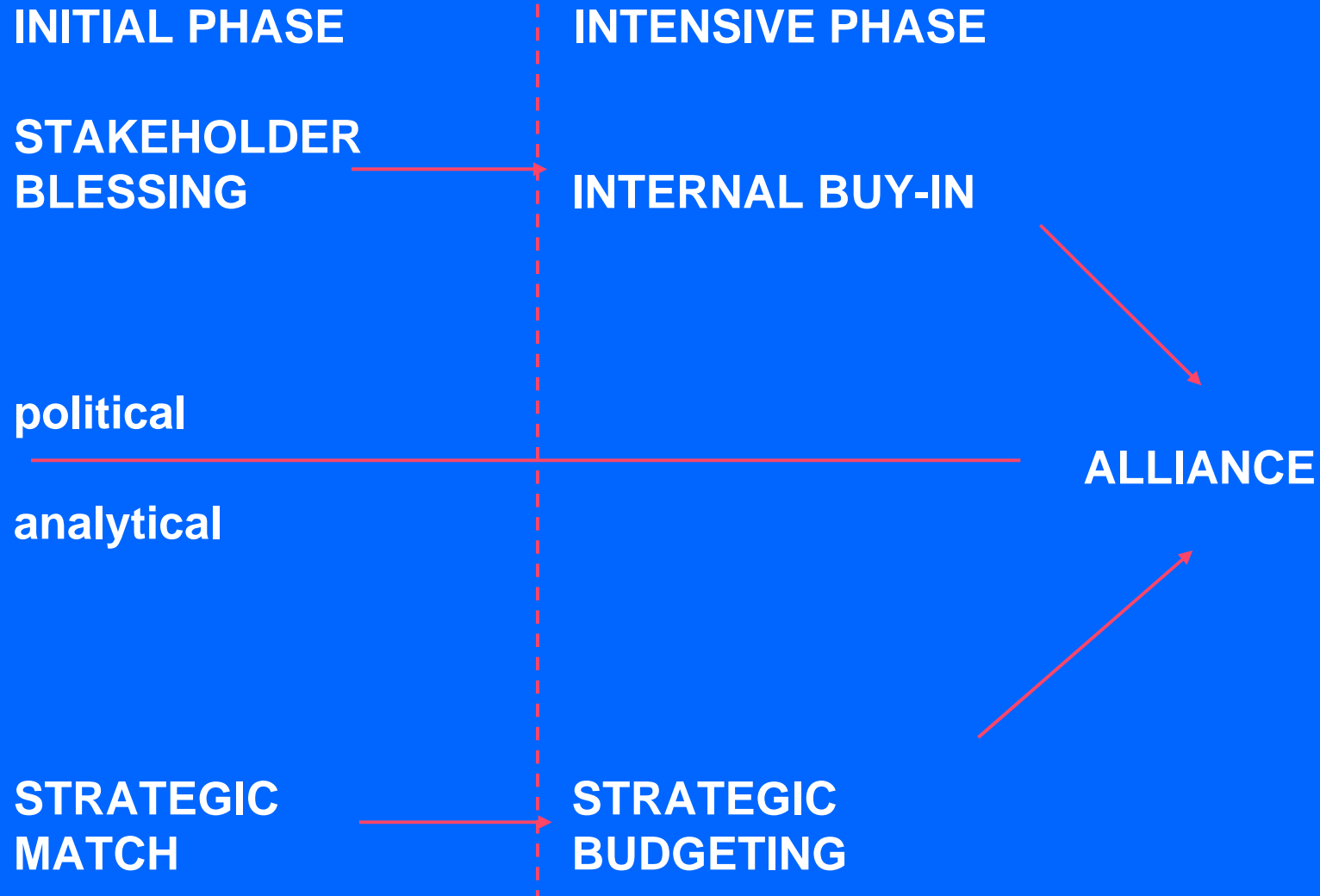
STRATEGIC
MATCH

INTENSIVE PHASE

INTERNAL BUY-IN

STRATEGIC
BUDGETING

ALLIANCE



Initial Phase Process

- EXTERNAL FORCES (INITIAL PHASE)
 - Stakeholder support
 - » Support of government
 - » Impact on customers
 - » Impact on suppliers
 - » Impact on employee groups

- STRATEGIC MATCH (INITIAL PHASE)
 - » Assessing asset complementarity
 - » Ensuring alignment in strategies
 - » Addressing hidden agendas

Intensive Phase Process

- INTERNAL FORCES (INTENSIVE PHASE)
 - Internal support
 - » Buy-in from key internal constituents
 - » Assessing which groups are positively and negatively affected by the alliance

- STRATEGIC PLAN (INTENSIVE PHASE)
 - » Linking plans to strategic intent
 - » Defining resource needs for implementation
 - » Determining the nature and magnitude of resources needed for successful implementation
 - » Linking the resource needs to strategic budgets, which become the basis for performance measurement

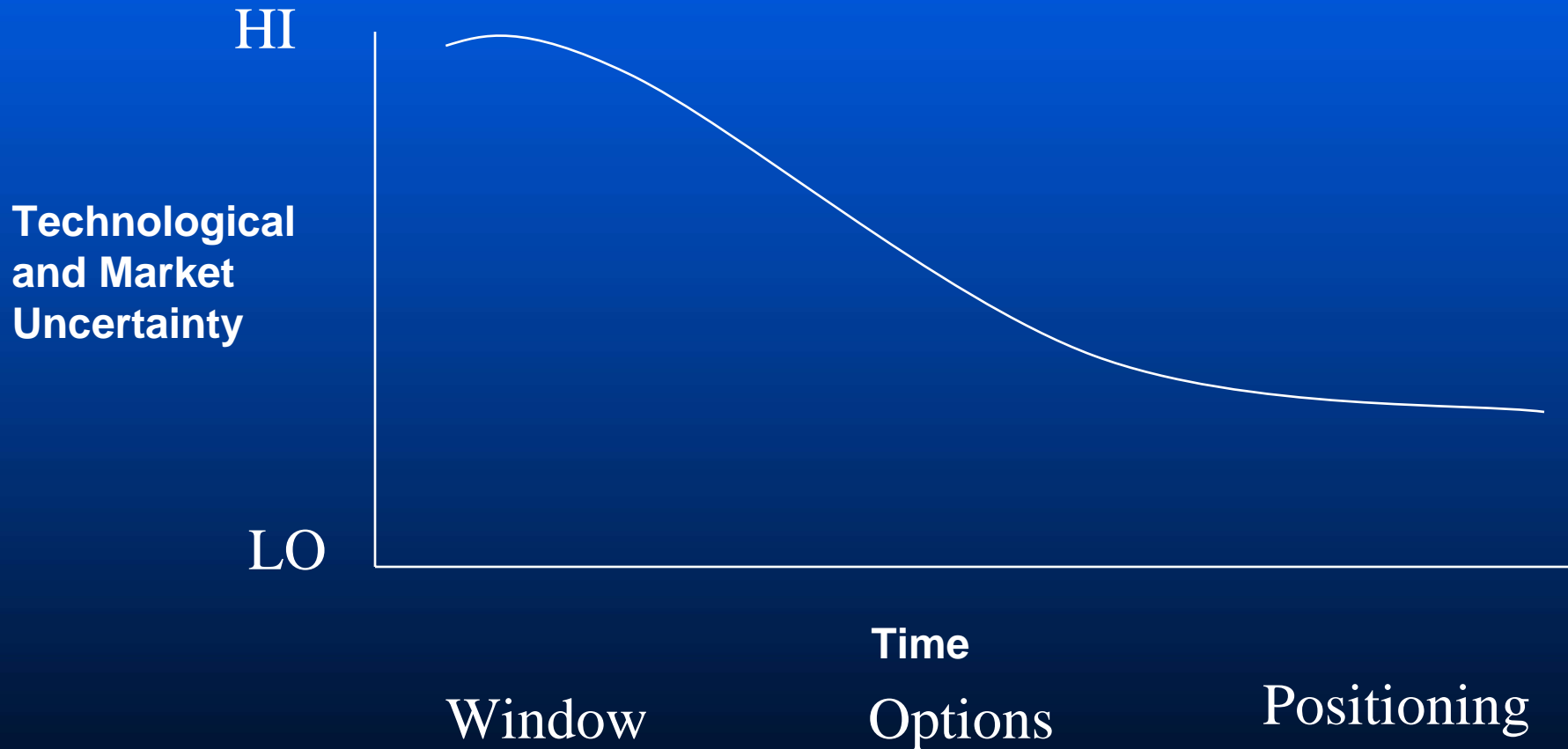
The Formation Process - Summary

- Need to pay attention to all four quadrants of the formation process: the analytical considerations and the organizational considerations
- In most organizations, there is a tendency to be biased either in favor of analytical considerations or in favor of organizational considerations
- Not separating the initial phase from the intensive phase results in too superficial an analysis of all candidates
- Otis in China as an example of initially poor attention to organizational issues

Challenges in Partnering

- Maintaining a focus and boundaries
- Identifying strategic complementarity
- Organizational system complementarity
- Strategic continuity
- Precision in agreement
- Cultural Differences

Linking Stage of Emerging Technology, Uncertainty and Alliance Strategy



Strategic Perspectives

■ WINDOW STRATEGY

- Objectives: Track technologies, learn what they mean, stay in the flow of ideas
- Key success factors: ability to learn, absorb new information
- Key hazards: misapplication of performance measures, protecting own proprietary knowledge

■ OPTIONS STRATEGY

- Objectives: Create new options for the firm, build a capability platform
- Key success factors: Build a combination of people, routines, and assets that can be scaled up or down
- Key Hazards: Reluctance to shift quickly after investing

Strategic Perspectives (Contd)

■ POSITIONING STRATEGY

- Objectives: Scale based advantages, market segmentation, creating a customer base
- Key Success factors: Positioning versus industry structure and customer preferences, scalability
- Key Hazards: Retain key talent that grew up in the window or options stage, managing cultural differences and tension between those who seek efficiency and those who are following innovation

Negotiation: Substance Issues

- Trading differentially valued assets
- Melding of financial and non-financial issues: e.g. Investments, organization of unit, control
- Numerical analysis as a qualifying criterion of the alliance rather than a driver
- E.g. develop scenarios of different outcomes and value the implications of these versus your objectives. Also value the other side's possible positions

Negotiation: Process Issues

- Need to build trust
- Separating signals from noise
- Embedding a high level of preparation: scenarios
- Sequencing of issues: sources of shared gain early

Negotiation: Substance Issues

- BATNA: Best alternative to negotiated agreement. This sets the walkaway condition
- Estimating and signalling whether there is a range of overlap on a key parameter, e.g. value of assets
- Assessing the differentials of value placed by each side on the same assets
- Distributive versus integrative negotiation:
 - distributive involves sharing a fixed pie, integrative involves increasing the perceived size of the pie using multiple attributes of the transaction

Building Integrative (Win-Win) Agreements: Increase the Size of the Pie




- Build trust and share information
- Give away some information
- Make multiple offers
- Use differences in expectations to create mutually beneficial tradeoffs
- Use differences in risk preferences to create mutually beneficial tradeoffs

Building Integrative (Win-Win) Agreements: Increase the Size of the Pie - Continued

- Use time preference differences to create mutually beneficial tradeoffs
- Consider adding issues to those on the table to create mutually beneficial tradeoffs
- Consider whether there is some way to reduce costs of the other party to allow you to get what you want, and vice versa
- Consider ways to reduce scarcity of resource over which you are having conflict
- Search for novel solutions which meet neither party's stated position but do meet their underlying interests

Primary source: Bazerman and Neale

Critical Issues in Partnerships

- Convergence of objective Strategy  Revisit
- Shared / common vision with partner: Co-Destiny
- Consistency of position of the alliance within the larger firm  Role of Senior Management
- Managing the interface Teams  Use of Internal

Co-Destiny

- A process to create coordination of strategies and objectives
- Summit meetings twice a year to revisit vision and strategy, but also to discuss divergence of opinion
- Became an effective: identifier of future conflict, source of convergence and revisitation of strategy and conflict resolution mechanism
- Key is to keep it time limited and replace with the next generation, to retain freshness and to redefine critical focus

Divergence of Objectives

- Cultural distance
- Hidden agendas
- Miscommunication and ambiguity

FORMATION AND MANAGEMENT OF ALLIANCES

INTENSIVE PHASE

INTERNAL BUY-IN

ALLIANCE

INITIAL
FEEDBACK

MANAGEMENT

Milestones vs
budget

scale-up or reduce

managing the
interface

STRATEGIC
BUDGETING

Questions to be Asked Prior to Forming Alliances

■ Strategy

- What are the joint advantages of this alliances?
- What are the implementation difficulties?
- How does this alliance change the competitive landscape?

■ Transaction

- What role should equity pay in the deal structure?
- Is alliance the best way to achieve strategic goals (versus acquisition or internal development)?
- How are we determining the exit clause provisions?
- What are the deal breakers in this case?
- Have we thought about an option to acquire?

Questions to be Asked (continued)

- Management of the alliances
 - Setting up the joint business plan
 - Key management control issues
 - Parent resource support – financial and nonfinancial
 - Accountability on operations and performance
 - Strategy milestones
- Alliance Capability
 - Role of the alliance function
 - Role of skilled personnel in each role, and virtual teams
 - Disciplined formation process
 - Creation and implementation of knowledge sharing routines

Conclusion

- Alliances are formed in response to rapid and discontinuous change in the firm's competitive environment
- Effective formation of alliances requires a balanced approach, considering both analytical fit and organizational fit
- Managing the interface of the alliance is important for continuity and effectiveness over time
- Firms can create significant competitive advantage by creating and managing a proprietary alliance capability