Do You Really Have an Alliance Strategy?

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Surely, your firm has a strategic alliance. It probably has several. But do you really have a coherent "alliance strategy"? The two terms are not the same, and the difference is more than semantic. An alliance without a coherent strategy behind it is doomed to fail.

In 1988, Mitsubishi and Daimler-Benz launched their strategic alliance with much fanfare. The capabilities of these giants seemed well-matched and global competition drove them into each other's arms. The leaders of the companies signed a deal in principle to collaborate in various areas. But no concrete projects were launched then, and no major ones were forthcoming later. The alliance was stillborn. It has faded away quietly.
IBM and Apple launched another much-touted strategic alliance in 1990. A multi-part agreement outlined areas of collaboration, including investments in joint ventures and collaborative labs. Together, they would take on Intel and Microsoft. It didn't happen. Eight years later, this strategic alliance, too, is fading away, though not so quietly.

There are many other examples. Alliances formed at high levels and often blessed with the designation "strategic" or "corporate" often fail to deliver real benefits to the partners. Analysts and managers will argue eternally over what caused each link-up to fail. Some will blame egos and clashing cultures, others will cite business conflicts and ruthless competition. Yet these cases of unfulfilled promise often share one syndrome: Amid the hoopla, the creation of the big alliance came to be seen as an end in itself rather than a means toward a broader strategic goal. The failure of these deals teaches one clear lesson: It's the strategy behind the deal that matters, not the deal itself.

Companies that have heeded this lesson have been more successful in their alliances than those that have ignored it. Sun Microsystems has leveraged its core capabilities impressively through a multitude of alliances. Some of its alliances have survived long, others have been short-lived; some were narrowly focused, and a few were broader. Sun's partners are big and powerful, including Fujitsu, Toshiba, Oracle, and IBM. But none of these partners or individual alliances accounts for Sun's success. Rather, the way in which Sun has used its alliances has allowed it to get the most out of this strategy.

The story of Corning Glass in fiber optics is no different. The company's deals were important and well managed, but its overall strategy was key. Corning used a portfolio of alliances to test the market and develop related aspects of the technology, all the while continuing to invest in its own core capabilities. The same can be said of Fujitsu in large computers and Microsoft and Intel in microcomputers.

Intel's first generation of X86 microprocessors were licensed to several allies; later generations were licensed to progressively fewer firms. Today, Intel is the sole producer of its high-end chips. Intel's X86 alliances in and of themselves were tools-steps on the ladder, so to speak; the real goal was creating and dominating the microprocessor standard.

The Elements of an Alliance Strategy

As these examples suggest, a coherent alliance strategy has four elements:

- An underlying business strategy that shapes the logic and design of individual alliances.
- A dynamic view that guides the management and evolution of each alliance.
- A portfolio approach that enables coordination among alliances and enhances flexibility.
- An internal infrastructure that supports and strives to maximize the value of external collaboration.

Taken together, these elements determine whether a firm is successful in using alliances. As a general matter, alliances themselves are neither good nor bad for a firm--it all depends on how they are used. At the right time and when managed well, they can create tremendous value; at the wrong time and when managed poorly, they can be costly distractions.

The underlying business strategy. In principle, most managers would agree that an alliance needs to be backed by a business strategy Ideally, this strategy would dictate why this partner and this structure are better than alternative options, what the firm expects to get out of the partnership, how the risks will be managed, and so on. Yet, time and again, firms enter into alliances without a clear sense of their underlying strategy. Why?

The reason lies partly in the tendency of the deal's champions and negotiators to see the alliance itself as a goal. Often, the opportunity for an alliance arises suddenly--prompted by an inquiry, a competitor's move, or a CEO's conversations with a counterpart. Before you know it, you are "doing the deal" rather than determining whether you need a deal, and, if so, what kind of deal you need. In today's fast-paced environments, time to think can sometimes seem a luxury. But, as the old saying goes: "Married in haste, repent at leisure!"

Precisely because of this tendency to focus on the transaction, it is essential to think in advance about how alliances fit into your business strategy. Today's alliances fill many goals, depending on the strategy in which they are embedded. Supply alliances aim to take advantage of economies of scale and specialization by having one partner supply the other with products or services. Positioning alliances help partners enter new markets or expand existing markets. Learning alliances develop new technologies through collaborative research or transfer skills between partners. Many alliances exhibit combinations of these goals.

Being clear on how the alliance fits into a business strategy is also important for accurately measuring its performance down the road. A supply alliance needs a different measuring stick than a learning alliance. Furthermore, the true value of any alliance is usually not evident from the narrow costs and revenues of the collaboration, even when the alliance is a stand-alone joint venture. Because the alliance is a tool in a broader strategy, its effect must be measured in terms of its contribution to that strategy. Thus, we must also account for the opportunity costs of options foreclosed by the alliance and for any qualitative benefits that the alliance brings to the firm as a whole.

Take the well-known case of Fuji Xerox. This joint venture between Xerox and Fuji Photo Film was originally created to help Xerox sell copiers in Japan. Over time, Xerox's strategy and Fuji Xerox's capabilities evolved so that the joint venture also became a supplier of products to Xerox's global sales and a partner in developing new technologies. The joint venture itself became profitable, grew in size, and issued modest dividends and royalties to Xerox. But its true value lay in how it helped Xerox beat back the Japanese competition in the 1980s, halt its previous decline in the copier market, and launch new product development and manufacturing initiatives worldwide. Fuji Xerox saved Xerox, though you wouldn't know it just by looking at the cash returns from the venture. The alliance's role in strategy is much bigger and broader than the partnership itself.

A dynamic approach. The example of Fuji Xerox also shows the value of a dynamic approach to managing alliances. Just as the broader strategy is more important than the individual deal, so, too, the long-term evolution of the relationship is more important than the initial deal.

But here, too many firms commit fatal mistakes. The tendency to focus on doing the deal again diverts attention to the subsequent management of the alliance. The fact that in many firms the deal negotiators are different people from the alliance managers doesn't help either. High-level alliance champions, too, often tend to move on to other courtships once one deal is done.

In fact, alliances by their very nature are open-ended and ever-changing. If all the terms of an exchange between two firms can be completely specified and agreed upon at the outset, they need not form an alliance; a simple purchase order or legal contract would do. An alliance is a way of sharing control over future decisions and governing future negotiations between the firms-it is a recognition that the initial agreement is in some sense incomplete. That is why success in alliances depends so much on their governance structures and on the ongoing relationship between the firms, including the personal relationships between managers.

This tendency of alliances to change over time is often misinterpreted as a weakness. Managers complain about the high "divorce rate" in alliances, and academics conduct statistical studies of the "instability" of these structures. The attention to termination rates misses the central point of this article-the survival of the alliance is not the goal, only the success of the alliance strategy is. Sometimes, the strategy will call for using alliances as transitory mechanisms on the way to a full acquisition or full divestment. At other times, particularly when market or technological uncertainty is high, the strategy may involve launching several alliances at the same time, and determining over time which ones are worthy of further investment and which ones should be terminated. Such a strategy is no different from internal investment strategies that have companies hedging their bets or pursuing parallel projects to develop new products. The flexibility--and thus the instability--of alliances is often a strength, not a weakness.

The early history of the Personal Digital Assistant (PDA) industry offers a good illustration of the dynamic nature of alliances. Starting in about 1992, leading firms in computers and telecommunications began forming alliances with each other and with other electronics firms to develop and later to market these hand-held devices that promised to organize our lives and keep us connected everywhere. By 1994, several constellations of firms had launched products: Apple and its partners sold the Newton; AT&T and its partners offered the EO; Lotus and Hewlett-Packard made the LX series; and so on. Notably, firms like Sharp pursued several product designs and had alliances with several firms, each for a different type of PDA.

Three years later, few of these PDAs were still in the market (the Newton and Sharp's products survive), and few of the alliances were still in force. Does this signify the failure of the alliances? I think not. The field in which these firms were entering was inherently uncertain and fluid. A good share-even the majority-of the product designs launched was bound to fail or needed to be changed, whether they were created by a constellation of allies or by single firms. But what the alliances allowed the firms to do was conduct market experiments quickly and at relatively low cost. This was their underlying strategy and the dynamic logic behind their use of alliances.

Portfolio management. The alliance strategies of the PDA firms were instructive for another reason: They illustrate the value of careful design and management of a firm's whole portfolio of alliances. The PDAs were produced by integrating components of more than one firm and then selling through multiple channels; the alliances among these firms, therefore, could be made to reinforce each other. Conversely, a disorganized portfolio of allies could easily lead to a fragmented approach. Here again, the effectiveness of the alliance strategy depends on a perspective that transcends the individual deal.

Companies in systems- or network-type businesses usually recognize the importance of having a portfolio of allies. At a minimum, business units that use multiple components will depend on multiple supply alliances; business units that sell in multiple vertical or country markets will use a collection of allies to reach different customer sets. Airline alliances among various national carriers are examples of this strategy. Similarly, when a critical mass of "sponsors" is important to future market acceptance--as it is in many high-technology sectors--firms will often try to sign up many allies quickly. Battles over standards in computer software, consumer electronics, and communications are good examples.

Alliance portfolios can also be important in industries driven by innovation. Pharmaceutical companies, for example, are increasingly using multiple external alliances to complement their internal R&D. They may invest in several small biotech firms and fund several university laboratories, all the while doing internal research on related topics. The reason for such a seemingly fragmented approach is that the chance of success of any single project is low and unpredictable. The portfolio of alliances is a way to place multiple bets and hope for a jackpot somewhere.

But being involved in multiple alliances is not sufficient in these situations. Two different partners may either complement each other, or they may conflict with each other. The same is true of a network of many alliances. A poorly designed, mismanaged network can entangle the firm and waste scarce managerial bandwidth-the conflicts among partners will overwhelm any potential value to be gained from multiple partnerships. Good coordination, on the other hand, can save resources and diversify options for growth.

In every industry where the alliance revolution has progressed far (e.g., information technologies, air travel, transportation equipment, health products, and professional services), the leading firms by now have a substantial portfolio of partners. They all face the challenge of managing this portfolio, and many are experimenting with tools, procedures, and organizational structures. None stands out as yet as a benchmark to be emulated. But there are some early examples of success.

Ernst & Young, for example, has created a Business Alliances Group to guide field personnel in forming new alliances and to monitor the progress of existing partnerships. So far, this team of five, headed by an E&Y partner, has created a detailed template for evaluating alliances consistently across business units and a sophisticated groupware tool for reporting and tracking alliances. Field personnel negotiating with a partner or wishing to offer a partner's services to a client can tap into this database through the company's electronic network and quickly locate business information and personal contacts.

Internal infrastructure. Ernst & Young's system is not only important for coordinating a portfolio of allies, but also for upgrading the internal capability of the firm to manage alliances. In case after case, it has now become clear that the internal organization of a firm is critical to the success of its external partnerships. Without a supportive internal infrastructure, every alliance strategy will fail, no matter how ingenious the external deals.

All too often, however, alliances are seen as peripheral to the firm's core operations and not deserving of the resources and attention granted to internal projects. This syndrome is particularly common--and dangerous--in foreign-market joint ventures. For example, some U.S. companies have rushed to form joint ventures in China, only to starve them of resources later because they simply did not fit into the firms' standard ways of doing business. The problem is compounded when the foreign joint ventures are created by a firm's international division and not "owned" by operating units back home. The stage is then set for internal friction that can undermine the foreign-market strategy. The lesson is clear: Purely internal problems can doom the external alliances.

A good alliance strategy therefore starts at home. The firm must not only define a business logic for its alliances, keep an eye on the future, and manage the group of partners well, but it must also align its organization and invest resources in the strategy. Firms that are doing this (e.g., Corning, Xerox, Hewlett-Packard, Oracle, and Sun) are frequently cited for their capability. The essence of this capability is that alliances are made part of the everyday functioning of the company. They are not special deals relegated to a group of alliance experts. At the same time, where special expertise is needed, the company has found a way to share best practices internally. Finally, a good internal infrastructure identifies and mediates the internal conflicts that affect its alliances.

Crafting an Alliance Strategy

An alliance strategy is thus more than a strategic alliance. There are now plenty of books and legions of consultants ready to sell you the keys to success in strategic alliances. Everyone has a top-ten list of critical factors. (Mine are shown in Exhibit 1.) And there is no denying that many alliances stand or fall because of how they are designed, how the partner is chosen, and other elements specific to the deal itself.

But unless your firm is fully accomplished in forming alliances (and who is?), then you need much more than this. You need to create an organizational process that incorporates alliances as a natural option for the firm, much as investing in this or that market or opening or closing this or that plant. Such a process recognizes that alliances are not a panacea; they have risks and rewards, and they will work for some things but not for others. You do not need to determine in advance what the costs and benefits are, but you do need a method for evaluating them. And you need a system for defining and tracking your goals for the alliances. Do this, and you have the first step in crafting an alliance strategy.

Next, you'll need a way to manage change. Again, do for your alliances what you would do for any other business function-recognize that change is endemic and demands flexibility in management. If the market changes, would the production schedule not change? If a competitor moves into your market, would your marketing plans not change? If the history of other alliances is any guide, chances are that you will not get everything you wanted out of an alliance, but you can get much that you didn't expect. The key is to grab opportunities for change, not ignore them.

Exhibit 1
Alliance Success Factors
An alliance strategy creates the context for the success of individual partnerships, as is explained in this article. In addition, ten factors pertaining to the deal itself are critical:

1. *Have a clear strategic purpose*. Alliances are never an end in themselves--they ought to be tools in service of a business strategy.
2. *Find a fitting partner.* This means a partner with compatible goals and complementary capabilities.
3. *Specialize.* Allocate tasks and responsibilities in the alliances in a way that enables each party to do what does best.
4. *Create incentives for cooperation*. Working together never happens automatically, particularly not when partners were formerly rivals.
5. *Minimize conflicts between partners.* The scope of the alliance and of partners' roles should avoid pitting one against the other in the market.
6. *Share information.* Continual communication develops trust and also keeps joint projects on target.
7. *Exchange personnel.* Regardless of the form of the alliance, personal contact and site visits are essential for maintaining communication and trust.
8. *Operate with long time horizons.* Mutual forbearance in solving short-run conflicts is enhanced by the expectation of future gains.
9. *Develop multiple joint projects.* Successful cooperation on one project can help partners weather the storm in less successful joint projects.
10. *Be flexible.* Alliances are open-ended, dynamic relationships that need to evolve in pace with their environment and in pursuit of new opportunities.

Having set in place these two elements of an alliance strategy, the last two will cry out for attention. The number of deals in which your company is engaged will have grown and will need to be managed. Doing this requires prioritizing among alliances and creating an organizational hierarchy responsible for optimizing the portfolio. This is not painless. It will probably call for making tradeoffs among partners or even among goals of different business units. Sometimes one alliance will foreclose the option of doing another. Just remember that ad-hoc growth of your alliance portfolio and a chaotic network are costly to your alliance strategy. Often, it is only after these costs emerge that the need for coordinating the alliance portfolio becomes clear to all.

As your alliances grow in numbers, the importance of a supportive internal infrastructure will also become evident. Suddenly, tending to alliances will begin to place substantial demands on scarce resources, not least among which is the attention of top management. When the organization is taxed, it will either resist change or find new ways to accommodate and support the alliance strategy. Only the latter route offers a hope of success. Tomorrow's companies will not survive if they try to do everything themselves, nor will they be saved by a strategic alliance here or there. But having a real alliance strategy will give them a fighting chance.

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