Competing in Alliance Constellations: A Primer for Managers[1]

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In an increasing number of businesses, alliances between firms are transforming the nature of competition and strategy. When two or more firms link up in an alliance, they begin to reshape competition from a pattern of firm versus firm to one of group versus group (Nohria and Garcia Pont, 1992; Gomes-Casseres, 1994). Take the case of airlines: Star, Oneworld, and Sky Team are "constellations" of allied firms that compete against each other. Each of these constellations is composed of individual firms, but the firms coordinate their actions when they compete together as a group. There are other contemporary examples in automobiles, telecoms, multimedia entertainment, and elsewhere.

When firms are engaged in this kind of "collective competition," what will determine their success? Will success depend on the management of the firm or the management of the alliance group? How does success of the group shape the returns to the member firms within it? In previous work, I have begun developing a framework for analyzing collective competition among groups (Gomes-Casseres, 1996 and 2003). In this paper, I develop the managerial implications of this approach.

The managerial agenda in this field is broad and not yet well understood. Pioneering firms have experimented with alliance constellations in many industries, but we do not yet have solid conclusions about what works and what doesn't. Among salient issues that need to be addressed in this field are the following (see Bamford, Gomes-Casseres, and Robinson, 2003):

- Where in the business value chain and in the market space of the company should the alliances be formed, how many alliances should there be, and of what type?
- What should be the relationship among the various alliances and partners in the constellation?
- How will interactions among alliances of different divisions be identified and managed?
- How should the company's multiple linkages be structured; for example, should there be a loose network, a stand-alone consortium, or an equity joint venture?
- How will the company's constellation compete with rival constellations and to whom will added value ultimately flow?

[1] This paper is a companion to two previous works of mine: "Competitive Advantage in Constellations," *Strategic Organization*, August, 2003 and James Bamford, Benjamin Gomes-Casseres, and Michael Robinson, *Mastering Alliance Strategy: A Comprehensive Guide to Design, Management, and Organization* (San Francisco: Jossey-Bass, 2003). It draws on these works and extends them by developing new managerial guidelines.

I will not address all these questions here, but instead will focus on fundamental issues that shape the answers to these managerial questions. My intent is to outline an approach that can guide analysis and management.

From Firm to Alliance to Constellation

What is an Alliance? To avoid confusion, some definitions are in order. First, let's define "alliance." There is finally some agreement about this between the academic work on economics of the firm (Baker, Gibbons, and Murphy, 2001) and the managerial literature (Bamford, Gomes-Casseres, and Robinson, 2003). It is well understood, for example, that alliances can be used to fulfill any number of corporate goals, including gaining scale, reducing costs, accessing new skills, products, or markets, and sharing risk. The real question is whether such a goal is best achieved with an alliance or another organizational approach. Here too, it is usually agreed that an alliance can take on a wide range of forms, from classic stand-alone equity joint ventures to non-equity relationships, including enhanced supplier agreements, contractual research collaborations, marketing affiliations, licenses, and multipartner consortia.

What do these arrangements have in common? Three characteristics. First, all alliances are agreements between two or more separate firms that involve ongoing resource contributions from each to create joint value. Typical partner contributions include technology, staff, customers, brands, capital, and equipment. Second, all alliances are in some sense an "incomplete contract"— a phrase from the economics of law that refers to an agreement in which the terms cannot be completely specified and agreed at the outset. As a result of these first two conditions, all alliances share a third characteristic: joint decision making to manage the business and share the value.

Why do firms enter into such loose agreements, and willingly endure the associated difficulties and risks? In simple terms: the alternatives are less attractive for the given situation. One alternative to an alliance is an arm's-length contract. In many situations, such contracts do not provide sufficient incentives for firms to collaborate deeply. Another alternative is a merger or acquisition. In many cases, such an approach is infeasible, or too expensive or risky. As an arrangement short of merger but deeper than an arm's-length contract, an alliance may strike just the right balance.

What is a Constellation? There is less agreement on what constitutes a "constellation." I define it here simply as a set of firms linked together through alliances and that competes in a particular competitive domain. The key here is that the alliance form (defined above) is used as the thread to "stitch" together the members of the group – this creates a unit that is looser than if the members were merged through complete ownership, yet tighter than if the members just had short-term, arm's-length transactions with each other.

This definition leaves open the actual motivation and structure of the constellation. Again, any number of goals might be pursued by the group and the group can be structured in many ways. For example, some typical goals of constellations are:

- Expanding market reach rapidly and with low investment
- Exploiting multiple geographic or vertical markets simultaneously
- Developing, making, and selling "system products" with various components
- Spreading and gaining industry acceptance for a technical standard
- Hedging bets and creating options for future actions

- Promoting various products or services under one umbrella brand

Just as with alliances, constellations too can take on a variety of forms. Examples of possible forms are these:

- A production joint-venture with several owners
- An R&D consortium with multiple members
- A jointly-owned "shared utility" serving various clients
- A co-marketing network or franchising system with multiple local channels
- A committee to set standards (official and de facto)
- The alliance portfolio of a business unit or of a company

While the forms and purposes of constellations may vary, they share certain characteristics. Strategic thinkers today commonly see the firm as a bundle of resources or capabilities, administered to achieve competitive advantage for the firm (the original statement in Penrose, 1956; a recent synthesis is Collis and Montgomery, 1997). These capabilities might consist of physical assets, intellectual assets, brands, technical know-how, and so on. I see a constellation as an alternative way to govern such a bundle of capabilities (see also Powell, 1990). Just like the firm, the constellation attempts to govern these capabilities so that it gains competitive advantage in the marketplace. But, unlike the firm, the constellation is governed by a system of alliances, not by full organizational integration and full control through ownership.

In other words, while I agree that the firm can be seen as a resource bundle that competes in the market, I argue that not all resource bundles need to be organized as firms -- some may well be organized as constellations. As a result, one might see single firms competing against constellations; this simply means that the single firm has more required capabilities in-house than do the members of the constellations. The underlying theme of my framework is that the design of a constellation affects how it competes and that the position of a firm *among* and *within* constellations influences the gains made by the firm. (For related concepts, see Nohria and Garcia-Pont, 1992; Jarillo, 1988; and Hagel, 1996; Lorenzoni and Ornati, 1988; and Normann and Ramírez, 1993.)

Implications for Managers Most of the managerial literature assumes implicitly that the firm is the primary unit of competition. This assumption needs to be modified for a world with multiple alliances and competing constellations. In businesses where collective competition is important, managers need to govern not only the activities within the strict boundaries of their firm, but also their alliances and constellations outside these boundaries. Even without further analysis of collective competition, therefore, we can define two clear implications for managers:

- *When competitive performance depends on the firm's alliances, managers need to pay attention to two sets of actions: (1) The initial design of alliances (i.e., setting goals, choosing a partner, and crafting the structure) and (2) the management of alliances after start-up (i.e., building relationship, adjusting plans, and making joint decisions). Elsewhere, I and others have discussed guidelines for doing this; the rest of this paper does not discuss these actions at the level of individual alliances.*

- *When the firm uses constellations to compete, success will depend on a parallel set of actions, i.e. constellation design and constellation management. These actions will require management to think broadly about its business and its capabilities, and often demand an outside-in perspective that seeks to shape the competitiveness of the whole value-chain surrounding the* *firm. The rest of this paper discusses an approach to doing so.*

Creating Value: Constellation Strategy and Structure

As constellations become important in a business, the competitive advantage of a firm comes to depend more and more on factors outside the firm, in addition to the usual factors under the firm's control. Put simply, the firm's performance comes to depend on the capabilities of its allies and on how the relationships among allies are managed. As noted earlier, the constellation's control over the resources inside its boundaries is analogous but not identical to the control that a firm exercises over the resources inside the firm. Still, to understand how value is created by constellations, we can ask the same kinds of questions that strategists ask about firms: What are the resources available to the constellation? And how does the constellation manage these resources? Answers to these questions go a long way toward determining the "group-based advantages" created by the constellation.

Constellation membership is the main determinant of what resources are assembled inside the constellation. Because of the mix and number of members, the constellation may be able to count on a greater or lesser scale and scope of operations, on a variety of technical capabilities, on market presence in certain segments, and so on. Which of these resources is actually relevant to competitive success, of course, varies from industry to industry – e.g. scale and scope may not be important everywhere, technical variety may or may not be valuable, and so on. But, given a competitive domain, managers ought to be able to define the set of capabilities needed for success. This is the first step in designing a viable constellation.

The next step is to stitch these capabilities together effectively. Because collective competition is still a young art, we have incomplete evidence of how best to organize a constellation. But, the evidence from a number of industries suggests that an effective constellation requires a unifying force of some kind – leadership at the core (Lorenzoni and Baden-Fuller, 1995), shared business strategies, or common motivations (sometimes a common enemy helps too!). (See cases of Coca-Cola, Visa, and Colliers in Bamford, Gomes-Casseres, and Robinson, 2003; and of RISC and PDA constellations in Gomes-Casseres, 1996). A corollary to this is that competition among members erodes the cohesion of the constellation (Hwang and Burgers, 1997). Other organizational elements matter too, but the point should be clear: A constellation can only hope to gain advantage from member resources if it is able to combine and govern these resources effectively.

Implications for Managers The discussion so far allows us to draw some preliminary guidelines for mangers about constellation strategy and structure:

- *Constellation designers will face a tradeoff between (1) expanding the group in an effort to assemble more and greater aggregate capabilities, and (2) keeping the group simple in an effort to promote effective governance. The appropriate balance between expansion and governance depends on the competitive context – e.g. the structure and behavior of rivals and the need for integration – and the dynamics of the emerging group, e.g. the alignment of incentives among players.*

- *Successful management of constellations requires careful mapping of the competitive landscape and consideration of various options for membership and structure. This is not an activity that currently is regularly done by strategists in many firms; it also requires careful* *monitoring and analysis of alliances of the firm's rivals.*

Claiming Value: Bargaining within the Constellation

Although constellations are created to generate group-based advantages, they must yield value at the firm level in order to attract and retain members. The game of competition may have changed, but we still keep score the old way. Given that a constellation creates some value, what determines how much of that value an individual member can claim?

To see why this question is crucial to competing in constellations, consider the history of the personal computer. The IBM PC was launched in 1981 by a constellation created by IBM, with Intel supplying the microprocessor and Microsoft the operating system. As a group, this triad created the microcomputer format that within a few years drove both the Apple II and the previously dominant CPM operating system to the periphery of the market. Later, this IBM PC constellation slowly fell apart, but Microsoft and Intel went on to develop the powerful Wintel alliance. The main lesson here is that the constellation created tremendous group-based advantages (it established the dominant industry standard), but the firms within the constellation benefited to different degrees. IBM, it turned out, ended up with the least claim on the joint value, even though it initiated the constellation, held a central position, and was much larger than its partners.

The key reason for this outcome lies in the nature of the resources each party contributed to the joint enterprise. In IBM's case, its resources were marketing, manufacturing, and the architecture of the product. To IBM's surprise, Compaq and a slew of IBM-clone makers were able to imitate the architecture and then out-manufacture and out-market IBM. Intel's and Microsoft's resources, however, were protected by copyright and by the firms' efforts to block imitation and stay ahead of clones. As a general matter, the better a scarce, valuable resource contributed by a partner is protected by formal legal means, the greater will be the ability of that partner to exact value from the constellation. Intel and Microsoft also benefited from competition among systems vendors, i.e., among their suppliers of complements. IBM had no such luck. (For a discussion of theoretical approaches to this case, see Gomes-Casseres, 2003.)

Implications for Managers Again, because the art of constellation management is young I can only suggest preliminary guidelines:

- *For a firm to gain from participation in a constellation, it must be able to claim some of the value created by the collective. This means that it needs to position itself within the constellation so as to try and control key, scarce resources or otherwise increase its bargaining power vis-à-vis other members in the group.*

- *This often raises a Catch-22 in constellation growth: By sharing its capabilities generously, a lead firm in a constellation can attract strong partners, and perhaps erode the power of rival constellations. But, this growth may well come at the cost of the firm's ability to appropriate value from its constellation. One way out of this dilemma is to begin the constellation with generous sharing, and to try to increase the firm's bargaining power over time.*

Conclusion: Managing beyond the Firm

This short paper has emphasized that modern competitive strategy depends increasingly on managing resources that lie beyond the traditional boundaries of the firm. Managers in businesses that rely on cooperation with governments have long known this, as have managers in entrepreneurial businesses, which must continually leverage internal resources with external ones. But the spread of alliances in a large variety of businesses means that many more firms need to manage beyond their boundaries.

To help managers in alliance-intensive industries, I propose that they think more broadly about the resource bundle with which they compete. These bundles don't lie exclusively within their firm, but are created by the alliance constellation around their firm. Because of this, it is critical for these managers to identify, shape, and manage these alliance constellations. This is not a typical managerial assignment, certainly not for line managers concerned with profit and loss on specific operations within the firm. But, for those firm leaders thinking about strategy and about how the firm should be positioned in its environment, the kind of analysis suggested here is critical.

The right time to address these issues is *before* alliances have spread too far in an industry. Alliances often spread in waves as one firm reacts to its rivals and before long the whole industry is populated by constellations. When this happens, "strategic gridlock" can preclude new alliances and severely restrict the scope of constellation design. At the same time, firms that did not prepare their alliance strategy in advance, will find that an ad-hoc group is no match to a well-designed constellation (Bamford, Gomes-Casseres, and Robinson, 2003).

A final piece of advice: If you think you don't have to compete in constellations, think again. It may creep up on you without warning. And, if upon reflection, an alliance constellation might be in your future, learn fast how to manage beyond your firm. The approach in this paper can serve as a starting point.

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