Microsoft verdict reveals dark side of strategic alliances

by Benjamin Gomes-Casseres
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Judge Penfield Jackson's verdict in the Microsoft anti-trust case last week should be required reading for any corporate strategist contemplating an alliance with another firm. It shines a spotlight on the dark side of alliances that is often hidden by the euphoria surrounding the topic.

Some companies -- such as Microsoft, according to Jackson's verdict -- enter into alliances with the intent of stifling competition, not to create new value through synergy. As a result, they raise what I have called "barriers to collaboration" for their rivals: a new type of barrier to entry that can be particularly onerous in today's networked economy.

Judge Jackson's earlier Findings of Fact and last week's Conclusions of Law describe in detail how Microsoft forced its partners -- ranging from Intel and Apple to AOL and Compaq -- to refrain from forging comparable alliances with Netscape and Sun. Microsoft's intent, according to the Judge, was not to create new value through tight alliances, but simply to block Navigator and Java from benefiting from channels of distribution and complementary technologies.

Because Microsoft achieved this result through exclusionary acts that lacked pro-competitive justification, the Court deems Microsoft's conduct the maintenance of monopoly power by anticompetitive means," wrote Judge Jackson.

By their nature, alliances are preferential arrangements in which partners commit to work closer with each other than they might with non-allied third parties. Often, these preferences are a pre-requisite to convincing the firms to invest jointly in risky new technologies or to tailor their products and services to each other. To achieve such positive results, good alliances also must attenuate the competition between partners. The concept of "co-opetition," in which firms are said to cooperate productively and compete fiercely at the same time, is at best a euphemism and at worst a strategic mistake -- it does not work in most cases; either the cooperation or the competition has to give.

So, the fact that there was an exclusionary effect in Microsoft's alliances is not surprising. The legal test, according the Court, is whether there was a pro-competitive justification for it. This is the first lesson for alliance strategists: Use exclusivity sparingly and only to enable cooperative synergy.

A second lesson pertains to the potential victims of strategies that erect barriers to collaboration. To them the message of the Microsoft case is: Barriers to collaboration work and can kill you. Every new alliance of your rival is in a small or large way a new barrier to your firm. A corollary to this lesson is that the denser the network of alliances in your industry becomes, the harder it will be for you to strike new partnerships. If you need such partnerships to succeed, your entry or success can effectively be blocked.

The browser and Java wars are by no means the only illustration of this effect, just the most detailed pubic record of it. Today, the density of alliances in fields from airlines to telecommunications already constrains the freedom of action for firms that have yet to enter the fray. A few years ago, the network of alliances in advanced microprocessor architectures effectively foreclosed Digital Equipment Corporation from gaining sufficient support for its new Alpha chip. In the future, fields like broadband multimedia, wireless Internet, and business-to-business commerce are sure to become similarly saturated with entry-blocking alliances.

A third lesson seems to follow from this: Get to the dance early, and don't be shy. Many companies know this instinctively, and fall over each other to form new alliances or avoid being locked out of future deals. Sometimes the alliance frenzy is overdone. When a fad threatens to overcome sober strategic thinking, managers can again learn from Microsoft. Regardless of legal and other objections to Microsoft's behavior, the cleverness of its alliance strategy cannot be denied. It did not promiscuously waste time on alliances for their own sake, but focused on a few major ones that served its strategic intent.

In fact, Bill Gates, still holds the record for the most astute alliance deal ever struck: Microsoft's license contract with IBM to supply DOS to the new IBM PC. Whether through foresight or luck, Microsoft retained ownership of the software and the all-important right to sell DOS to third parties.

Perhaps Gates's poker skills were just one step ahead of those of IBM's negotiators. More likely, the long-running anti-trust suit that hung over IBM at that time constrained IBM from simply buying Microsoft or striking a more exclusive deal. If so, Bill Gates has the Sherman Act to thank for his success. Now the tables have been turned.

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