Another Enron Casualty: Trust in Partnerships

Benjamin Gomes-Casseres, January 2002 (unpublished opinon piece).

Until a few weeks ago, partnerships were good. Now they are bad, or at least suspect. The term used to connote give-and-take; now it often stands just for take. On free association, “trust” used to come up after “partner;” now “scam” is more likely. What happened?

What happened is that one excess was overturned by another, just like boom leads to bust. The pendulum here was not in economics but in rhetoric. Aside from its strict legal meaning, the term partnership had been used in business all too often as an euphemism for what were mundane relationships.

When a vendor wanted to wow its clients, it called them partners; when corporations wanted to instill devotion in its workers, it called them partners; when government wanted to show a friendlier face to business, it became its partner. This worked like a charm for a long time.

The technology boom of the late 1990s helped boost the reputation of partnering. Major high-tech companies, from computers to pharmaceuticals, boasted tens of thousands of partners in everything from R&D to sales. These were sometimes also called strategic alliances and joint ventures, but to show just how cooperative they were, the giants of industry vied to become “partner of choice.”

By the end of the decade, the dot-coms had joined in and the trend turned into a craze. In a start-up’s efforts to get big fast, nothing did the trick better than a slew of partnerships. Lacking profits to show progress, or sometimes even sales, many turned to a popularity contest – who could sign up the most partners, the fastest.

Venture capitalists, the media, and even academics chimed in: the New Economy was said to demand continual partnering, even with competitors. All of a sudden, business partnerships were no longer like marriages – they became more like a series of one-night stands. On their websites, the dot-coms proudly publicized their conquests.

And now we hear of yet another excess: companies using closely-held partnerships and other special purpose entities to hide debts, inflate revenues, and who knows what else. Except for those of us steeped in accounting and securities rules, most did not know of this novel use of the age old euphemism. The charm just doesn’t end.

So, our trust in partnerships is now shattered. Whether as investors, as professional managers, or as observers, we cannot help but raise an eyebrow when we hear the sweet talk of another fresh partnership. Of course, we always should have done that. Now we know. Thanks, Enron.

Where do we go from here? From rhetorical high to hangover, to . . . sobriety. We must begin by recognizing that substantive partnerships can indeed help firms compete and create real value for shareholders. At least that holds for partnerships that are “real” and not fake shell-games.

We know this from the long experience of companies that practically built their fortunes on real partnerships. Corning developed its optical fiber business through a series of R&D partnerships, followed by a large joint venture with Siemens. Both Intel and Microsoft owe their initial success to their partnership with IBM in the 1980s. IBM itself, after a less-than-stellar experience with its PC partnerships, has turned into one of the most effective users of partnerships in technology, manufacturing, and services. Drug companies from Lilly to Millennium have used partnerships in R&D and sales to develop and commercialize new medicines.

Real partnerships such as these are not created to manage accounting numbers. Sure, a CFO may be happy to reduce assets in manufacturing, or share risks in R&D, and so on, but the prime motivation in a real partnership always lies in an exchange of value for value, not value for appearance.

Partnerships created purely for accounting reasons generally work only paper – and only as long as regulations and public perceptions allow. Partnerships created to combine the skills of two companies or to bring products to new markets have the potential to generate lasting value. This is the distinction we must now keep in mind.

How do you know a real partnership when you see one? And how do we know it will work? This is where there is still much work to be done.

Researchers have identified several factors that are keys to success in a real partnership. First among these is that a sensible business strategy drives the partnership; the latter can never be an end in itself. Second is that closing the deal is taken only as a beginning – it sets the stage for creating value, provided the post-deal exchange is managed well. Third is that the various partnerships in a company's portfolio must hang together, not conflict with each other. And fourth, partnering should be treated as a serious corporate capability, not as an ad-hoc task.

As an investor, it is not easy to know when a company is doing all these things. And, as we now know, their rhetoric alone is not convincing. Unfortunately, today's rules of accounting, even if we got rid of the most egregious loopholes, do not help enough.

The financial statements of a company begin and end at the legal boundaries of the company's property. What it owns or controls is included, what it doesn't is not. Partnerships often fall in a gray zone – they are important to the company's performance, but they are not owned or controlled by it. After all, they are partnerships, with give-and-take, remember?

This gap in what is reported is not the stuff of a scam. It is simply that while the game has changed, we are still keeping score by old rules. The new game in many businesses requires good management of real partnerships, but the scoreboard has no slot to measure their performance on this task.

One of the good things that might come out of the Enron debacle, therefore, would be a better way to measure and recognize the real value of partnerships. This is important to avoid shell-game partnerships. But, it is even more important for the many more companies that work hard to design and manage real partnerships.

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