# Introduction

## What Is Alliance Strategy?

Alliances have come of age. In the last ten years, they have gone from being a peripheral tool of management, used mostly to enter restricted overseas markets, to a centerpiece of corporate strategy and competitive advantage. Today, many companies have portfolios of twenty or more alliances—and some have more than a hundred. Because of this, it is now common to see alliances account for 20–50 percent of corporate value—whether measured in terms of revenues, assets, income, or market capitalization. Alliances are fueling the success of a wide range of firms, including British Petroleum, Eli Lilly, General Electric, Corning Glass, Federal Express, IBM, Starbucks, Cisco Systems, Millennium Pharmaceuticals, and Siebel Systems.

As alliances moved from periphery to center of corporate strategy, the discussion surrounding them changed subtly. Executives are no longer asking “Why do an alliance?” but rather “How do we make our alliances succeed?” Over the years, numerous studies have shown that between 30 percent and 70 percent of alliances fail—that is, do not meet the goals of the parent companies. Whatever the number, it is clear that in many companies alliance performance lags far behind what could and should be achieved.

How can managers improve the performance of their alliances? Those involved usually have a unique story for why their alliance is troubled; popular among the reasons cited are unclear strategies, poor partner choice, weak or unbalanced alliance economics, dysfunctional governance, clashing corporate cultures and goals, and lack of sufficient operating staff skills and parent commitment. Although these explanations for alliance failure may be true in one case or another, we believe that they are expressions of a larger syndrome: companies are taking too narrow a view of what it takes to make an alliance succeed.

A simple memory aid will help. Instead of focusing on "the strategic alliance," we believe that managers should develop a comprehensive "alliance strategy." The term *strategic alliance* stands for a deal, a new venture, an organization—often one that is announced with some fanfare. An *alliance strategy* represents much more than the deal—it is an intent, a dynamic process, and a logic that guides alliance decisions. A strategic alliance without an alliance strategy is doomed to fail. Now that alliances are central to strategy, we must adopt this more comprehensive view of how they work.

## The Four Elements of Alliance Strategy

This book discusses issues and presents guidelines for management of the four key elements that should be part of every alliance strategy: alliance design, alliance management, using a constellation of alliances, and building an internal alliance capability. Representative questions in each the elements are shown in Exhibit I.1.

### Alliance Design

The business strategy of a firm or division must shape its alliance strategy and, ultimately, the design of every alliance. Corning Glass has long used alliances to exploit its glass technology in different vertical markets; this meant allying with Samsung in television glass, with Dow in silicones, and with Siemens in fiber-optic cabling. Cisco Systems uses alliances to scout for new technologies, with the intent of bringing these technologies in-house if they prove successful. Even though these are very different uses for alliances, in each

**EXHIBIT I.1** Issues in Alliance Strategy.

*Design of an Alliance*

- Why use an alliance, as opposed to relying on internal resources, acquiring a company, or buying services and products on the market?
- What is the scope of the alliance, that is, what is included and excluded? Which markets or products, technologies, and business systems does it include?
- What are the criteria and methods for selecting a partner?
- What are the options for structuring the alliance, and what effects will these structures have on governance and value sharing?
- How should the alliance be negotiated, that is, what are the priorities, who should be on the negotiating team, how will the relationship be affected by bargaining, and so on?

*Management of an Alliance*

- How should the relationship be launched, that is, what should be done in the first 30 to 180 days?
- What is the process for making decisions in the alliance when issues arise that have not been resolved in advance, as they surely will?
- How will operational decisions be made within the alliance, on both routine business and new strategic directions?
- How will the performance of the alliance and the relationship between the parents be measured and monitored, and how will these measures be linked to individual incentives?
- What is the process for adjusting the alliance design (or even terminating the alliance) as the partners accumulate experience working together?

*Design and Management of an Alliance Constellation*

- 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?

**Exhibit I.1** Issues in Alliance Strategy, Cont'd.

- 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?

*Development of an Internal Alliance Capability*

- Who in the corporation should be responsible for specific tasks in alliance design, alliance management, and in coordinating the alliance constellation?
- What skills, human resources, processes, tools, and systems are needed in each area?
- How centralized or decentralized and how formal or informal should the alliance capability be?
- How will the corporation capture and disseminate learning from its own experience with alliances?
- What will encourage incorporation of alliance thinking into the general management of each business?

case the role and design of the alliances is consistent with a clear business strategy. By *alliance design* we mean identifying the role of the alliance in the business strategy; setting the goals, rationale, and scope of the alliance; determining the criteria and method for selecting a partner; and crafting the structure and processes for sharing value and decision making in the alliance.

In Part One of the book, issues of alliance design are covered in two sections. The first section deals with the links between strategy and alliances. It contains perspectives and advice on how to set strategic goals for an individual alliance, how alliances add value to a strategy, and how strategy shapes the general design of an alliance. The second section deals with key challenges in selecting a partner and designing the structure of the alliance. Among these challenges are how to collaborate with a competitor, how to negotiate an alliance, how to combine the legal and business aspects of an alliance, and how to differentiate between vendors and partners.

One broad conclusion from these chapters is that alliance designers must think beyond the narrow concerns of their day-to-day functional tasks. Lawyers must understand business objectives, competitors must also think like collaborators, negotiating teams must do more than bargain for the last dime, everyone must define risk broadly, and so on. By the same token, the task of designing an alliance should not be relegated to deal makers or some group of partnership specialists. Instead, alliance design must be an integral part of strategy making and business leadership.

## Alliance Management

Even with the benefit of a good design, an alliance will never take care of itself—the partners must make continual investments of effort and adjust their relationship in response to new circumstances. The success of an alliance thus depends as much on the unfolding relationship between the partners, including the personal relationships between managers, as on its initial design. A prime example of this is Xerox's forty-year-old joint venture with Fuji Photo Film in Japan, which yielded benefits way beyond initial expectations because the partners were flexible and forward-looking in managing their relationship. Guidelines and case studies on alliance management are in Part Two.

In a real sense, the initial deal is merely an *opportunity* to develop an alliance—it declares the ground rules for the growth of the relationship that should bring value to the partners. Unfortunately, the tendency of an alliance to change dramatically over time is often misinterpreted as a weakness. At the extreme, change can lead to exit, resulting in the high divorce rate of alliances. But this attention to termination rates or general instability misses a central point—the stability of the alliance ought not to be a goal in itself; only the success of the alliance strategy matters.

The three sections in Part Two show how excellent practitioners manage the relationships between partners. The first section covers the basic mechanisms for working together and governing an alliance relationship. These mechanisms recognize that alliance managers have less exclusive control than they have in internal decisions, and that they must find ways to make joint decisions. That, after all, is the soul of an alliance. The second section gives evidence and advice on the role of alliance leaders, from top-level champions to day-to-day managers. Finally, the third section covers exiting from alliances—why alliances end and how to prepare for a graceful separation.

These chapters show that success in alliances is as much an organizational challenge as a strategic one. In fact, studies that have attempted to find which factors are most important in the success of individual alliances invariably have yielded a split decision: organizational issues in alliance management are about as important as strategic issues in alliance design. These two sets of issues determine the fate of individual alliances. In the remaining chapters of the book, we address ways to maximize value in a whole program of alliances.

## Alliance Constellation

Because most business strategies include more than one alliance, success often depends on how the whole collection of alliances fits together. This collection of alliances has been called a *constellation;* it often acts as a distinct unit of competition. In fact, in many industries, competition has been transformed from a battle of firm against firm to one of group against group. Probably the best known example of this type of competition in the early 2000s was the battle among the airline constellations Star and oneworld. Part Three gives perspectives and lessons that help in designing and managing an effective alliance constellation.

Constellations are often important for companies in systems- or network-type businesses. At a minimum, business units that use multiple components will depend on multiple supply alliances, and 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. Standards battles in computer software, consumer electronics, and communications are good examples of such constellations.

But being involved in multiple alliances is not sufficient in these situations; the firm must also manage the constellation as a whole. In principle, two alliances of a firm may either complement each other or they may conflict with each other. The same is true, in spades, of a network of many alliances. A poorly designed and managed constellation 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.

Part Three focuses on firms with extensive networks of partners, but many of the guidelines from this part are also applicable to firms with just a few partners. It examines two different forms of constellations. One is the portfolio of alliances of a firm, such as Coca-Cola's portfolio of bottlers. Another form is a collection of firms allied with each other, such as the groups of firms in Visa International or Colliers International. With both of these forms of constellation in mind, the first section in this part of the book outlines how strategic goals shape group design, how multipartner alliances may be governed, and how constellations spread and grow. The second section describes how constellations have flourished in three very different industries.

As these chapters show, constellations take many forms and are used for various purposes, just as is the case with individual alliances. In the same way, designing and managing constellations requires decisions, capabilities, and structures that are related to those important in individual alliances. But the complexity and scope of constellations adds new challenges.

## Alliance Capability

Firms that use alliances as extensively as do our constellation pioneers have also discovered another important lesson: the success of external alliances often depends on having a supportive internal infrastructure. This lesson is by no means limited to firms with many alliances. Unfortunately, proofs abound in every organization. Managers involved with external relationships can all testify to how important it is to get internal organizational support for these relationships.

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, it must also align its organization to this strategy and invest the right resources in it. Firms that are doing this are frequently cited for their alliance capability. In some industries, such as pharmaceuticals, the early 2000s saw a rivalry among firms to become "partner of choice" by building an internal capability that would make them attractive to technology providers. 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.

A firm that truly values its alliance capability will seek ways to share best practices among its business units and to develop special expertise where it is needed. The best practitioners therefore record the lessons from their own alliance experience, assemble tools for future alliance designers and managers, and train managers involved in alliances. Finally, a good internal infrastructure identifies and mediates the internal conflicts that can pit one alliance against another.

Part Four shows how leading firms have built their alliance capabilities and draws lessons from their experience. It covers such issues as how alliance knowledge can be managed, how alliances across business units can be coordinated, how managers can be trained for alliance work, and how the health of an alliance might be measured and tracked.

The evidence suggests that there are many ways to build an alliance capability. What works depends on the organizational culture of the company—some firms use extensive data storage and sharing tools, others do just fine with personal interaction and a minimum of technical overhead. Some firms place alliance management under a centralized organization, say at the corporate level, while others prefer to distribute responsibility for alliances across all business units. Furthermore, the degree to which a company is willing to invest in a permanent alliance capability, or indeed needs to do so, also depends on its organizational and strategic circumstances.

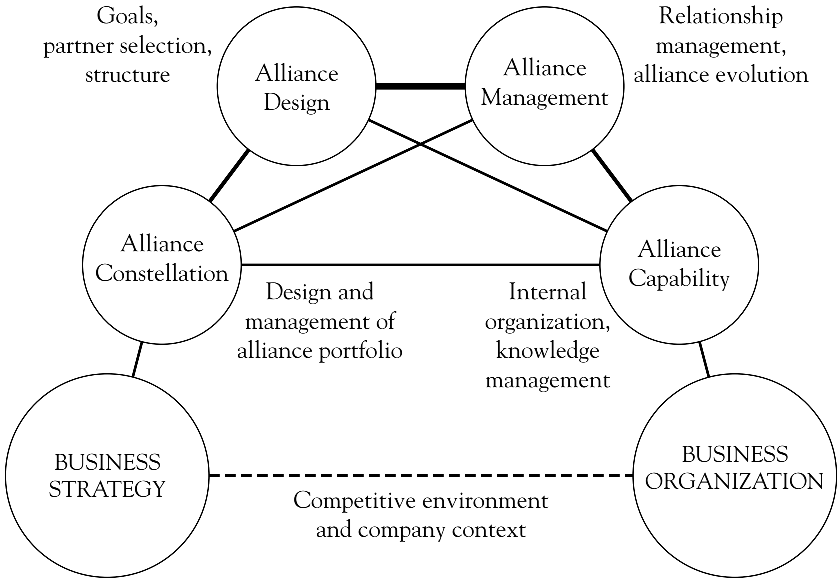
## The Arc of Alliance Strategy

Superior performance comes from managing this whole array of issues. To help keep track of these issues, we designed the Arc of Alliance Strategy shown in Figure I.1. The four elements of the alliance strategy arc rest on a foundation that is the general strategy and organization of the firm. This arc represents an integrated view of what it takes to succeed with alliances. It is also a road map for this book.

Although mastery of these individual elements of alliance strategy is essential, it is the overall workings of the arc that drive success. Within the arc, the strongest links are between alliance design and management. The success of one clearly depends on the other. The design must set the stage for management, and management must strive to bring to fruition the goals set at design. These two elements apply to every alliance of the firm, and carry roughly equal weight in the success of any given alliance.

The other alliance elements shown—alliance constellation and alliance capability—apply to the collection of alliances of the firm.

**FIGURE I.1** The Arc of Alliance Strategy.




Here too, there are important interdependencies. On the left side, constellation design often sets the stage for the design of individual alliances, because it influences goals and partner selection criteria. On the right side, the firm's alliance capability often determines how it will tackle alliance management. Weaker links exist between the management of the alliance constellation and the management of individual alliances, and between capability and design.

Finally, it is clear from this diagram that the whole arc rests on two broad foundations—the strategy and organization of the firm. These elements go well beyond alliance strategy and are influenced by considerations in other fields, such as marketing, finance, production, and so on. Broad strategic decisions help determine the constellation strategy of the firm, and broad cultural and organizational norms influence the way the firm will manage its alliance capability. The business model of the firm, in other words, shapes the arc of alliance strategy.

## Using the Arc

How should managers navigate this arc? That depends on where one starts. Logically, one must reason up from firmwide strategy and organization to the top elements. But, practically, that is not how most managers will learn to master alliance strategy.

Most readers will come to this book with urgent needs at the top, and only later will address the broader elements at the bottom. Certainly, for newcomers to alliance strategy, it is more effective to start at the top—first understand the key success factors in design and management, and then work your way down to the broader implications for the firm. That is why the parts of the book are ordered as they are.

We encourage readers to enter at any level and move around this space. One can just as well read the book backward. Start by asking: What capabilities do we need? How do we design the overall constellation? And, only then: What are the implications for alliance design and management? But such an approach already assumes a good understanding of alliance strategy.

What is most important is to understand the logic and to keep a view on the whole arc. Wherever one sits, that element will doubtless loom largest and most important. That is why deal makers in business development think their alliance design activities are the keys to success and why operational managers in the alliance feel that it is their implementation of the deal that really matters. Both are right. And both sets of specialists must deepen their skills and advocate their views. But the specialists must also be generalists. They must know where their piece fits in the totality.

That is why alliance strategy is an essential part of general management. No general manager of a business unit or division or company would be content to leave financial decisions to the financial managers and marketing to marketing departments. So too, alliance strategy is too important to be left to alliance managers. It must become part of natural thinking in every general manager's mind.

This holds for top management too. Senior executives are not immune to tunnel vision, notwithstanding their role as overall company leaders. They too are sometimes fooled into adopting too narrow an approach, centering perhaps on striking this or that deal with such-and-such powerful ally. That is only one move in a dynamic alliance strategy. In addition, leaders of the firm must evaluate their total portfolio, ensure that there is follow-up management, and sustain performance by building lasting capabilities. This book is for them too.

## Definition of Alliance

Before launching into the book, one bit of terminology is needed: What exactly is an alliance? In our definition, alliances can be used to fulfill a broad range of corporate goals, including gaining scale, reducing costs, accessing new skills, products, or markets, and sharing risk. In fact, any goal of corporate strategy can, in concept at least, be achieved with an alliance. The real question is whether such a goal is best achieved with an alliance or another organizational approach.

Answering that question requires understanding what kind of organization an alliance is. Here too, our definition covers a wide range of forms, from classic stand-alone equity joint ventures and 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 difficulties and risks associated with all three characteristics? 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.

## Mastering Alliance Strategy

So, how do you *master* alliance strategy? As in other activities, mastery comes from deep understanding, frequent practice, and some wisdom from others. This book is designed to help on each of these fronts.

This is not a book of best-practice formulas—we don't believe in the cookie-cutter approach to management. Instead, we have gathered here what we consider the best thinking that is also useful in practice. Best-practice formulas have limited shelf lives and narrow applicability; best thinking, on the other hand, prepares managers for sustaining good practices even when the situation changes.

Best-practice surveys used to be all the rage a few years ago. But companies that invested in these surveys have come to realize that no matter how successful a practice is in one company, it may be completely wrong for others. The effectiveness of a management practice depends critically on its organizational and strategic contexts. To know what works for you, therefore, you must first understand not only *what* another company is doing, but *why* its people are doing what they are doing. Then, you must know how to translate the foreign experience to your own company.

That is where best thinking comes in. This book gives practical approaches, frameworks, examples, models, and other tools to spark your thinking. The result, we hope, is a deeper understanding of how alliance strategy works, why some companies do what they do, and what you might consider doing in your company. But the work of applying it to your own organizational and strategic context remains yours.

## Sources of Wisdom

Most of the chapters in this book are based on articles in *The Alliance Analyst,* a management strategy newsletter that from 1994 to 2001 documented every few weeks what leading companies were doing and thinking with their alliances. The three authors of this book were instrumental in driving that publication—as editor, adviser, and publisher.

Many of the original articles were written with or about experienced practitioners. Over the years, we interviewed more than a thousand executives, many on multiple occasions, and in the process came to understand their issues deeply. The original articles have been revised, updated, and edited for this book with one goal in mind: to sharpen their lessons and advice. What remains is alliance wisdom accumulated over eight years and filtered down to its essence.

Many of the case studies are presented here as histories. They are not intended to portray how individual companies operate today or to rank one company over another. Instead, they were chosen for the timeless lessons they teach. Many of the companies described have continued to develop their alliance practices or taken different directions. But their experience will serve as a guide for others.

How should readers use this book? Browse it, read what is most intriguing, and most of all, discuss and debate the implications for your firm. The varying and sometimes even contradictory views of different contributors have not been forced into a common prescription, intentionally. Each may see the world slightly differently, but they are here because their views will help you find the answers that work best for you.

You already recognize that your company cannot succeed if it tries to do everything by itself—you know you need alliances. But you will not be helped by a strategic alliance here or there; you need a comprehensive alliance strategy. This book will help you craft one. The rest, as they say, is practice.