



Scoping Out Alliances And Joint Ventures

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INTRODUCTION

This white paper is the first of two white papers that are concerned with the development of a company by means of operational and strategic alliances. As business generally becomes more globalised, the incidence of joint development is increasing. One factor influencing this trend is the changing nature of competition – away from product and service towards the overall business model and supply chain structure. This is prompting companies increasingly to seek collaborative approaches to building a business, and it influences decisions and relationships in companies of all types and sizes.

White paper number one consists of two sections:

Section One considers the circumstances in which an alliance or joint venture is potentially the best mechanism for developing a business. In doing this we examine (a) the rationale for selecting the joint venture mechanism as a means of developing a business and (b) the risks/rewards and managerial challenges that are faced in this type of organisational structure.

Section Two sets out a process for finding alliance or joint venture partners. In doing this we examine (a) the profiling of the characteristics of an alliance/joint venture partner and (b) the means of achieving robust progress towards selecting a partner or partners.

SECTION ONE – RATIONALE FOR ALLIANCES AND JOINT VENTURES

ALTERNATIVE MECHANISMS FOR DEVELOPMENT OF A BUSINESS

There are five main mechanisms via which a business can be developed:

1. Go-it-alone
2. Acquisition
3. Merger
4. Divestment and re-investment
5. Alliance/joint venture

Let us look briefly at the rationale and requirements for each of the above mechanisms.

Go-It-Alone

The simplest mechanism for development of a company is via organic growth. This requires one or both of the following conditions.

- (i) A growing level of demand, sustained over time.
- (ii) Improvement of competitive position within a defined business, sustained over time.

An additional go-it-alone mechanism is via diversification. This requires some or all the following business conditions.



- (i) Unsatisfactory organic growth potential in core business(es).
- (ii) Possible market diversification on the basis of product marketability.
- (iii) Possible product diversification based on current or easily accessible technology.

Acquisition

The main reasons for undertaking an acquisition are as follows.

- (i) To improve competitive position by gaining market share and greater resources.
- (ii) To reduce competition.
- (iii) To diversify into new business areas if go-it-alone is not possible.

It involves persuading owners of a target business that their interests are better served by selling to an acquirer who is able to add more value than the current management team.

Merger

Merger is sometimes preferable to acquisition. It differs from acquisition in that one company does not buy the assets and goodwill of another but two or more companies form via agreement an integrated whole, such that the former individual companies combine and a new legal entity begins to operate. It is generally a lower-cost option than acquisition. It is particularly appropriate when products, markets and/or technologies are complementary thereby ensuring that synergies and economies of scale/scope can be achieved.

Divestment and Re-Investment

Divestment normally occurs when one or more of the following business conditions are encountered.

- (i) Obsolescence of a product line.
- (ii) Demonstrable inability to manage part of a business portfolio effectively.
- (iii) Opportunity cost of remaining in a given business area when better alternatives exist.
- (iv) Unsolicited opportunity to sell part of the business portfolio at an attractive price.

Alliance or Joint Venture

These terms are often used somewhat imprecisely and misleadingly. Let us therefore start by distinguishing between types of alliance. I find it useful to start by thinking of two main types, and I term these 'partial' and 'full' alliances.

A partial alliance, of which there are a rapidly growing number in international business, does not in general affect the **strategy** of partner companies, but their **operational performance**. They are mostly **relationships of convenience** – to take two types as examples, (i) cost cutting or cost sharing by jointly using facilities or (ii) forming a consortium to undertake a specific contract or project or to share facilities/capabilities for a specific function, market or project. Often they are envisaged at the outset as being of **fixed duration**.



In contrast, a full alliance is concerned specifically with improving the competitive position of the partners in a way or to an extent or at a speed that is not possible by using other development mechanisms. Because this type of arrangement is a central contributor to the future direction and competitive position, such an alliance is a key strategic option and is most often envisaged as a long-term undertaking. This is what can be termed a true **joint venture**.

Given, therefore, that there is no wholly satisfactory definition of the generalised term “joint venture”, let us look for some characteristics.

A true **joint venture** is generally considered to be a **full alliance** in which an **independent entity** is created, involving two or more partners. The concept of an entity – an organisational form having separate structure and identity from the participating partners – is central to the joint venture concept and differentiates it from other types of collaborative relationship.

Two European examples will help to illustrate the difference between a PARTIAL ALLIANCE (collaborative agreement) and a FULL ALLIANCE (joint venture). There are of course many other aspects that bring out the contrast, but the points below are sufficient to illustrate the concept of **entity** that it at the heart of a joint venture. The contrasting examples are Glaxo-Roche in starting to market the drug “Zantac” in the United States of America (*partial*) and Airbus Industrie in manufacturing airplanes (*full*).

Glaxo-Roche

(Partial alliance - collaborative agreement)

It was a project - marketing in the USA
Roche markets Zantac in USA only
No R&D linkages
No production by Roche
No strategic management in Roche
No commitment to further similar activity

Airbus Industrie

(Full alliance - joint venture company)

A new company was created
Airbus Industrie operates worldwide
R&D specialisation by partners
Production specialisation by partners
Integrated management structure
Airbus Industrie plans its own future

CIRCUMSTANCES IN WHICH AN ALLIANCE IS STRATEGICALLY SOUND

Is an alliance, partial or full, a last-choice option within business strategy?

No. In some circumstances it can be the only option. In others it can be the first choice. Alliances can become something of a “bandwagon”, but there are circumstances in business development in which they produce better outcomes than those achievable by the partners separately. Let us consider the reasons for which an alliance is a strategically optimal mechanism for developing a business. The main ones are as follows:

- Minimising the risk of entry into a new market or developing an existing market further
- Achieving minimum size for operating in a market
- Overcoming legal constraints on operating in certain countries
- Pursuit of complementary interests and objectives
- Taking up a specific investment opportunity



Minimising the Risk of Market Entry or Market Development

In these circumstances the objective is to meet market entry costs on a shared basis, where solo entry would constitute an excessive cost to the business, thereby putting a significant part or even the whole of the business at risk.

This is a set of circumstances commonly encountered in:

- entering a highly competitive, mature market;
- entering a market in which the company has little or no experience;
- developing a new product that is significantly different from the base-load business.

Achieving Minimum Size for Operating in a Market

Linked to risk minimisation, there is a minimum operating size in certain product markets. Airbus Industrie is an example of a joint venture set up to achieve minimum operating size in a world market with very few individual competitors. None of the partners in Airbus Industrie could have contemplated entering the market for medium-sized airliners because of the minimum size required to take on the major competition - Boeing and McDonnell Douglas (whose civil aircraft interests were later acquired by Boeing).

The motor manufacturing industry is becoming characterised by alliances. Examples of this are alliances between Mercedes Benz-Swatch in niche small cars and Ford-Fiat-Magirus Deutz in medium and large truck manufacturing.

Overcoming Constraints on Operating in Certain Countries

In certain countries, especially socialist and developing countries, the full joint venture is often the sole means by which a non-native company may operate. These circumstances usually arise principally because of:

- policy of a country to gain economic development leverage via technology transfer;
- ideological/legal barriers to direct investment.

Both the above sets of circumstances have resulted in almost all the joint-venture activity that took place in China and the former Soviet Union plus its satellite countries until fairly recently. It remains the case in many developing countries that are concerned with promoting technology and know-how transfer to support economic and industrial development more generally.

Pursuit of Complementary Interests and Objectives

Alliances between members of a supply chain (suppliers-manufacturers-customers) and also between direct competitors are used where there is a complementarity of interest to be pursued.

Compaq in its earlier stages is a particularly good illustration of this. Compaq Computers Inc was founded in 1982. Its rate of growth has been good. From the first day of its existence Compaq sought alliances with dealers, component manufacturers and software companies. By developing a complete package, Compaq was able to challenge IBM and others in



personal computers and also gained a strong position in portable computers from an initial position of disadvantage. Compaq worked with Intel to design and incorporate a new type of microchip in a fast-developed new generation of portable computer.

Taking Up a Specific Investment Opportunity

There is a form of alliance that consists of one partner making a financial commitment simply as an investment opportunity and having little or no involvement in its management and development. The requirement of the investment partner is simply a financial one. Though this can be termed an alliance using our definition, it implies that one partner is taking the role of investment banker only. The managerial dimension of the relationship is absent. It is not a common form of joint venture, and is perhaps the least satisfactory from the strategic standpoint. It can give rise to problems if the investment partner subsequently attempts to get involved in the management of the alliance, particularly if the alliance is performing below target. The incidence of failure in this form of alliance is high.

MAIN RISKS AND REWARDS OF DEVELOPMENT VIA ALLIANCES

Alliances are difficult to manage (this will be taken up in detail in the second white paper on this subject). Most people who have managed alliances consider the experience to be amongst the most testing of a career. Added to the normal challenges of managing a legal entity, there are specific problems arising from the fact of partnership between two or more differing organisations.

Main Risks

- (i) Culture clash between the participating organisations.
- (ii) Lack of clarity about desired contribution of the alliance to the strategy of each partner.
- (iii) Generation of unproductive cost, sometimes very rapidly if (ii) occurs.
- (iv) A requirement for very talented management.
- (v) Divergence of strategy and objectives of partners during life of the joint venture.
- (vi) Major shift in basic competitiveness of one partner during the lifetime of the joint venture.

Main Rewards

- (i) Rapid acceleration of development, especially in R&D activity.
- (ii) Reduction of unproductive competition.
- (iii) Tax benefits if structured carefully.
- (iv) Entry into a market that would be too costly to enter solo.
- (v) Access to low-cost manufacture worldwide.
- (vi) Risk reduction through spread in geographical coverage and financial commitment.
- (vii) Further opportunities, especially in technology transfer.

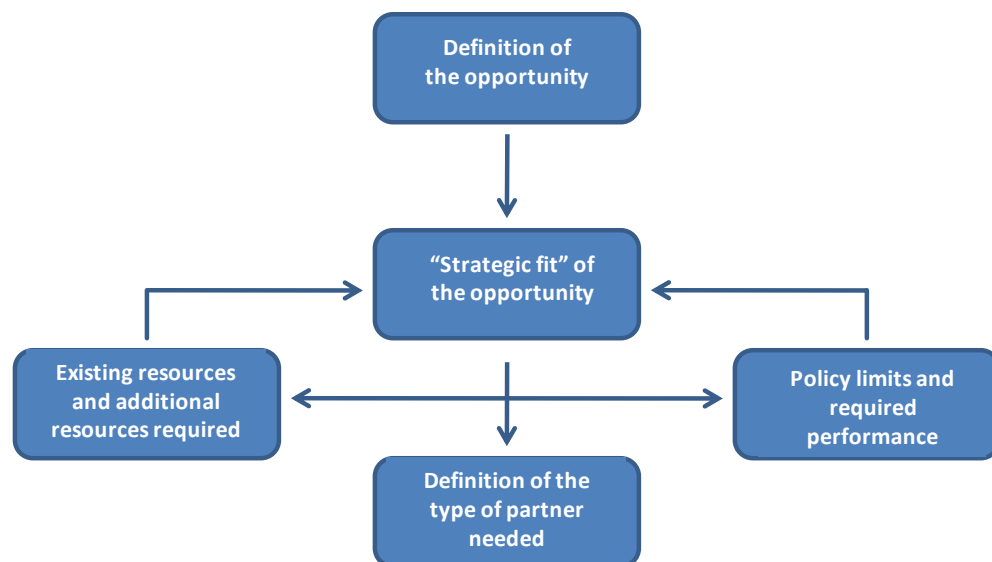
SECTION TWO – PARTNER SEARCH AND EVALUATION

STAGE ONE – PROFILING THE REQUIRED PARTNER

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Time spent in preparation and analysis is time well spent when it comes to achieving success in setting up robust alliances. The need to find and engage a committed capable partners or partners cannot be over-emphasised, but it is this aspect that in so many cases does not get sufficiently rigorous attention and the problems associated with this can lay hidden for a long time with potentially serious impact.

This stage can be set out in the following diagram.



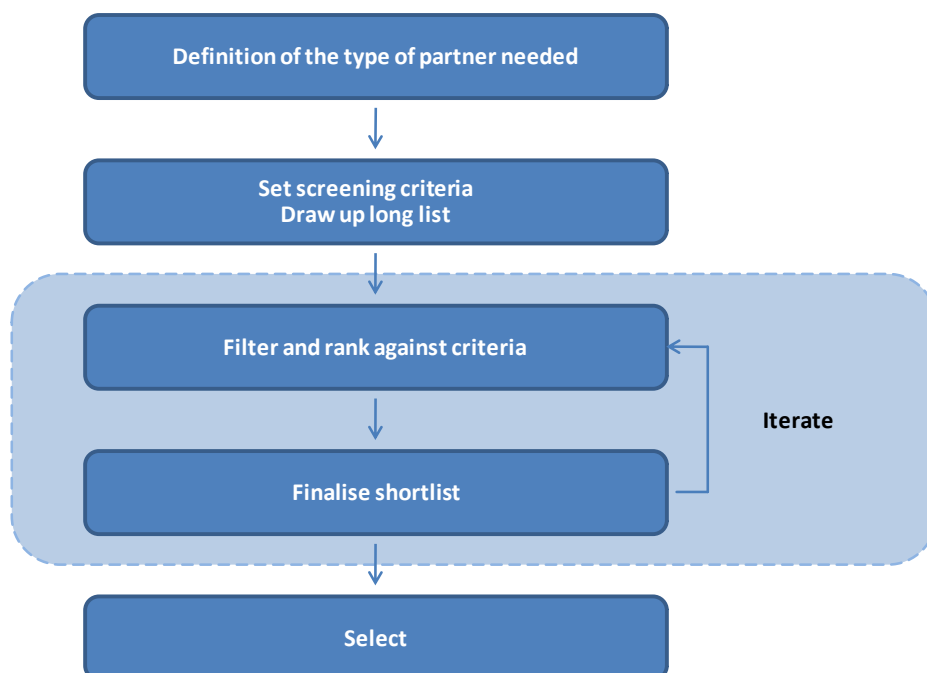
The first question is to define and quantify the potential contribution of the alliance to one's organisations. What is the likely impact, financial and non-financial, on the organisation? What is the strategic rationale for the opportunity and how does it fit with the business strategy that one's organisation has been following and wishes to pursue in the future?

The next stage is to clarify the policy limits within which one's own organisation will agree to operate and the "hurdle rates" of performance that will be sought. This is needed in order to evaluate later the potential partners for compatibility in this area. At the same time the organisation needs to be clear as to the relevant resources that it brings to the opportunity and the additional resources that are needed. (Not least, part of this analysis should be undertaken subsequently by the possible partners to ensure compatibility.)

This analysis will give one's organisation a view as to the type of partner that will be needed to make the alliance work.

STAGE TWO – EVALUATION AND SELECTION

This leads directly from the final element of the “profiling” phase (partner definition), and can be set out in the following diagram, thus constituting a complete process.



Having established that an alliance is the best of the alternative mechanisms by which to develop the business idea and having set the basic characteristics sought in a partner or partners, screening criteria can be set up and prioritized, against which a long list of possible partners can be drawn up and refined into a short list. Naturally the more specific and differentiated is the opportunity, the briefer and more focused will be the long and short lists.

This part of the process is simple in structure and content but difficult in analysis and decision. Its importance is illustrated in the next section.

CHANCES OF SUCCESS

What are the chances of success in a partial alliance (collaborative agreement) or full alliance (joint venture entity)? The following analysis was undertaken by the Harvard Business School in the early 1990s and is based on a major (1000+) sample of international alliances, both “partial” and “full” to use our terminology.

The terms “poor”, “satisfactory” and “good” relate to performance of the alliance against the original objectives that were set.

“Dominant partner” relates to an alliance in which one partner had majority ownership, majority management authority, majority control over resources, etc, or all of these.



“Shared management” relates to an alliance in which no partner had overall majority ownership, authority or control.

| Structural characteristic | Poor | Satisfactory | Good | Resulted in liquidation or restructuring |
|---------------------------|------|--------------|------|--|
| Dominant partner | 23% | 23% | 54% | 15% |
| Shared management | 55% | 20% | 25% | 50% |

The key conclusions that can be drawn from the above data are as follows:

- Democracy is not always a robust business principle as far as alliances are concerned.
- If you go for a “democratic” structure you have a 1 in 2 chance of hitting financial trouble and necessitating further capital injections or liquidations and write-offs.
- If you go for a “dominant partner” structure, your chances of meeting the objectives and performance criteria of all partners are higher than the “democratic” approach.
- Even in a “dominant partner” structure as many as 1 in 6 operations may need financial attention during their lifetime.
- Accept that if you generate a good idea for an alliance you do not necessarily have to end up as the leading or majority participant for the alliance to be successful.

SUMMARY

Alliances are a potentially powerful and cost-effective way of developing a business, especially where international market entry or further market development constitute part of business objectives. Collaboration is becoming increasingly necessary if differentiation is to be secured. Differentiation on the basis of product or service attributes is getting increasingly difficult to achieve and easier to emulate in all but a few cases where the value of intellectual property can be maintained via patents or other legal provisions. In this environment the ability to configure and re-configure quickly the different aspects of the business model and supply chain becomes the differentiator, and on related grounds of cost and time collaboration via alliances becomes more significant. This approach is one logical response to an issue discussed in an earlier B2B white paper (“Differentiation - Are Product, Brand And Service Still Enough?”)

Managed effectively, an alliance can enable an organisation to achieve what it could not achieve alone, or achieve only at high cost over an extended time-period and usually with a fairly high degree of risk. Top level managerial skills are required to make sure that this organisational form works, and many of the core managerial competences are unique to collaborative relationships and full joint venture entities. But significant rewards are available to those organisations that take the processes of evaluation, development and implementation seriously.

This white paper has dealt with two issues: (i) the context and rationale of alliances and (ii) how to scope them out. A second white paper (“Managing Alliances and Joint Ventures”) deals with the specific challenges in operational management that are faced in this type of organisation.



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