Corporate Relationships: Pros and Cons

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Harish has over 20 years of experience in the Information Technology industry encompassing international business development, establishing business partnerships/alliances, strategic planning and management, product development, project management, business management, technical infrastructure architecture and systems integration.

He is customer focused, results oriented and believes in providing value to organizations and its stakeholders. As an entrepreneur, he has been involved in several ventures as a owner/partner in: offshore software development firm in India; professional consulting firm in USA; customized PC ‘s and systems integration company (import/export to Europe, Asia, America).

Currently, Harish is working as a Project Manager at EDS on large infrastructure business transformation project. He also sits on the advisory board of USA & Indian business ventures.

Harish expects to complete his EMBA in early 2002 and help other businesses become successful in the global environment.

The document that you are about to read will give you a high level view of the corporate relationships: pros and cons (in particular as it relates to strategic alliances). Please do contact Harish, should you wish to learn more about how to go about forming strategic alliances and succeed. He can be reached via the email info@24hrmarket.com or infosharma@rogers.com

Enjoy.
I would like thank the following individuals for their assistance in my research for this project:

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Pros and Cons of Corporate Relationships

Abstract

Globalization and rapid developments in technology has introduced tremendous competitive pressures on businesses around the world. With limited financial resources and high risks involved in developing innovative technologies/processes and bringing it to market in short period of time, most businesses are looking for ways to share financial risks & knowledge plus create value for its shareholders in a challenging environment. Relationships in the form of alliances, mergers and acquisitions are generally the means by which businesses have achieved their strategic objectives of business growth. This document examines the importance of this growing phenomenon of alliances along with merger and acquisition (M&A) to achieve growth and survive in this new edge economy from the perspective of what is required to succeed and the benefits (pros) derived through such relationships when they work. Conversely, we look at why these relationships fail and the reasons (cons). Furthermore, we look at how different environment/market conditions affect the selection of these relationships as a business growth tool. The information contained in this document covers primarily the high technology industry and is based on surveys conducted by well-known organizations, online search, plus experiences/challenges that senior management of several companies faced in forming/managing various relationships.
Introduction

Rapid growth in technological developments and globalization has forced businesses of all sizes from small to medium to large corporations to investigate mechanisms to achieve growth and competitive edge over their competition in an uncertain environment. Given this rapid pace of developments, it is impossible for a single company to have and spend all the resources on a new product/service/market and take the risk of going to the market alone. Jack Welch, CEO and Chairman of General Electric, has commented:

“If you think you can go it alone in today’s global economy, you are highly mistaken.”

If this is the case, then what must a business do to survive in uncertain economic environment?

Jack Welch’s statement suggests that the only alternative is to join forces with other businesses i.e. form some type of relationship which will offer mutual benefit to both parties. In fact businesses have used relationships in the form of partnership, alliance or merger or being acquired by another business to survive and prosper. Relationship traditionally has been formed between friends to combat competitors. However, times are changing. Recent research shows that almost 50% of alliances are being formed amongst competitors (Fig. 1).

![Half of Recent Alliances Are Amongst Competitors](image-url)
Survey further indicates that certain sectors (Airlines and Healthcare) alliance formation rate is as high as 75%. Bigger is better attitude seems to persist these days. Given this, high technology companies have no choice but to form alliances with competitors to survive in this environment. From this research it can be concluded that rivals are becoming allies and competition is transforming into cooperation & collaboration (i.e. so-called co-opetition). Survival of business under environmental uncertainty is driving businesses to form such relationships. It has become a question of how to leverage such relationships (i.e. each other’s capabilities and resources) to survive and to increase shareholder value.

By focusing on the core competencies and sharing knowledge with other companies, businesses can further capitalize on these relationships and provide integrated solution to meet customer’s requirements. With this focus on specialization, businesses have gone a step further by outsourcing non-core competencies (e.g. manufacturing, marketing, accounting, and logistics).

This document will attempt to cover at high-level basics of corporate relationships, answer the question of why and what are critical success factors and benefits achieved through relationships, and also look at why there is such a high failure rate (various studies show up to 60%). Environmental/market conditions impact on choosing the type of relationship to achieve the strategic goals and objectives will also be examined.
Leveraging the Pyramid

All relationships are about leveraging alliance member’s capabilities and resources to get company’s product/service to the customer in an efficient manner whether the customer is located in domestic or foreign market. Depending on the size of business and at which stage of business life cycle the business is at, will dictate how much the relationship has to be leveraged to grow the business. For example, if a business is at the start-up stage or entering the foreign market then business relationship has to be leveraged significantly in order to get to the customer. Businesses have to capitalize on credibility gained through such relationships. Typically, alliance member selection process will ensure that the selected alliance member already has the established distribution channel for the product/service that you have to offer to reach the customer. Leveraging pyramid (Fig. 2.0) shows highest level of leverage you have is with your alliance member and the least with the customer. Similarly, the relationship that will be formed will be strategic with the alliance member than with the customer. Normally, customer relationships are tactical. This pyramid illustrates the importance of business relationship for growth of the business alliance members.

![Leveraging the Pyramid](image)

Fig. 2.0

Companies such as: Microsoft, HP, Intel, IBM, Canon, Xerox, Corning and other well known companies have leveraged capabilities and resources to grow their businesses. Microsoft
relationship with IBM allowed it to get the DOS operating system out to the masses. HP used Canon’s laser printer engine to become a powerhouse in the laser printer industry. Intel’s relationship with Microsoft allowed it to sell its processor and earned a nickname ‘wintel’. These are examples of few of the companies that have successfully leveraged their relationships to grow the business.

What this further tells us is that right type of relationships when leveraged properly can produce very positive results. Companies can share risk and resources through leveraging. But it will largely depend on the firm’s ability to develop, cultivate, manage & leverage such relationships. Companies have to spend time and resources to develop this capability.
Relationships: Alliances or Partnership or Partners?

What do these mean? Is there a difference? Or do these mean the same?

Legally, there is a difference in definition. However, these words are very loosely used in the high technology industry. As a result, there is no clear definition. These words have become synonyms.

According to Oxford dictionary,

“Relationship is a state of being connected; connection, association.”

“Alliance is formal union”

“Partner is sharer; person associated with others in business”

The one common element is some sort of ‘association’ or ‘union’.

Relationship can be defined as: *When two parties agree to work together for mutual benefit to meet a critical business need.*

There are different types of relationships. Strategic alliances are the most popular choice of relationship in this economic environment to grow and survive.
What is Strategic Alliance?

*Strategic alliance is a mutually beneficial long-term formal relationships formed between two parties to meet a critical business need.*

Strategic alliance members often form close operating linkages, sharing strengths, information and have vested interest in each other’s future. Strategic alliance members usually participate jointly in any one or combination of areas of: marketing & sales, production & manufacturing and knowledge (know-how) sharing.

Strategic alliance members may have any combination of the following formal agreements as part of their business agreement:

- OEM Agreement (e.g. HP’s agreement with Canon on laser printer engine)
- Joint Marketing Agreement (In a foreign market)
- Investment/Financing Agreement
- Patent/Trade-Mark License Agreement
- Outsourcing Agreement (e.g. Cisco and Solectron, manufacturing)
- Channel partner or Agent (Distribution Agreement)
Other types of Alliances

- **Tactical Alliance**: Short term alliance primarily project/task oriented with predefined deliverables. All communication is based on the task at hand and is not relationship oriented. Any party involved can easily terminate the alliance if it does not meet the immediate needs of one of the parties. *For example: Several companies may form an alliance to bid on an RFP. This relationship is tactical & virtual and only lasts for the duration of the project. This arrangement is very common these days and primarily to meet customer requirements.*

- **Joint Venture**: This relationship is strategic in nature with a formal structure resulting in the creation of a new separate business entity and usually staffed and managed by a separate management team. *For example: two companies join forces in a foreign market to deliver a specific project. One company usually from the home country, which lacks the necessary know-how for the project and the other from a foreign country which possess the required knowledge/resources. The venture only lasts for the duration of the project.*

- **Equity partnership**: This is an add-on to strategic alliance in which parties involved take on a minority equity position (5% - 35%). The parties involved have option for additional shares along with pre-emptive and first refusal rights in the business entity. *For example: Microsoft’s investment in Corel to get access to technology for .NET initiative.*

- **Outsourcing**: Process in which companies outsource business activities that are not their businesses core competencies. *For example: companies often outsource IT support services to other companies such as EDS, IBM, CGI. Manufacturing outsourcing to such companies as Celestica, Solelectron.*
Sometimes these alliances lead to merger that creates a new business entity or acquisition of the business by one of the alliance partners (M&A). M&A process is typically a formal and lengthy process in which target’s perspective has to be clearly understood and how it impacts the acquired business entity (people, operation, customers), plus legal considerations and tax strategies. According to J.J. Vanasse, Celtic House,

“You probably will not find a great deal of people that have gone through an acquisition that could say “we had a great acquisition” be glad if in the end you can say “it was good acquisition”.”

Basically, things can get out of hand very quickly and the whole deal can unravel very fast. Often the initial ABC expectations turn to XYZ by the time the whole deal closes. The whole process is not a positive experience for all the parties involved.
Why use strategic alliances?

In order to survive in this competitive global environment, companies form strategic alliances for the following reasons:

- Build critical mass, branding
- Share risk and resources
- Develop new competencies
- Reach new markets
- Satisfy customer requirements

Businesses are motivated to form relationship primarily due to:

- Increasing cost of research and product development (Innovation)
- Decreasing product lead times and life cycles (time pressures)
- Access knowledge and expertise beyond company borders (technology transfer)
- Products are often solutions to meet customer requirements
- The need to rapidly achieve scale, critical mass and momentum (bigger is better)
- The need for channel and international market presence (marketing and sales)
- Build credibility in the industry and brand awareness
- Provide added value to customers

and research shows
• Large companies that are active in alliances produce returns 50% higher than those who are not (Fig. 3.0)

![ALLIANCES AS PERCENT OF REVENUE](image)

**Fig. 3.0**

• Those with the most ‘alliance experience’ produce returns 2x that of novice companies (Fig 4.0).

![ROI VERSUS ALLIANCE EXPERIENCE](image)

**Fig. 4.0**

• Growth firms participating in alliances are growing 37% faster than their peers who are not (*Coopers & Lybrand 1995*)
• Stock market usually view alliances as a positive development, while M&A is looked upon negatively on the acquirer. Fig. 5.0 shows that when AOL formed an alliance with Hughes by investing $1.5 Billion to access DirecTV, market capitalization of AOL went up by $21 Billion. But when AOL merged with Time Warner, the market capitalization went down by $39 Billion.

Fig. 5.0

This impact on market capitalization was one of primary reasons that lot of dot com’s issued plenty of press releases stating formation of alliance with company X. Generally, right after a press release the price of the stock went up.
Benefits of Strategic Alliances

Business drivers that motivate businesses to form strategic alliances, ultimately produce the following benefits:

- Accelerate product development
- Spread risk/share resources
- Access to new markets, expand customer base
- Increase market presence
- Provide added value to customers
- Access knowledge and expertise outside of your company
- Strengthen reputation – credibility

Jonathan S. Linen, Vice Chairman of American Express, has commented:

“Alliances are not an important part of the future, they ARE the future. Anyone who does not understand this is not going to be around for long.”

What this means is relationships are very important although they may take different forms or may be referred as alliances or partnership. Relationship can help in the growth of the business. If you don’t pay attention to this phenomenon, business will most likely not survive in this global economy.
Reasons why alliances fail

Numerous studies have been done, which suggest that almost 60% of alliances fail. One such survey of 500 CEO’s conducted by BA&H (fig. 6.0), found that most of the alliances fail for the following reasons:

- Selected wrong partner
- Overly optimistic
- Lack of management commitment from both partners
- Lack of strategy (clear goals and objectives)
- Poor Communications
- Poorly defined roles and responsibility
- Chemistry (lack of trust and co-operative spirits)
- Environmental (market conditions)
- Lack of experience
- Poor business plan
- Failure to investigate alternative to alliance

Fig. 6.0
Quite often seeds of failure are sown long before an alliance forms. Some of the very basic elements for forming a relationship are ignored because of human behavior as parties involved forget the reason for forming the alliance – it is a business deal.
Critical success factors for Alliance Success

If business leaders were to pay attention to all of the reasons for failure then they should succeed by eliminating those factors. Parties involved must come to the table with a cooperative and collaborative attitude. ‘Command and control’ management philosophy has no place in today’s uncertain economic environment.

Following are the critical success factors to ensure success in forming an alliance:

- Alignment of strategy and objective
- Value proposition clearly understood by both partners
- Senior management commitment
- Cultural fit – management philosophies
- Trust and co-operation
- Communication
Some framework has to exist that needs to be followed in order to identify, evaluate, negotiate and implement any business relationship. Booz Allen & Hamilton have developed a process that the alliance partners can follow as depicted in Fig. 7.0 to be successful in alliance formation initiative. There are four stages to alliance formulation: Identify, Evaluate, Negotiate and Implement.

### ALLIANCE FORMULATION METHODOLOGY

- **Identify**
  - Strategy & Objectives
  - Screening for Partners
- **Evaluate**
  - Opportunity Definition
  - Stakeholder Assessment
- **Negotiate**
  - Tradeables & Leverage Assessment
  - Bargaining Power Assessment
- **Implement**
  - Integration Planning
  - Implementation

Any process must evolve through continuous improvement after implementation based on the lessons learnt. This will allow the company to develop and enhance their capabilities to form a network/portfolio of alliances for mutual benefit.
Several studies have been done which prove that if you follow a process consistently (Fig. 8.0), alliance will be successful.

Studies have further shown that the more alliances you have the better chance of success in alliance formation. As the saying goes ‘practice makes perfect’ also applies here. You learn by doing.
Impact of environmental factors

Today’s uncertain environment gives every business an opportunity to sit and evaluate what type of relationship they must consider before going out and looking for partners to grow the business. Fig. 9.0 shows what elements one must consider before deciding whether to form an alliance, get involved in M&A activity or use internal growth mechanism to grow and survive in this uncertain market conditions. The management must decide first on the level of risk involved in executing their strategy. If the risk is very high, business need to expand fast, resource availability is moderate to low, alliance partner offers complementary capability/knowledge/product and there is extensive change in environment then it is better for management to look outside of the company to find an alliance partner. In a similar fashion, business managers have to choose the route of M&A or internal growth.

Fig. 9.0

Under uncertain environment conditions, companies do not necessarily follow the above matrix. Slow environment affords companies who have high resource availability to acquire businesses at a much lower price than they could when the business valuations are very high. M&A activity can increase in the slow market conditions. GE has taken advantage of such opportunities and build a diversified portfolio.
Conclusion

There is no doubt that relationship is key to success in the new competitive edge economy. Strategic alliances, the most popular type of relationship, can be redefined based on the lessons learnt in this document:

*Strategic Alliance is a mutually beneficial long-term relationship formed between two businesses with senior management commitment who share the same vision to achieve strategic goals and objectives of the firms by leveraging the complementary capabilities & resources of both parties to grow the business & satisfy customer requirements and in turn generate increased shareholder value.*

Considering the benefits of strategic alliance, businesses have to have strategic alliance capability, as it is becoming a ‘core competency’. If businesses do not acquire the capability, chances are that they will not be around for long.

Overall, alliances are an excellent strategic business growth tool in today’s economic environment and to generate increased shareholder value at a faster pace. M&A and internal growth mechanism generate growth at slower pace.

Environmental uncertainty poses numerous hurdles in business life cycle. Slow market conditions present special opportunity for businesses to examine and evaluate the right growth tool that is in line with the businesses goals and objectives.
According to Ohmae:

An alliance is lot like a marriage. There may be no formal contract. There is no buying and selling of equity. There are few, if any, rigidly binding provisions. It is a loose evolving kind of relationship. Sure, there are guidelines and expectations, but no one expects a precise, measured return on initial commitment. Both partners bring to an alliance a faith that they will be stronger together than they would be separately. Both believe that each has unique skills and functional abilities the other likes. And both have to work diligently over time to make the union successful (Ohmae, 1992)

In conclusion, in the new competitive edge global economy, companies that have or are able to develop a sound strategy and the capability to leverage the relationship will survive and prosper.