## Alliances and Partnerships

## Module 4

## Learning Summary

This module has considered risk and risk management in the context of alliances and partnerships. It should be appreciated that alliances and partnerships generate conditions that produce unique combinations of risks. The module has explained that, in order to understand these risks and how to manage them, it is necessary first to understand what risk is and how risks can impact on a company that is a partner in an alliance. It is also necessary to understand how risks can be identified and treated as part of a companywide risk management system.

Risk should also be considered in terms of both actual and perceived magnitude. The module has stressed that there can be a significant difference between these two magnitudes. The final section considered some specific risk types that are applicable in alliances and partnerships.

The candidate should now understand:

* the concept of risk;
* the concept of risk and opportunity;
* the basics of risk interdependency;
* the concept of risk levels and cascade;
* the difference between actual and perceived risk;
* the basic idea of trust and power balance;
* the basic elements of a risk management system;
* some of the primary risks associated with alliances and partnerships.

The following section briefly summarises the primary learning outcomes from each section included in this module.

#### Some Common Questions about Risk in Alliances and Partnerships

* There are numerous drivers behind strategic alliance risk. One of the most significant is the fact that the alliance is a change, and it operates under conditions of change.
* Loss of control is another risk driver. Partners have to allow other partners to have an element of control.
* In most cases, there has to be a degree of trust between the various partners.
* Financial risk can to some extent be reduced by sound business practice, although the full complexities of the market can never be fully evaluated.
* There is some evidence to suggest that the companies most at risk during the formation of alliances and partnerships are those that have least experience of the process and those that depend the most on a number of key variables.
* Risk and opportunity go hand in hand. In order to increase value there has to be a degree of risk. In order to exploit opportunity there is always a degree of (hopefully) managed risk.
* Companies form alliances and partnerships in order to exploit the market. The market itself is dynamic and subject to constant change
* Alliance partners do sometimes behave in ways that other partners consider to be improper. There are numerous examples of companies that have formed alliances with partner companies and have then carried out actions such as acquiring a company that is a competitor in the other partner’s home ground. This type of problem sometimes occurs in large international joint ventures where the partners are all in a similar industry or sector.

#### Some Common Misconceptions about Risk in Alliances and Partnerships

* There is considerable evidence in the alliances and partnerships literature and in practice to show that a significant proportion of alliances and partnerships are unsuccessful, at least to some extent.
* Mergers and acquisitions tend to be more prominent in the media because they often involve huge sums of money and are often characterised by a degree of conflict and opposition. Acquisitions, in particular, can lead to widespread publicity.
* Not all alliances and partnerships make use of a formal contract. Where a contract does exist it will indicate an implied risk distribution by stating the rights and obligations of each party.
* The literature suggests that in alliances and partnerships there is a balance between trust and power: the greater the degree of trust, the more sensitive the weaker party is to negative actions by the stronger party.
* Alliances and partnerships tend to be more common in industries and sectors that are associated with high technology and rapid change. Such industries are relatively high-risk by definition, because change generates uncertainty and uncertainty increases the overall level of unforeseen risk that enters the risk profile.
* There is, however, no apparent evidence to suggest that alliances formed in relatively high-risk industries are any more likely to be unsuccessful than alliances formed in relatively low-risk industries.

#### The Concept of Risk

* Risk is an inherent component of any alliance or partnership, just as it is for any other type of business activity or venture. Risk has to be present in order for value to be created. In order to create value some form of action has to take place.
* As soon as an action is involved there is an associated risk.
* It is usually not possible to remove all associated risk from a given business scenario, nor in most cases is it even desirable to do so.
* Most risk classification systems recognise four primary risk types or levels that are present in most business activities. These levels are:
	+ strategic risk;
	+ operational risk;
	+ change risk;
	+ unforeseeable risk.
* Strategic risk relates to the risk associated with the strategic planning and strategic objectives of an organisation.
* Operational risk relates to the risk involved in the day-to-day operations of an organisation.
* Change risk includes those risks that are generated as a direct result of the changes brought about by the implementation of the alliance or partnership itself.
* The implementation process may fail to deliver the range and level of integration required of the alliance. This could occur for a whole range of reasons including:
	+ poor planning;
	+ creeping scope;
	+ inadequate change control;
	+ poor monitoring and control;
	+ cultural resistance;
	+ rapid external change.
* Unforeseen risk relates to impacts or events that cannot readily be foreseen.
* Unforeseeable risk can be distinguished from the closely related unforeseen risk by reference to the degree to which an event could have been foreseen if a sufficiently detailed analysis had been carried out.
* In terms of alliances and partnerships, the most likely unforeseeable risks are those relating to changes in the market.
* In terms of functional distribution, most organisations can be considered in terms of a five-point classification:
	+ process;
	+ people;
	+ finance;
	+ support;
	+ interface.
* Process relates to the area of the organisation concerned with the actual processes involved in production.
* People relates to employees and other people who are directly involved with the organisation.
* Finance relates to the financial aspects of the organisation at various levels.
* Support relates to the typical administration and other support functions, such as IT and HR.
* Interface relates to the direct contact across the organisational boundary between the company and the environment.
* Most classification systems for risk consider the magnitude of a risk in terms of its likelihood of occurrence and the impact of the risk if it does occur.
* Risk can be classified as:
	+ low likelihood – low impact;
	+ low likelihood – high impact;
	+ high likelihood – low impact;
	+ high likelihood – high impact.
* Risk can also be classified in terms of actual and perceived risk.
* Actual risk is the risk that actually exists in a given situation. It may be possible to measure it objectively using statistical tools and techniques.
* Perceived risk is the level or risk that a person perceives to be present rather than the actual risk that is really present.
* Perceived risk is often measured in subjective terms. The degree of likelihood of a perceived or subjective risk often cannot be determined based on observation, as the perceived magnitude is a function of the individual or organisation concerned.
* The perceived risk in any application can be larger or smaller than the actual risk, and it can be directly affected by:
	+ the risk attitude of the decision-maker;
	+ the amount that the risk taker can afford to lose;
	+ the potential gain to be made for any corresponding potential loss;
	+ the amount of information that is available;
	+ the success or otherwise of related ventures.
* Alliances and partnerships are inherently risky. As business relationships they generate risk because each partner loses a degree of control over its own destiny.
* In any kind of alliance a company exposes itself to a degree of risk that is outside its own control because it relies, at least to some extent, on the alliance partner.
* This reliance generates a need for trust and power. Trust, in this context, can be defined as belief in the honesty, integrity and goodness of an organisation or people. Power can be defined as the ability to control events and people.
* Trust is basically a measure of the belief that one company has in the other, whereas power is a measure of the control one company has over the other. In any alliance there is a balance of both variables.
* The balance between trust and power in an alliance is very important.

#### The Concept of Risk Management

* Companies manage risk through corporate risk management systems. These systems vary widely from company to company, but they all have a number of common elements.
* In the simplest form, a typical risk management system comprises the following elements:
	+ risk context;
	+ risk identification;
	+ risk classification, analysis and evaluation;
	+ risk evaluation;
	+ risk appetite;
	+ risk response;
	+ risk management system monitor and review.
* The risk context has to be established so that the risk can be accurately considered within the overall strategic, project and operational framework and the main performance requirements that have to be met. The significance of the risk may be different at each level. The risk identification process ensures that all risks that are relevant to a particular consideration or process are brought to light.
* Risk classification, analysis and evaluation considers the type of risk and its effect on the organisation. It involves the identification of the primary risk drivers and the development of some kind of risk map or grid.
* Risk evaluation specifically evaluates the consequences and likelihood of risk using some form of evaluation or analytical technique.
* Risk appetite is concerned with the attitude of the decision-maker or the organisation and the effects that this can have on the assessment of risk. The risk attitude of the decision-maker will affect the level of risk that is deemed to be acceptable.
* The risk response considers how the risk should be managed (keep it or transfer it). This includes introducing the risk-handling strategy in the business plan and establishing a risk holder and response where appropriate.
* Risk management system monitor and review uses feedback and formal documentation to ensure that ongoing control and monitoring of the system is working correctly.
* Some examples of risk response are:
	+ transfer;
	+ avoidance;
	+ mitigation;
	+ acceptance;
	+ risk monitoring and feedback.



#### Risk in Strategic Alliances

* The main risk associated with working with another company is the loss of control that is necessarily involved. As soon as a company relinquishes a degree of control over its own destiny, the degrees of risk involved across the organisational risk strata increase greatly.
* The processes involved in cooperation are often more complex that initially perceived, and there are numerous examples of alliances and partnerships that have failed to perform to their potential level because of difficulties in cooperation.
* Failures in cooperation sometimes occur because the business philosophies of the alliance partners are too far removed from each other, or because the underlying rationales behind the partners are too remote.
* There appears to be some kind of link between cooperation difficulties and geographical distribution.
* As well as being able to cooperate, companies have to be able to trust each other.
* Most companies develop in a competitive environment and evolve with the basic corporate instinct to compete in order to survive. In some respects, the concept of forming a strategic alliance goes against this basic survival instinct. There is always a danger that one company will seek to exploit the alliance in order to further its own interests at the expense of the partner.
* As the degree of cooperation between partners increases, the degree of trust risks associated with the alliance increases.
* There are two basic types of potential benefit that can be developed from the alliance:
	+ individual benefits to single alliance partners;
	+ mutual benefits to both alliance partners.
* Predation risk is the risk that one alliance partner will use the alliance as the starting point of a hostile takeover bid for the other partner.
* Performance risk is the risk that one or both companies will not perform to expectations.
* There are numerous examples of alliances that looked good on paper but where the partners failed to perform to their expected standards.
* One or more partners can underperform for a whole series of other reasons that are not directly related to cultural integration issues. Some examples are:
	+ changes in the economy;
	+ technological change;
	+ legislative change;
	+ competition base change;
	+ exchange rate changes.
* Strategic misalignment risk is the risk of an alliance or partnership being formed in the wrong strategic area. Alternatively, the alliance or partnership may initially be formed in the right area but this area becomes obsolete before new alliances or partnerships can be formed to address new areas.
* Synergy limitation risk occurs where the eventual outcome value of combining individual technological and people elements is insufficient to improve the market or sector position of one or more partners.
* A particular combination of technology and people competence may be unbeatable for a period of time, and competitors who form similar alliances may not be able to improve their position because, even though the combination of technology and people competences is good, it is not as good as the combination used by the market or sector leader.

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| **Table 4.1 Risk interdependency** |
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|   | Process | People | Finance | Support | Interface |
|  |
| Strategic |   | Incorrect choice of CEO for equity joint venture |   |   |   |
|  |
| Operational |   |   |   | Inadequate IT support or systems failure due to hackers |   |
|  |
| Change |   |   |   |   | Loss of customers resulting from production breaks |
|  |
| Unforeseeable |   |   | Sudden increase in UK interest rates |   |   |
|  |

