## Alliances and Partnerships

## Module 5

## Learning Summary

This module has addressed some of the main issues to be considered in alliance partner selection.

The module has considered some important questions and misconceptions in relation to partner selection. It has also considered some important partner selection issues and some of the primary opportunity types offered by partner types. The module has stressed that final partner choice depends on the nature of the alliance and what the alliance is designed to achieve. Partners that are appropriate for one type of alliance may be inappropriate for another type of alliance.

The module has also considered the issue of due diligence. It is always appropriate to carefully analyse prospective partners before committing to an alliance or partnership. Due diligence supplies a mechanism for conducting this analysis to a level that should be acceptable to all alliance partners.

The module has also considered payback period. Alliances and partnerships are formed with varying degrees of payback period. The module has stressed that a shorter payback period often involves greater risk, whereas a longer payback period involves less risk provided the overall process is monitored and managed.

The final section of the module considered the issue of partner reliability. The module stressed that reliability is not the same as trust, and that reliability should be carefully considered at the inception stage and carefully monitored during the operational stage. The module also stressed that reliability is an important final stage or termination issue.

The candidate should now understand:

* the primary partner selection issues;
* the importance of prospective partner scrutiny;
* how partner selection relates to the opportunity or opportunities sought;
* how opportunities have to be balanced against partner availability;
* the importance of due diligence;
* the basic phases of due diligence;
* the concept of long-term and short-term alliance payback;
* the issues involved in short-term or long-term partner selection;
* the concept of alliance partner reliability;
* the importance of alliance partner reliability.

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

#### Some Common Questions about Alliance Partner Selection

* The choice of partner or partners depends on what the alliance or partnership is trying to achieve.
* The most obvious success criterion is financial return. In fact, most strategic alliances are formed with the intention of achieving long-term competitive advantage, and in some cases short-term return could be secondary.
* In other cases, the overall objective of the alliance might be to achieve some form of political objective, and financial viability might not be a consideration at any point.
* There is an element of trust in any alliance or partnership. The trust has to be there because it is not possible to engineer a position of such power where no trust is needed.
* If such a position ever could be secured the value of the powerless partner would in most cases be minimal.
* Short-term alliances and partnerships may appear to be relatively low risk because the number and range of unknown internal and external events that can impact on the alliance or partnership are relatively low. In fact, longer-term strategic alliances often provide lower-risk opportunities provided they are correctly monitored and managed.
* Contracts are used in some cases to formalise the rights and obligations of each party.
* Contractual agreements are nearly always necessary where the alliance takes the form of an equity joint venture company. In such cases, the contract covers everything from the investment levels of each alliance partner to the form of corporate governance to be adopted by the joint venture company.
* In other cases, no formal contract may be required. There are examples of long-term alliances, particularly where a supplier provides components for a manufacturer, where long-term informal alliances have continued for many years with no formal contract, other than standard renewable supply contracts, in place.
* Organisations entering into a strategic alliance should always carry out a full risk assessment and develop a comprehensive enterprise-wide risk management (EWRM) process.
* In any partnership the pooling of resources can lead to obvious advantages. One of the main downsides is that both partners have a say in how the pooled resources are used.

#### Some Common Misconceptions about Alliance Partner Selection

* Alliance partners should always be carefully selected. The levels of risk involved in forming an alliance can be considerable, and it is important that the risk profile is carefully evaluated and that risk groupings are reduced wherever possible.
* In the case of an alliance, the risk profile can be reduced by carefully analysing the characteristics of potential partners.
* Old and well-established companies offer a certain permanence and sustainability that might initially make them attractive as potential alliance partners. The fact that a company has been in existence for 80 years, however, does not make it any more trustworthy or likely to deliver as an alliance partner.
* Older companies tend to be less amenable to flexibility and change.
* Alliance partners remain as separate entities. They retain their own corporate identity and ultimately act in their own interests. Company policy is driven by a wide range of variables including corporate governance, stakeholder attitudes and priorities, and interaction with the business environment.
* Where one company acquires another company, the acquirer can impose its required management structure and strategic objectives on the target. In an alliance this degree of control does not exist.
* The only way of limiting or restricting the actions of a partner, other than by mutual agreement, is through the use of an alliance contract, as is the case in the formation of most equity joint ventures.
* A well-designed contract limits the actions of partners to a range of actions that is risk-acceptable to the other partners. Contract terms and conditions could limit, for example, the actions of partners in terms of the use of joint assets or withdrawal from the alliance.
* There is significant evidence to suggest that alliances and partnerships, like mergers and acquisitions, that are strategically focused are more likely to add value to a partner.
* Alliances and partnerships that reinforce the key business areas of a company tend to be more useful to the company than alliances that reinforce non-core areas.
* It is important, however, to remember that the strategic objectives of the alliance must be defined so they do not interfere with the strategic objectives of the partner.

#### Partner Issues

* Partner issues range from reliability to financial stability. It is important that a range of issues are considered rather than just those that may initially appear to be most important to the alliance or partnership.
* From a business point of view there is no point in a company entering a strategic alliance unless the alliance allows that company to add value to itself.
* In a good alliance the partners should really need each other.
* The financial capability or otherwise of potential partners is usually fully evaluated in the due diligence phase of forming the alliance.
* It is important to consider the reliability of the prospective partner.
* There is always a danger that the formation of the alliance will result in a degree of diversification and distraction of focus away from a company’s core business activities.
* In many cases the proposed alliance partner may be a direct or indirect competitor. Where the level of trust is high, the prospective partner must be very carefully assessed and appropriate control systems must be put in place to protect key information and knowledge.
* In some cases the level of knowledge transfer and intellectual property that is required for the alliance to succeed may be higher than can safely be released by a company. The company should proceed only where the exposed information and intellectual property can be adequately protected.
* Alliances are sometimes formed where the strategic objectives of the alliance clash with the strategic objectives of the alliance partners or parent companies. It is surprisingly common to find a degree of overlap between what the alliance is trying to achieve and what the parent companies are trying to achieve.
* A common problem in joint ventures, particularly those with a 50–50 interest split, is the lack of overall command.
* Alliances and partnerships sometimes fail because the alliance partners commit to the joint venture but then fail to assign to it the importance it requires. If an alliance is to work it must be adequately resourced.

#### Opportunity Partners

* Different partners may offer different opportunities. The choice of partner depends on the opportunity sought.
* One of the most common forms of opportunity is speculative financial potential. In this scenario, one company seeks to form a joint venture with one or more other companies to exploit a speculative opportunity by the formation of a joint venture.
* Another common form of opportunity is development. This scenario often happens with old companies that currently use modern technology and the existing production facility offers considerable opportunity for development.
* Organisations sometimes identify opportunities for alliances and partnerships in the development of new or expanded markets and customer bases.
* Alliance partners may sometimes be chosen because they allow consolidation of the alliance partners or even consolidation of an entire sector or industry. This scenario may be appropriate in sectors or industries that are stagnant or where there is an external change causing over-capacity.
* It may sometimes be advisable to form an alliance with a partner that offers acceleration opportunity. An existing company may be operating effectively but may have reached the limits of its market position because it cannot adapt and change as quickly as the competition. This type of scenario often occurs in old and well-established companies that were once, or still are, leaders in their particular sector.
* Companies sometimes form alliances to gain access to operating licences. This type of alliance is sometimes referred to as a *licence opportunity*.

#### Due Diligence

* Due diligence can be defined as the detailed analysis of an organisation with the objective of allowing a full and accurate evaluation of the commercial and financial position of that organisation.
* Most due diligence processes concentrate on commercial and financial characteristics either directly, such as the identification and evaluation of all financial liabilities, or indirectly, such as in the evaluation of the financial implications of health and safety policy.
* Due diligence is effectively a risk management tool in that it allows prospective partners to evaluate each other in detail and establish a detailed and reliable risk profile, before making a final commitment to an alliance.
* Due diligence is important because it is not always possible to evaluate an organisation in detail from standard published and publicly available information such as annual reports and balance sheets.
* In some cases, the financial and commercial importance of semi-hidden elements can be significant. An example is warranty agreements.
* Most due diligence processes contain two man phases or stages:
	+ general analysis;
	+ specific analysis.
* The general analysis stage covers standard elements that are common to most organisations. In many cases, a general risk analysis is carried out so that the risk and opportunity profiles associated with the proposed alliance can be generated.
* The specific analysis phase involves a more detailed analysis of specific organisational areas. The relative importance of each area varies in relation to the organisations involved and the aims and objectives of the alliance.

#### Payback Period

* Payback period is a measure of how long it takes for the alliance to achieve its strategic objectives. Some alliances are formed for relatively short-term payback whereas others are formed for longer payback periods.
* Prospective partners will usually have strong views on the length of payback period that is appropriate for them.
* Alliances and partnerships vary widely in lifespan. Some alliances are short term and last only until a specific short-duration objective is achieved. Others are formed in the knowledge that there will be a requirement for a long-term or even permanent agreement.
* Large international civil engineering projects often use long-term alliances for both construction and operation.
* Long-term alliance projects do not necessarily generate low risk. The overriding factor is the level of assessment that is carried out at inception and maintained through the lifecycle of the project. There are numerous examples of long-term and apparently low-risk alliance projects that have failed to deliver.

#### Reliability

* Even the most apparently reliable prospective partner may be intrinsically unstable. Prospective partners may carry too much debt, may lack innovation capability, or may lack a compatible organisational structure and/or corporate governance.
* Reliability is not the same as trust. A partner can be reliable in that it can be depended upon to perform the functions that it has undertaken to perform, but it may be untrustworthy. Similarly a partner could be trustworthy but unreliable.
* Reliability should be considered in the following three separate stages.
	+ At formation.
	+ During the operation of the alliance.
	+ At termination.
* Even the largest companies can have internal instabilities that are hidden. There have been several large-scale examples in the US over the last few years where companies have entered into alliances and partnerships at a time when they have been knowingly issuing misleading financial statements and company reports.
* In the US this practice, when conducted in collusion with consenting accountancy practices, became known as ‘creative accounting’. The companies concerned appeared to be highly successful, but the real position was very different. In some cases it was years before this difference became apparent.
* At all stages, one of the key reliability issues to consider is that of senior management. Companies are often only as reliable as the people who run them.