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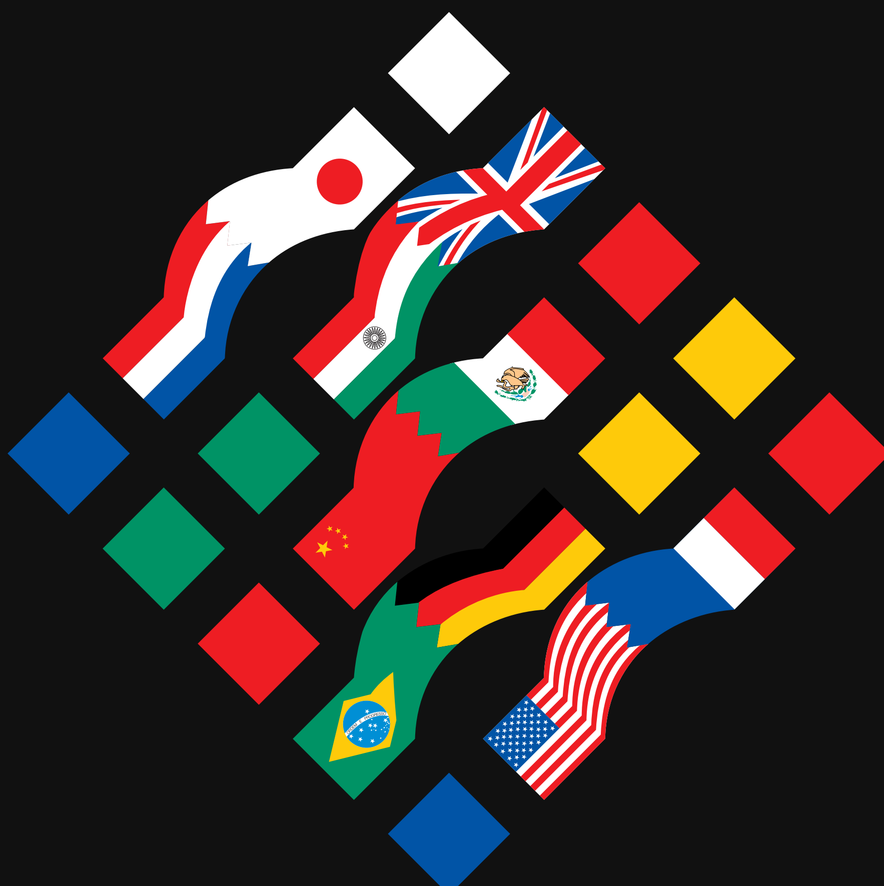
Cross-Border Alliances in the Age of Collaboration



Cross-Border Alliances in the Age of Collaboration

by John R. Harbison
Peter Pekar, Jr.

In the last two years, more than 20,000 alliances have been formed worldwide, and approximately 75 percent of those have been across borders. In the United States alone, more than 6,000 alliances have been formed, more than half with foreign companies (Exhibit 1). While cross-border alliances have been around since the early days of civilization, we're now witnessing a surge in their popularity and some fundamental shifts in what is required for an alliance to succeed. We're also seeing that alliances are yielding superior returns on investment and that the more experience a company gains in alliances, the greater its returns from them.

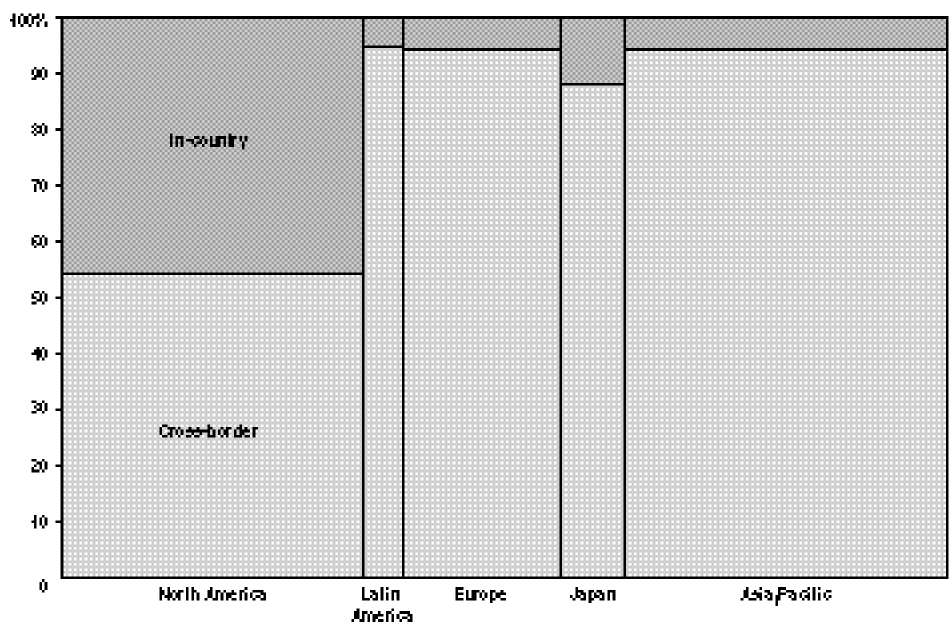
Flourishing cross-border arrangements are changing the global business environment in most industries in ways we are just beginning to understand (Exhibit 2). In many industries (including communications, electronics, health care, transportation, energy and services), the global demands on technology and financial resources are forcing companies to ally in order to be able to compete, often at the same time that industry boundaries are blurring and new capabilities have become critical. In these industries undergoing rapid change, alliances have grown the most quickly.

We believe that the world has entered a new age — "An Age of Collaboration" — and that only through allying can companies obtain the capabilities and resources necessary to win in the changing global marketplace. Self-reliance is an option few companies will be able to afford. Many academics and new-age gurus believe that cross-border alliances are a fad, but we strongly disagree. We are convinced that alliances are a central, essential and permanent engine to achieve growth.

Booz·Allen has been studying cross-border alliances for nearly a decade and has recently completed a global study of alliances and alliance practices, covering 5,500 alliances and more than 500 companies. Using this research and our work with clients, we will demonstrate that alliances are being formed in nearly all regions of the globe, are relevant to almost all industries and are resulting in higher returns to those companies proficient in alliance-building.

Exhibit 1
Geographical Access Is the Key to a Vast Majority of Alliances

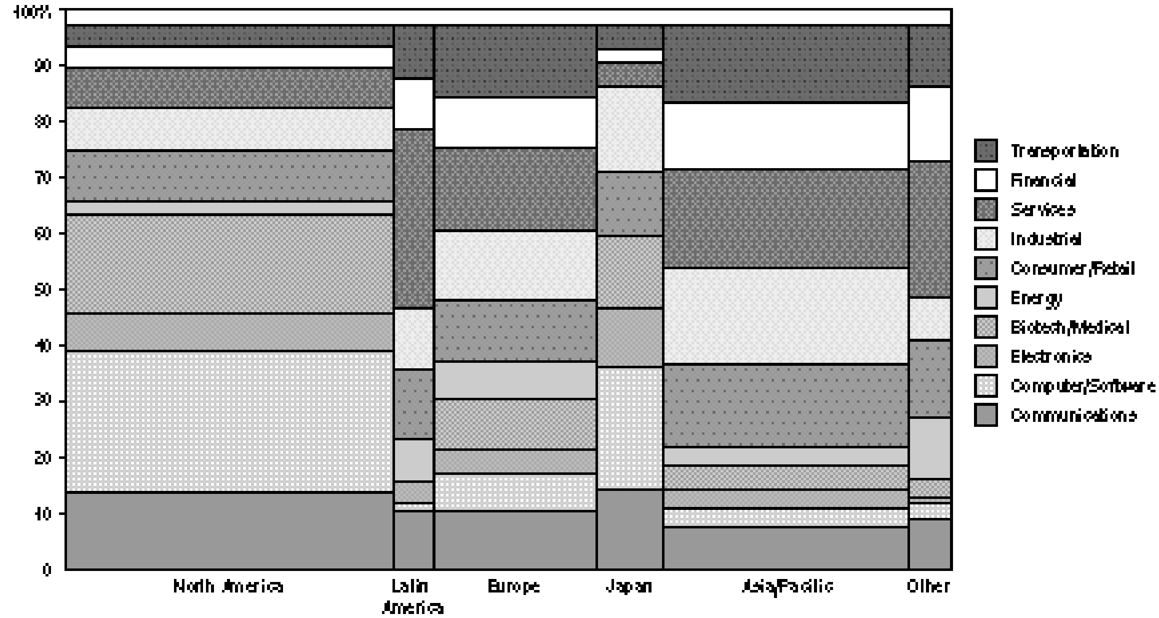
Cross-Border Intensity by Region



Source: BA&H analysis of worldwide transactions from 1994-1996

Exhibit 2
Most Industries Active in Alliances

Alliances by Region and Country



Note: Width and area are proportional to number of alliances.

Source: Alliance Analyst, SDC, BA&H Analysis

Defining a Strategic Alliance

In our 1994 viewpoint "A Practical Guide to Alliances: Leapfrogging the Learning Curve," we defined a strategic alliance as a cooperative arrangement between two or more companies in which:

- A common strategy is developed in unison and a win-win attitude is adopted by all parties.
- The relationship is reciprocal with each partner prepared to share specific strengths with the other, thus lending power to the enterprise.
- A pooling of resources, investment and risks occurs for mutual gain.

Within the overall domain of extended enterprise, a strategic alliance fills the middle ground between transactional arrangements and acquisitions. For a broader look at the domain of extended enterprises, please see the first viewpoint in our series, "A Practical Guide to Alliances: Leapfrogging the Learning Curve."

Choosing the Right Structure

At one end of the spectrum are **sourcing** relationships, best when the capability being accessed is not critical to the customer, where scale is required in some components or subsystem beyond what a company can achieve on its own or where there is no need for more lasting control.

At the other end of the spectrum are **acquisitions,** which are best in situations where one party is far larger than the other, where implementation must be done quickly or where the desire is great to avoid the protracted negotiations typical of equity joint ventures. In industries such as aerospace/defense or banking, with their dramatic excess capacity and need to cut costs ruthlessly and consolidate, acquisitions are usually the preferred route.

A good example is Ford's acquisition of Jaguar. Ford was seeking a luxury car with a global footprint to expand its product line upscale. But a cross-border alliance was not likely to have achieved Ford's objectives, because Jaguar lagged behind Ford in quality-control techniques and productivity standards. Ford correctly realized that control of the manufacturing process would be required to return Jaguar to world-class standards, and the only way to achieve this measure of control was through acquisition.

Strategic alliances are not better or worse than these other forms of extended enterprise. But in many circumstances they are the preferred structure, particularly when acquisitions are not feasible because of constraints on cross-border controls, financial limitations or when relevant capabilities are inseparable from the parent.

Among the circumstances in which cross-border alliances can be more advantageous than acquisitions are these:

- **Distance doesn't make the heart fonder** — Acquisitions are difficult to integrate when spanning great distances and crossing borders.
- **The empty-shell syndrome** — Too often the best people leave when a foreign parent becomes the new owner and moves to constrict local management's maneuverability.
- **Same bed, different dreams** — Trust-building and strategy formation are harder in foreign acquisitions because of the cultural differences that have to be overcome.

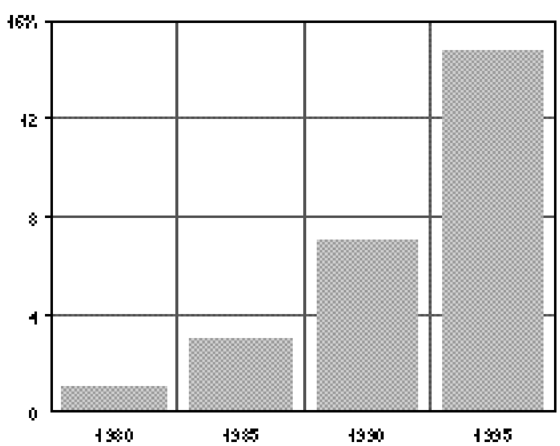
Alliances help avoid these pitfalls by making the partners work together in a disciplined manner, building trust at all levels of the organization. Alliances are also preferred where an evolutionary approach is desired, as in Apple Computer's alliances with IBM in PowerPC and Taligent. When these were being formed, the participants saw them as potential precursors to a broader relationship.

Yet strategic alliances can be an order of magnitude more difficult to negotiate than acquisitions. Newcomers to the world of alliances find negotiation the most frustrating element, and in some cases, they rush into a relationship without appropriate safeguards or adequate resolution of critical issues.

Experienced alliance practitioners recognize that the intense negotiation process allows the partners to agree on common objectives, quantification of value-creation opportunity,
relative contributions of the partners, rights and obligations, management structure, conflict-

Exhibit 3
Alliances Growing as a Source of Revenue

Alliances as Percentage of Revenue for
Top 1,000 U.S. Public Corporations



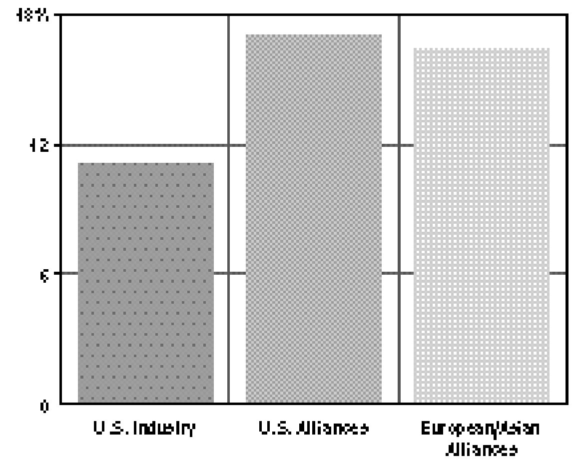
Source: Columbia University, European Trade Commission, Studies by BA&H
1983-1987, 1988-1993, 1994-1996

resolution procedures and cultural-integration issues. Indeed, the more complex the negotiations, the greater the likelihood the alliance itself will be successful.

No magic rule about 50/50 ventures, or 51/49 ventures, provides a clear guideline. It is best to make the choice of the right structure after assessing and understanding the objectives of the relationship, the motivations of the parties to the transaction, the drivers of value creation and the core capabilities that need to be accessed. One Japanese CEO, for example, revealed that his strategy was to seek control through key management positions rather than equity positions. His U.S. partners were so absorbed with the equity issue that they didn't realize that effective control was being ceded.

Exhibit 4
Alliance ROI Outperforms Industry

Average Return on Investment



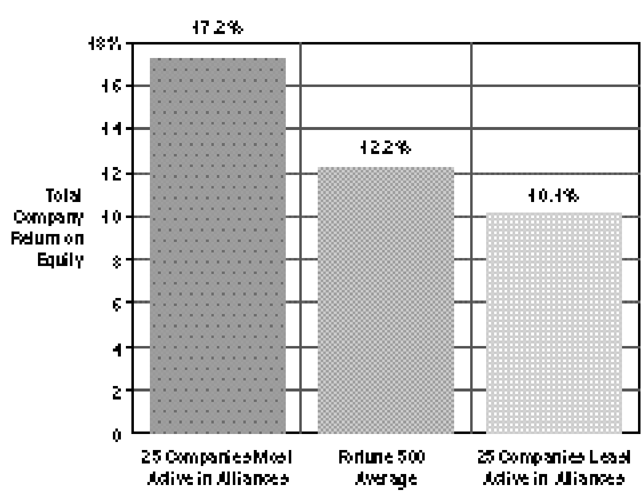
Source: 1989-1993 BA&H survey of 2,500 U.S. alliances and 1994-1996 BA&H alliance study of 200 non-U.S. alliances

The Momentum Behind Cross-Border Alliances:

Alliances are growing at a phenomenal rate and are yielding superior returns. Nearly 15 percent of the revenue generated by the top 1,000 U.S. firms comes from alliances — a fourfold increase since 1987 (Exhibit 3). In studying more than 5,000 U.S. and global alliances from 1987 to 1996, we learned that the average return on investment from strategic alliances is more than 16 percent, significantly higher than the average return the same corporations earn on other activities

Exhibit 5
Alliances Result in Higher ROE

Alliance Intensity Effect on ROE



Source: Alliance Analyst; BA&H Analysis

(Exhibit 4). A recent analysis of the Fortune 500 found that the 25 U.S. companies most active in alliances earn more than 17 percent on equity, compared with the Fortune 500 average of 12 percent. The 25 companies least active in alliances earned an average of 10.1 percent (Exhibit 5).

Alliances, a worldwide phenomenon, are digging deep roots. While high-tech communications, computer hardware, software and electronics account for 30 percent of worldwide alliance formations, other industries are also being affected, particularly health services, transportation, energy, consumer products and services. Even local businesses like electrical utilities and funeral parlors are being swept up in global alliances. Electrical utilities, traditionally a local industry, has seen a 57 percent annual growth in the number of alliances since 1992 alone. Overall, the U.S., Europe and Asia now account for about 90 percent of recent global alliance formations.

North American companies now represent more than a third of all alliances, and about 35 percent are strategic (defined here as an alliance involving an equity stake) (Exhibit 6). This is up from 20 percent in our 1994 survey. Interestingly, the Japanese are less active in equity ventures than companies in Europe and elsewhere in Asia. Latin America and India, both relative newcomers to the alliance game, are emerging from government protectionism and are rapidly becoming players.

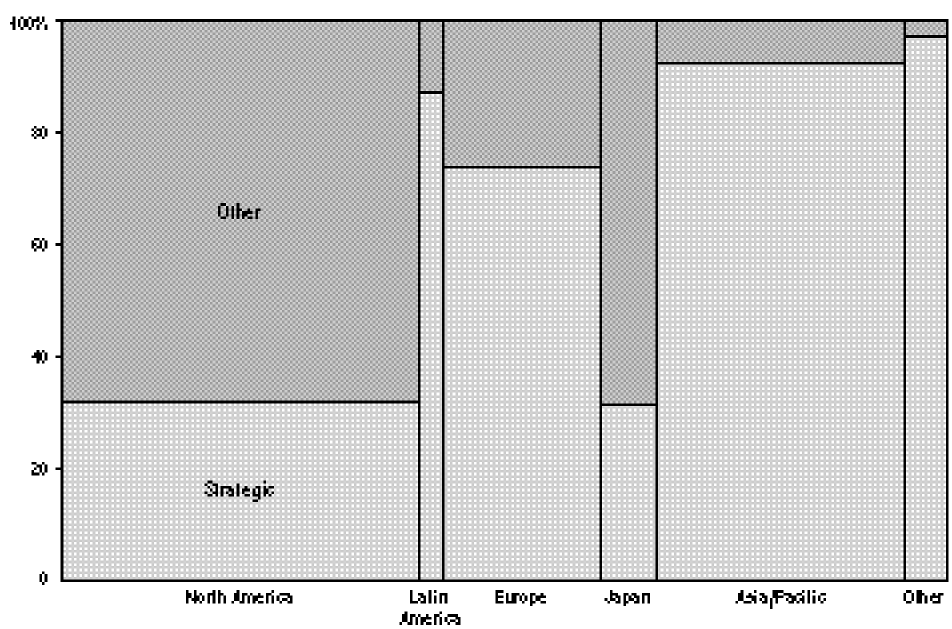
Alliance investment stakes are highest in Asia. The average cross-border alliance investment varies by country and region (Exhibit 7). As U.S. companies increasingly look oversees for alliance partners, they should recognize that the stakes required to participate are growing: the average global strategic alliance investment by the top 1,000 U.S. companies

Exhibit 6

U.S. Alliances Still Less Strategic

Alliances by Type

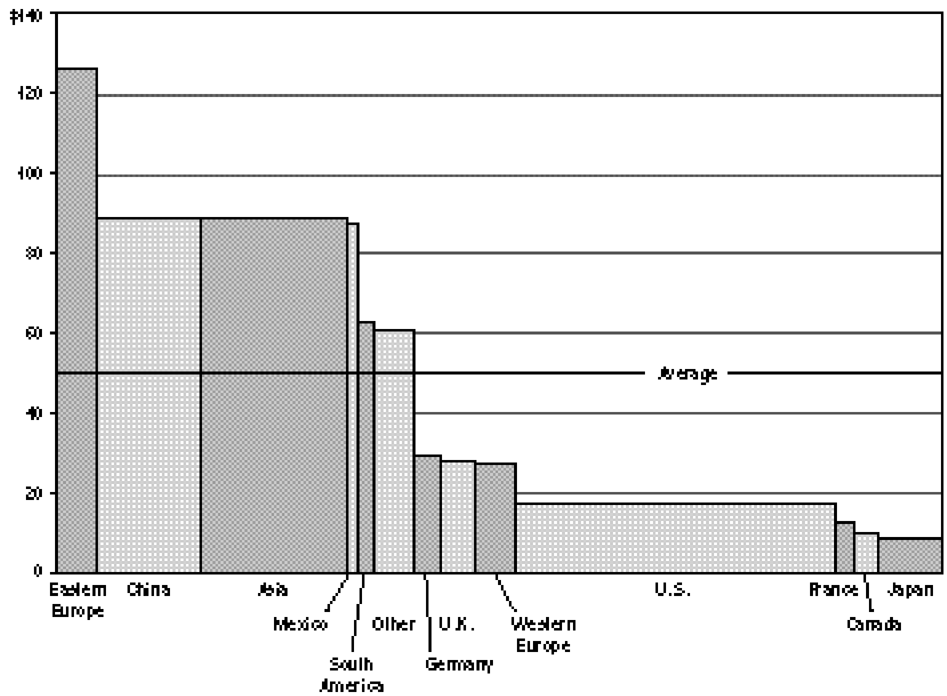
1994 – September 1995



Source: Alliance Analyst; SDC; BA&H Analysis of more than 15,000 alliances formed in 1994-1995

Exhibit 7
Alliances Average $48 Million Investment

Alliance Size by Country
Millions of Dollars Investment per Alliance



Source: Alliance Analyst, SDC, BA&H Analysis of more than 15,000 alliances formed in 1994-1995

amounts to only $20 million, compared with $90 million in Asian alliances. The U.S. also lags in sales per alliance, with only $80 million in contrast to more than $250 million for European alliances.

Learning yields results. The returns on investment improve as a company gains experience in alliances both in the United States and overseas. (See our 1994 viewpoint, "A Practical Guide to Alliances: Leapfrogging the Learning Curve.") Our surveys have found that experienced firms earn twice the return on their alliances compared with inexperienced firms. In some industries, we have seen four and fivefold increases as learning takes hold. We have also found that a set of best practices accelerates learning and increases the return on investment.

CEOs recognize the value of strategic alliances. Five years ago, our surveys showed that 20 percent of CEOs in the United States gave a favorable rating to alliances, far lower than the level of acceptance among European and Asian CEOs. Today we find that more than 60 percent of CEOs in the United States approve of alliances, approaching the acceptance rate in Europe and Asia.

Crusader Syndrome: Some Common-Sense Traps to Avoid

Pragmatic executives are often suspicious, and rightly so, of simple success formulas. Some executives maintain that "seat-of-the-pants management" and "pure luck" play an important role in any alliance. Luck certainly helps a business alliance succeed.

However, we will show that the "luckiest" and most successful companies are those that learn from others. As the baseball executive Branch Rickey once said, "Luck is the residue of design.''

In our examination of hundreds of failed and failing cross-border alliances, we have identified a number of traps to avoid:

1) Believing they are our kind of people — *failing to take the time to select the right partner.*

In domestic alliance-building, picking the wrong partner can lead to disastrous consequences. That is doubly true in cross-border alliances. Too many cross-border alliances are reactive, a response to overtures by other companies that have not been thoughtfully assessed. Evaluating the suitability of a potential partner's culture, behavior and capabilities is essential. Only after a number of hard knocks have such companies as Ford, Xerox, Hewlett-Packard, Corning and General Electric forged successful cross-border alliances.

2) Until death do us part — *failing to agree on objectives and goals.*

Too many companies assume their partner has the same aspirations and goals. This is especially true in developing countries where the host partner is seeking technology and the foreign partner market access. Often what seemed a perfect fit ends up in disagreement.

A U.S. computer company, for example, formed an alliance to build a personal-computer production plant in a developing Asian country. They hoped that with the local government's support, they could sell PCs to the country's engineering and scientific community. But those customers were purchasing computers in the U.S. because they believed that any home-produced product was inferior, and the alliance did not change that perception. What is more, the Asian partner was more interested in acquiring the new technology for export than in changing local customers' perceptions. The alliance foundered.

3) No paroles, no pardons — *failing to plan for flexibility and change.*

Asian and European companies excel in their ability to be flexible. Contracts are written with the idea that they may change should conditions change. "Pardons" and "paroles" are accepted modes of behavior, and partners frequently ask for time-outs to reassess the alliance.

Without an explicit understanding of each other's goals and expectations and the types of behavior that partners will assume should the alliance divert from its original objectives, misunderstandings will surface and more serious disagreements can develop. Partners need to structure clauses that allow for periodic reassessment and time-out periods for re-evaluation.

4) Relying on U.N. peace-keeping — *counting on third parties to come to the aid of disagreeing partners.*

Too often, cooperation fever grows so fast that it sweeps away good sense. Without clear communications, many cross-border alliances create unbridgeable gaps by talking past each other, which leads to tensions, frustrations and eventually suspicions.

In these situations, managers often turn in desperation to uncommitted third parties — such as government officials — for help in resuscitating the alliance. In the former Soviet Union, for example, many foreign companies rushed headlong to form alliances, making the misguided assumption that governmental support would iron out any difficulties that arose between partners. This rarely works. A successful alliance requires that communications processes, arbitration, penalty clauses and divorce conditions be agreed upon at the start.

5) Assuming no child support — *failing to plan properly for continuing resource requirements and the consequences of a termination of the alliance.*

While planning is important in any alliance, it is particularly crucial in a cross-border alliance. The dissolution of a deal is likely to result in the creation of a competitor and also risks alienation of the customers, suppliers and distributors of the foreign partner. The result is not just divorcing a spouse but all of the spouse's relatives.

Many times these parties have supported an alliance because the foreign partner used its leverage to line up support. Should the alliance quickly dissolve, the foreign partner and its senior management will lose face. To anticipate such situations and avoid the acrimony that can occur, Western managers need to have a clear understanding of the cultural dynamics and organizational forces at work in the partner's environment.

Cross-Border Best Practices: Adopting a Disciplined Approach

Our experience shows that a disciplined process is essential to achieving superior results in cross-border alliances (see our 1993 viewpoint "A Practical Guide to Alliances: Leapfrogging the Learning Curve"). The fundamental phases of activity — identification, evaluation, negotiation and implementation — involve eight steps (Exhibit 8). We have found that successful companies cover each of the eight steps in order, while less-experienced companies either skip steps or proceed in random order through the sequence. The results are usually disastrous.

For example, we were invited by a major pharmaceutical firm to discuss cross-border alliances. Before the discussion began, a divisional head said:

Exhibit 8
Roadmap to Alliance Success

Alliance Formulation Methodology

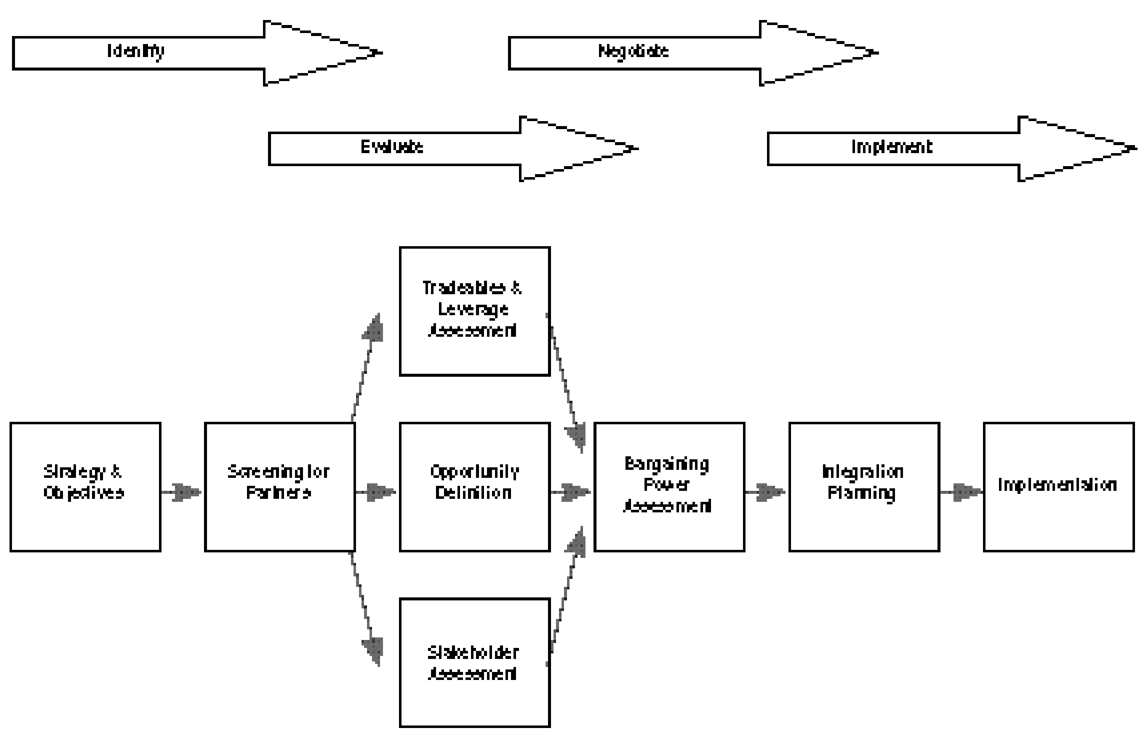
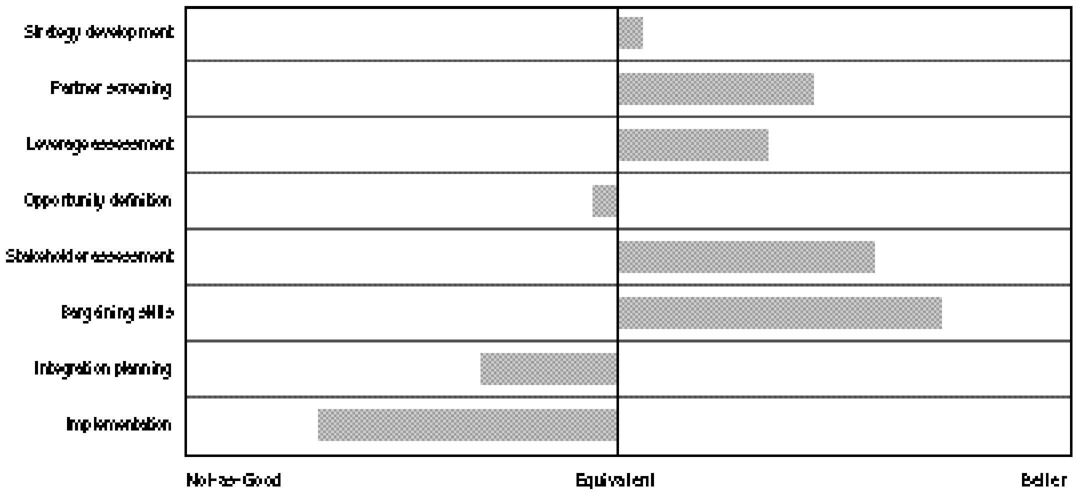


Exhibit 9

Europe and Asia Sees U.S. as Behind in Integration and Implementation

U.S. Alliance Skills Rated by Europeans and Asians



Source: 1994-1996 BA&H alliance study

"I have 18 exciting alliance proposals on my desk. Would you look at them and give me an opinion? There is a lot of pressure here to make something happen." It reminded us of when Alice asked the Cheshire Cat which way she should go.

"That depends a good deal on where you want to get to,'' he responded.

"I don't much care where,'' Alice said.

"Then it doesn't matter which way you go," the cat replied.

Booz·Allen has accumulated a body of knowledge and experience that can help management avoid repeating such mistakes. Each of the eight steps of our alliance formation methodology is broken down into its "best practice elements," which were developed by surveys, interviews and work with our clients.

We asked each company to rate its skill level for each best-practice element. Next, we created groups based on the number of alliances in which a company had been involved, and its average return on investment from each alliance. We focused on the best performers (companies with more than nine alliances and a return of more than 25 percent) and the weakest ones (companies with one or two alliances and a return on investment of less than 10 percent), and we isolated the elements that had the greatest spread in skills.

We have grouped the resulting 100 best-practice elements into the eight steps of our alliance formulation methodology. Associated with each element is a skill level — level 1, the weakest, through level 4. We found that this allows management to use self-diagnosis to compare its current practice level with those of companies that have achieved superior results.

Our most recent survey on alliances, covering the U.S., Europe, Asia and Latin America, produced these findings:

U.S. lags Europe and Asia in alliance skills.

Europeans' and Asians' self-assessment ratings were higher than the U.S. ratings, and this is supported by our client work and field interviews. We also asked European and Asian managers to rate their U.S. partners' skill base, and the findings were revealing — all the more so when you consider that Europeans and Asians have for the most part aligned themselves with experienced alliance-forming companies in the U.S. Our overseas clients also tell us that they tend to avoid inexperienced U.S. companies.

European and Asian managers see the U.S. having an edge in partner screening, leverage assessment, stockholders' analysis and bargaining skills (Exhibit 9). This is certainly an improvement from what we found five years ago. The Europeans and Asians said their U.S. counterparts were behind in the critical skills of integration planning and implementation. American companies are too quick to think the job is completed when the negotiations are finalized. As the Europeans and Asians know, that is just the beginning.

For American companies seeking alliances overseas, these findings hold significant relevance. How prospective partners perceive them has major implications on the structure and ownership formulas of cross-border alliances that American companies explore.

Of all the skill areas in which the Europeans and Asians have an edge, nowhere is the spread greater than in the negotiation and implementation stages (Exhibit 10). U.S. firms will need to close these skill gaps in order to become effective global partners and winners in the global age of collaboration.

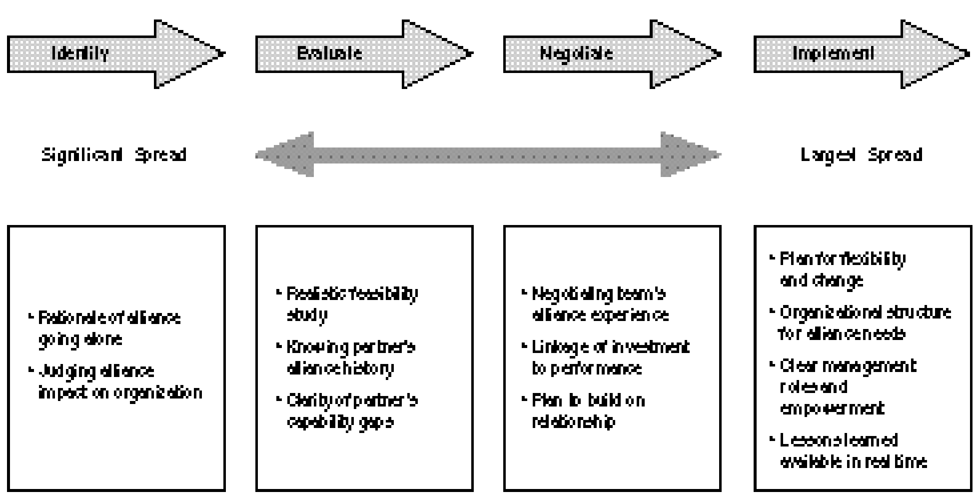
Issues and Concerns Vary by Region:

Companies in different regions also place different emphasis on the issues most important to their executives (Exhibit 11). Here too, U.S. firms are concerned more about transactional issues, European and Asian firms more about strategic issues.

Among experienced cross-border alliance firms in Europe

Exhibit 10
Top Strategic Alliances' Success Factors

Best Practices with Largest Spreads
U.S. vs. Europe and Asia



Source: 1994-1996 BA&H alliance study

and Asia, the concerns expressed by CEOs were:

- How to manage multiple or global alliances.
- Conveying to a partner the strategic nature of an alliance, and the possibilities of expansion and further cooperation.
- Anticipating and planning to meet the threat of other alliances.
- How much of the company's strategic intent to share with a partner, stakeholders and government officials.

American CEOs, on the other hand, were more concerned with operational issues, as well as with negotiation, integration and implementation. The lack of emphasis on strategic issues shouldn't be surprising, because Americans are still new to this game and are still learning how to make cross-border alliances.

Institutionalizing Alliance Skills

Many paths are available to achieve a superior institutional alliance capability. Corning is a good example of the *intuitive* approach. In this model, the means of transferring learning is largely oral tradition and alliance skills are deeply embedded in the fabric of the company's culture. Success under this approach takes many decades to achieve. Corning is clearly a grand master, with more than 50 major alliances, some dating back more than 60 years. All but four remain active, and many have become large entities in their own right, including Dow Corning, Samsung Corning, Pittsburgh Corning, Owens Corning, Siecor and Corning Asahi Video.

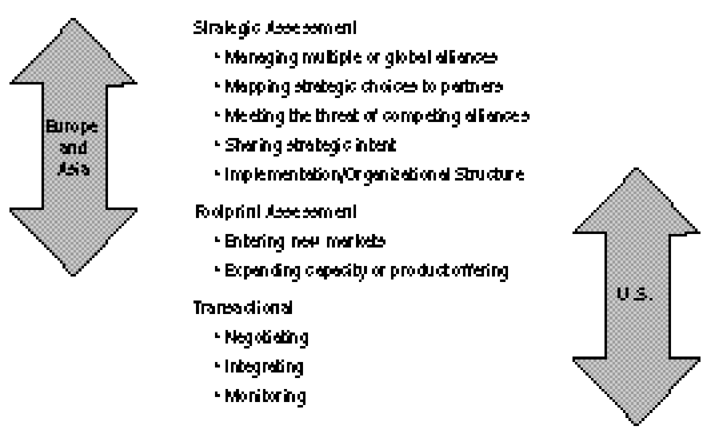
In the intuitive model, help is usually down the hall, and there does not seem to be a need for formal training and manuals of best practices. A singular geographic location, in Corning, N.Y., for corporate headquarters and many operating units facilitates this oral tradition and transfer.

For many other companies, a more *disciplined process* is essential, and Hewlett-Packard is a good example. H-P decided several years ago to build its alliance skills into a differential capability. The company organized a process group to synthesize learning from dozens of recent alliances, codify best practices and produced a 400-page manual. The top 1,000 managers received copies, and the manual became the basis for a popular training course. Because it has been so successful in institutionalizing best practices, H-P is reluctant to share its learning with other companies. The newfound skill in alliance management is a truly differential capability that it wants to exploit.

We have observed, however, that most companies evolve their alliance approach and capability over time. We call the first level the *ad hoc*

Exhibit 11
Alliances Issues/Concerns Vary by Region

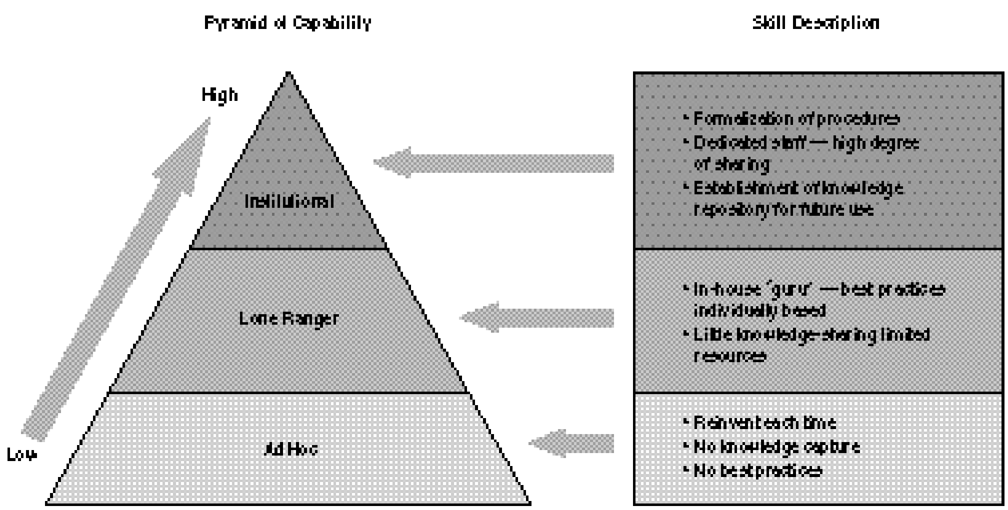
Concerns Expressed by CEOs



Source: Comments from 1994-1996 BAH survey

Exhibit 12
Most Firms Evolve Their Alliance Capability

Approach to Alliance Skill-Building



approach (Exhibit 12), and most U.S. companies are today behaving at this level. In this type of company, there is little knowledge capture and few best practices. Essentially, people are on their own, learning how to do alliances based on their own experiences. In an environment with few alliances, this is adequate. But given the increasing importance of alliances, this approach usually produces frustrating and probably unsatisfactory results.

The next level is what we call the *lone ranger* approach, where the learning of the corporation resides in one or two specialists who get called in during negotiations to act as the gunslingers of alliance knowledge. This is often quite helpful but has two drawbacks. First, with the surge in the number of alliances, the lone ranger is quickly overtaxed, even if the lone ranger becomes a small group of rangers. Second, the ranger is usually involved only in the formation of the alliance and not in its management. That leaves the operating entities without the guidance and assistance they need.

The most skilled level is the *institutional* level. Here, there is a normalization of procedures, often a dedicated staff with a high degree of sharing, and in general some established repository of knowledge for future use. There are many variations of how companies have sought to build such an institutional alliance capability, rather than one "right" approach. Lotus provides a good example of how companies are addressing the institutionalization of alliance skills.

In the early 1980s, Lotus was floundering and had no disciplined approach to its alliances. In 1992, recognizing the importance of strategic alliances to overall success, it decided to build an alliance organization that quickly grew to about 50 people. Underscoring the importance of alliances, the business-development function reports to the alliances vice president, a reversal of what takes place in many companies.

Lotus also assigns relationship managers to each alliance who are involved not only in the formation of the alliance but in its implementation and management. This approach has been left fairly intact since IBM's acquisition of Lotus.

This arrangement bears some similarity to product managers in consumer-product companies and program managers in aerospace companies. Their job is to make sure all the functional capabilities of the company come together to make the venture successful — without wielding line authority over these resources. The role is one of leadership, not execution, but clearly they are involved throughout the life of the alliance.

Future Role of Strategic Cross-Border Alliances

Why are cross-border alliances increasingly strategic? Exhibit 13 depicts the evolution of alliance drivers over three decades. The 1970s was the era of product performance, in which alliances generally focused on getting access to the latest technology and selling the product internationally. But the key selling point was product performance. In most cases, the boundaries between industries were very clear-cut, so a broader set of capabilities did not need to be accessed. In the 1980s, the emphasis shifted to positional focus. Companies sought to build industry stature, consolidate position and often gain economies of scale and scope.

Now, the emphasis is on capabilities. Industry lines are blurring, and markets are becoming global. In these newly defined competitive arenas, positional assets are not enough, and new capabilities are required to succeed. The name of the

Exhibit 13
Racing Toward Global Capabilities

Evolution of Alliance Drivers

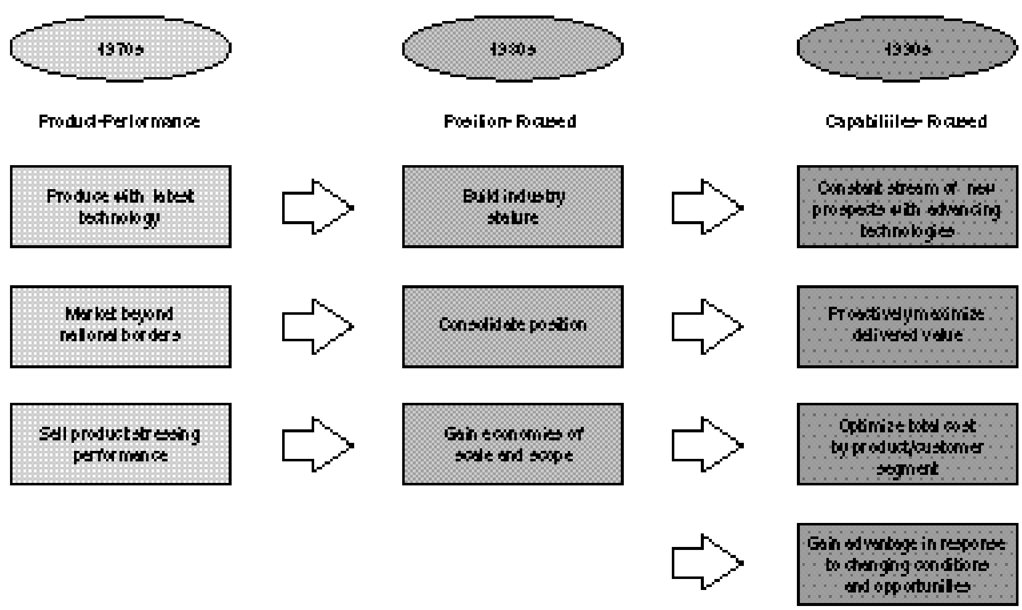
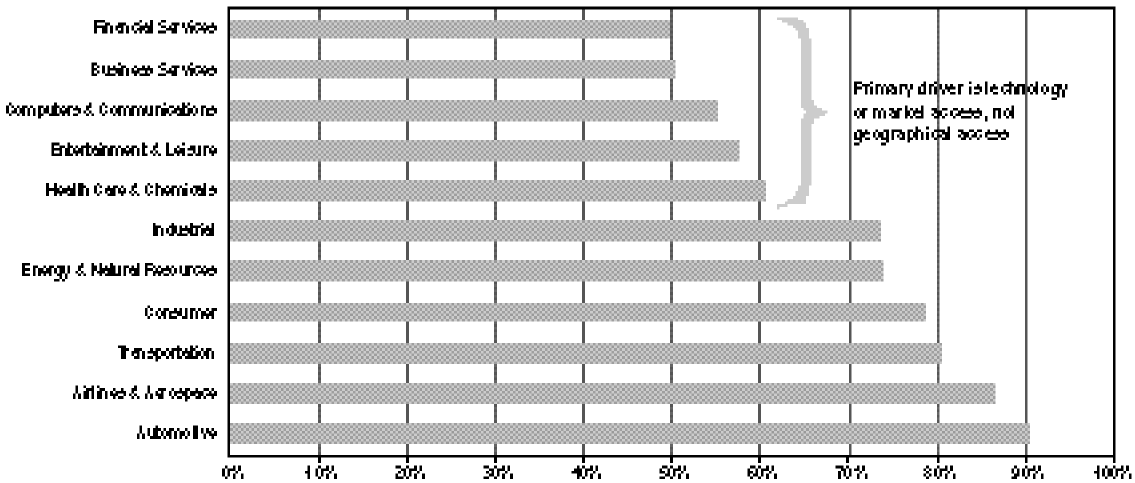


Exhibit 14
Industry Agenda Drives Relevance of Cross-Border Alliances

Cross-Border Alliances Activity
Percentage of Transactions Involving Multiple Countries



Source: BA&H analysis of worldwide transactions in 1994-1996

game is to maximize delivered value, to minimize total cost and to gain advantage.

At the root, three forces are shaping alliances today:

- *The globalization of markets*: It's hard to imagine an industry that is still dominated by local competition.
- *The blurring of industry boundaries*: Technology has driven many industries to converge rapidly, leaving everyone struggling to fill capability gaps that were not relevant under old definitions of industry segments.
- *Scarce resources and intensifying competition*: No company has the nearly unlimited resources (in time and money) to develop the world-class capabilities to excel in all aspects of its business.

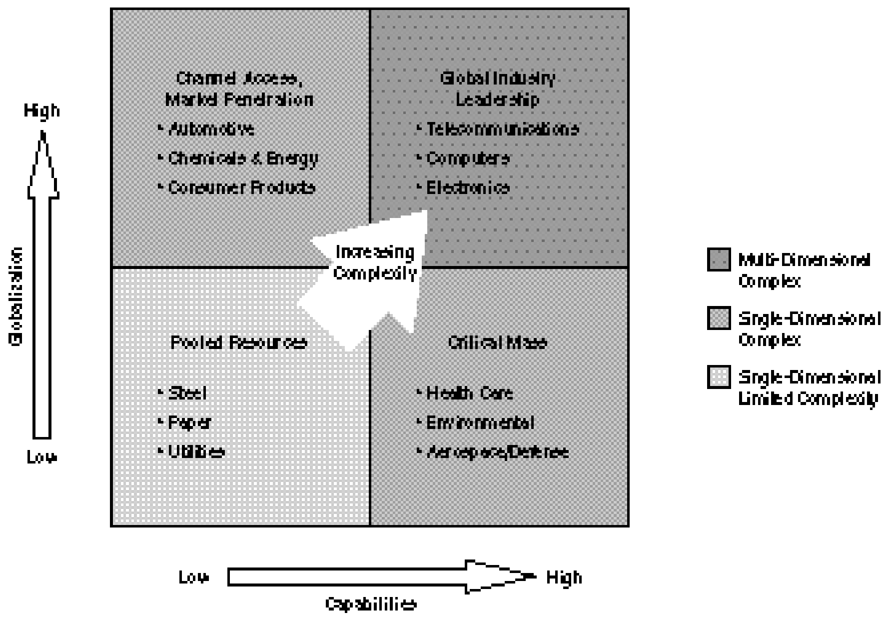
A recent Conference Board survey of 400 CEOs found 70 percent of their companies' alliances were with partners in other parts of the world. Our research reinforces this finding and goes on to provide the link between the level of cross-border activity and the agenda of each particular industry. Exhibit 14 shows the percentage of alliances that involve partners in more than one country, broken down by industry.

The bars at the top represent industries where the primary driver is technology or market access, rather than geographical access — because of the role alliances play in those industries. These industries are undergoing rapid redefinition of requirements as boundaries blur and more integrated product and service offerings become essential.

The bottom bars are industries that are more stable in their boundaries and that use alliances to extend the geographic footprint. However, even industries where capabilities are in flux are active in global alliances and represent almost half the transactions. One reason why North American companies are more involved in

Exhibit 15
Primary Alliance Drivers — Globalization and Capability Gaps

Alliance Drivers



Source: BA&H 1994-1996 survey

"in-country" transactions is that the U.S. is stronger in some of these industries where requirements are evolving rapidly. In North America, 45 percent of all alliances are formed in-country, compared with 10 percent of the alliances formed by Asian and European companies.

Consider how these two primary forces — globalization and capability access — are playing out in various industries. Exhibit 15 shows the capabilities-access dimension on the horizontal axis, and the globalization dimension on the vertical axis. In the upper right box are industries in the midst of a redefinition of capability boundaries and an internationalization of competition. The computer, telecommunications and electronics industries are excellent examples of how technology advances have created the need to build or access quickly new capabilities that were not relevant previously, as well as to establish global reach.

America Online, for example, within one month announced three major alliances that helped it reposition itself. Had it failed to make such deals, its demise would have been inexorable. Instead, it is better positioned to survive, through alliances with Microsoft and Netscape, as well as with AT&T.

At the bottom right of the chart are industries in which alliances are a critical element of accessing capabilities in sufficient critical mass but for which the globalization element is less important, because the markets tend to be local. Some of these industries will migrate into the upper-right quadrant area over time.

At the other end of the complexity dimension are the industries at the bottom left, such as steel, paper and utilities, which are pursuing alliances on a much more measured and modest scale. This group is using alliances as the critical element in achieving leadership and also as transactions to pool resources. The upper-left quadrant includes industries in which alliances are critical more for channel, market and geographical access than because industry lines are blurring and new capabilities are needed.

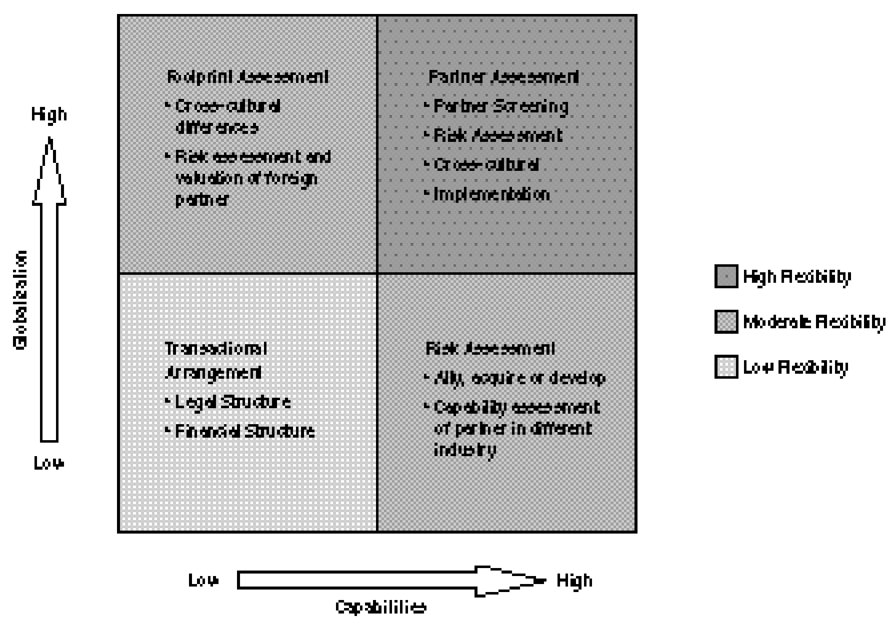
The challenges are different depending upon where an industry is in the matrix. Our survey asked companies to indicate their areas of greatest concern (Exhibit 16). For industries in the upper right, which are seeking leadership through alliances accessing both dimensions, the biggest challenges are in the area of partner assessment. This includes partner screening, risk assessment, cross-cultural issues and implementation issues.

For industries in the bottom- left box, the issues are more transactional, including such items as appropriate legal structures and financial arrangements. For industries in the bottom right, the overall issue is risk assessment, with emphasis on deciding whether to ally, acquire or develop the capability internally. A particular challenge is the assessment of the capability that the partner brings, given that the partner is involved typically in a different industry. Finally, in the upper left, the issues revolve around cross-cultural differences, as well as partner assessment.

One interesting phenomenon in alliances today is that they often bring together companies that compete, in ways that benefit both companies as well as their customers. Our analysis of 2,000 alliances in the past two years found that 52 percent were between competitors. The competitor alliance activity has been greatest in industries that are primarily in the upper-left quadrant of our matrix. The objective of these alliances is access to new regions rather than capabilities, as the airline, consumer products and energy industries have sought to do. In addition, industries such as health care have

Exhibit 16
Challenges Specific to Alliance Drivers

Alliance Challenges



Source: BA&H 1994-1996 survey

redefined the boundaries of the service offering to the extent that many alliances in that industry are between competitors. We also found that alliances among competitors are more likely in industries heavily involved in cross-border alliances.

AT&T has formed record numbers of alliances in recent years — more than 400 since 1990. One reason is that it is competing in an industry in the upper-right quadrant. At the same time, it is seeking to achieve both step-changes in capabilities and global expansion. This high level of activity is likely to continue as AT&T breaks itself into three separate companies.

PepsiCo is a company focusing more on the upper-left quadrant, where it seeks to expand its geographic access as well as to bring additional products to current distribution streams. In some cases, it is running circles around the competition by using alliances to move quickly into areas where it can extend its product offering without costly internal development or acquisitions. A good example is its relationship with Lipton, where it has beaten back the competition from Snapple after Snapple was acquired by Quaker Oats for $1.7 billion. By leveraging each other's strengths, Pepsi and Lipton brought iced tea to the Pepsi distribution network at a significant cost advantage over Snapple iced tea, and as a consequence, Pepsi has grabbed market share.

For companies struggling with the appropriate role of alliances in a globalizing industry, we have observed many different organization models (Exhibit 17). These organization models are often evolutionary, as companies grow from the models on the left to the models on the right. Most organizations start in some form of functional model and move eventually into some sort of matrix organization with overlapping functional, product and area organization. While this kind of interdependence can at least get issues on the table, it tends to fall apart, a victim of its own weight.

The next stage is a corporate strategic business unit model, where the product dimension of the model gains supremacy and reduces overall cost by eliminating the overlaps across geographies. The last three models contain various methods of mutual dependency and interdependency to ensure that the appropriate trade-offs are being made. The mixed-role model has a geographic dimension in charge in some areas of the world and product-line management in others. Gillette is one example of such a company.

The defined role model has different elements of the matrix responsible for different aspects, but it is clear who has control of any single element. Dow Corning is an example of this model. Most advanced in evolution is the global SBU model, with one executive running a global business, holding area responsibility, and also providing functional leadership; DuPont is an example of this. The mutual dependency in this model keeps everyone in a mode of trying to be supportive of and helpful to each other within the leadership team. It also avoids the power struggles inherent in a model where the geographic dimension has a different set of managers than the product-line dimension.

Implications for Management

Global managers must question the adequacy of the way they do business today. A new language of global cooperation has emerged to address the issues of the 1990s. Many companies have already begun to position themselves in this new environment, but they need to "raise the level of their game" in the area of cross-border alliance execution by an order of magnitude. Otherwise, they will face a consortium of competitors without the benefit of experience in alliance-building.

The important question is no longer, “Should we form a strategic alliance?” Now the questions are: “What types of arrangements are most appropriate?,” “How do we successfully manage these alliances?” and “Are we learning from the experience of ourselves and others?”

Judging from the many recently announced cross-border partnerships, an increasing number of global enterprises recognize that strategic alliances can provide growth at a fraction of the cost of going it alone. In addition to sharing risks and investment, a well-structured, well-managed approach to alliance formation can support other goals, such as efficiency and productivity. Alliances provide a way for organizations to leverage resources.

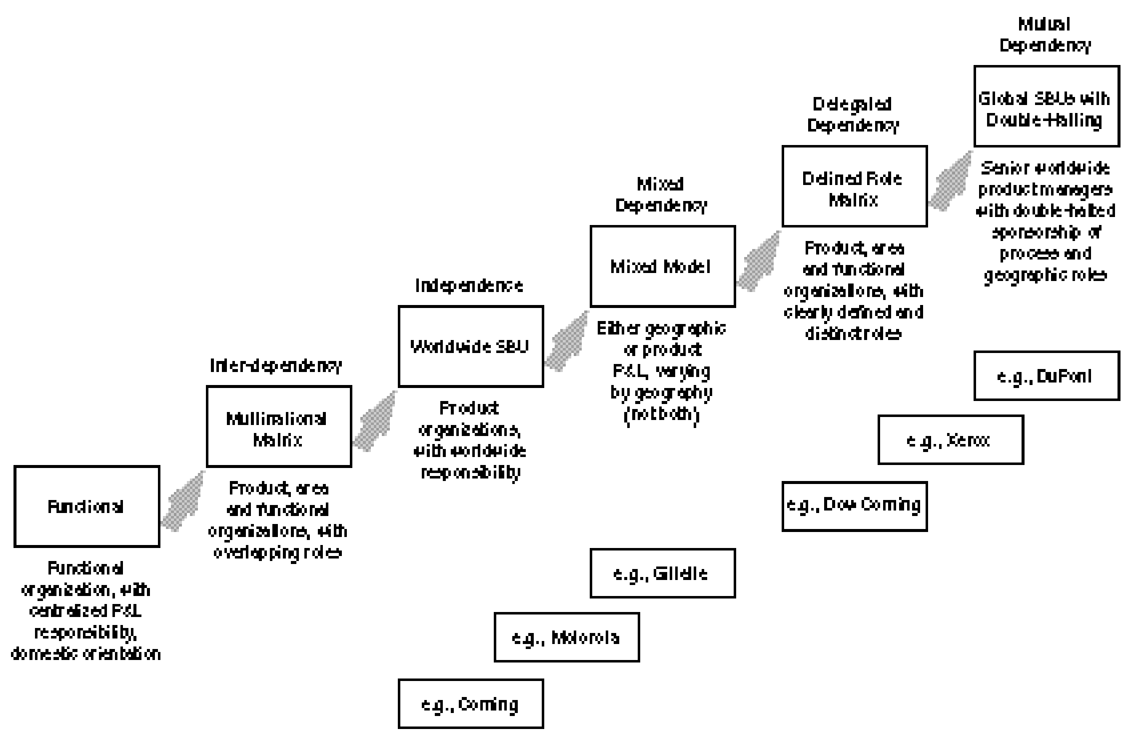
We have concluded that alliances are a winning option available to a wide variety of industries:

- The extended-enterprise era has started, and alliances can be successful on a global scale.
- Allying with competitors is not something to be afraid of.
- The U.S. is catching up but still behind in implementation.
- Companies are recognizing that alliance-formation skills are a core capability and that it is worthwhile to institutionalize them.

We recommend a disciplined approach to alliances in order to help propel companies to achieve superior results. We believe that less-experienced companies can accelerate their learning and achieve superior returns by actively embracing

Exhibit 17
Forces Shaping Alliances — Globalization of Markets

Global Organization Model Evolution



Booz·Allen & Hamilton is a global management and technology consulting firm, privately owned by its partners, all of whom are officers in the firm and actively engaged in client service. As world markets mature, and competition on an international scale quickens, our global perspective on business issues grows increasingly critical. In more than 75 countries, our 7,000 staff members serve the world's leading industrial, service, and government organizations. Each member of our multinational team has a single, common goal — to help every client we serve achieve and maintain success.

Our broad experience in the world's major business and industrial sectors includes aerospace, agriculture, automotive, banking, basic metals, chemicals, construction, consumer goods, defense, electronics, energy, engineering, food service, health care, heavy industry, insurance, oil and gas, pharmaceuticals, publishing, railways, steel, telecommunications, textiles, tourism, transportation and utilities.

With our in-depth understanding of industry issues and our expertise in strategy, systems, operations and technology, we assist our clients in developing the capabilities they need to compete and thrive in the global marketplace.

We judge the quality of our work just as our clients do — by the results. Their confidence in our abilities is reflected in the fact that more than 85 percent of the work we do is for clients we have served before. Since our founding in 1914, we have always considered client satisfaction our most important measure of success.

Booz·Allen & Hamilton has extensive experience assisting clients throughout the process of strategic alliance formulation, including vision definition, identification of critical capabilities, screening for partners, evaluating priority partners, negotiating and implementing alliances. We work together with our clients in three ways to help them improve their performance in alliances:

- **Process (Institutionalizing Alliance Capabilities):** Assisting clients build/improve their underlying capabilities in identifying, evaluating, negotiating, implementing and managing alliances — based on our best practices frameworks and methodology.
- **Content (Transactions):** Working together with a client on a specific alliance, at individual stages in the process or throughout the process.
- **Alliance Portfolio Renewal:** Revitalizing a client's portfolio of existing alliances by involving the client's current partners in an effort to improve performance of those alliances — by tuning them up and reinvigorating them.

We couple the understanding from our industry practices with our functional expertise in alliances and our geographical footprint to help our clients achieve superior results in their alliance efforts.

John R. Harbison, Vice President for Booz·Allen based in Los Angeles, specializes in strategic alliances, acquisitions and post-merger integration.

Peter Pekar, Jr., Ph.D., Visiting Associate Professor at the London Business School, is a recognized expert in the area of strategic alliance, with 30 years of business experience in forming and managing alliances. He has authored more than 40 articles on alliances and related subjects and is Senior Advisor to Booz·Allen.

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