The competitive advantage of strategic alliances

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In today's environment, creating sustainable value for customers and shareholders requires creating effective alliances. Alliances are essential building blocks for companies to achieve stronger and more effective market presence. Alliances are now a fact of life for business, an important piece of current operations as well as future strategy.

This article provides an important and useful perspective on strategic alliances. Approaches, examples, models, and other tools are discussed to develop a deeper understanding of how competitive advantage of the alliance can be achieved.

The article shows that there are many ways to build a competitive advantage which depend a lot on management of the alliance. Some firms place alliance management under a centralized organization, while others prefer to distribute responsibility for alliances across all business units. Furthermore, the competitive advantage of a strategic alliance also depends on its organizational and strategic circumstances.

As the pace of global business accelerates, and customers continually become more demanding and sophisticated, companies are finding the competitive landscape dramatically changing. Markets are moving so quickly that is very difficult for one company to stay current on all technologies, resources, competencies, and information needed to attack, and be successful in those markets. Strategic alliances offer a means for companies to access new markets, expand geographic reach, obtain cutting-edge technology, and complement skills and core competencies relatively fast. Strategic alliances have become a key source of competitive advantage for firms and have allowed them to cope with increasing organizational and technological complexities that have emerged in the global market.
Nowadays, strategic alliances are a business concept that’s changing the structure and dynamics of competition throughout the world. Using a broad interpretation, strategic alliance is a relationship between firms to create more value than they can on their own. The firms unite to reach objectives of a common interest, while remaining independent.

Companies are forming alliances with their rivals, their suppliers, and even their customers. Increasingly, groups of companies are competing against other groups, changing the distribution of economic power in society and nudging more and more single companies into alliances.

In recent years, there has been an explosion of alliances around the world and across industries. For example, in February 2001, The Coca-Cola Company and Procter & Gamble announced a $4.2-billion U.S. dollars joint venture to use Coca-Cola’s huge distribution system to increase reach and reduce time to market for the P&G products Pringles and Sunny Delight. Star Alliance is the largest partnership in the airline industry; its reach extends to 130 countries and more than 815 destinations, with collective revenue for the partnership at more than $63 billion U.S. dollars. Hewlett-Packard and NTT DoCoMo created a partnership to conduct joint research on technology for fourth generation mobile phones, bringing together HP’s network infrastructure and computer servers with DoCoMo’s wireless broadband technology.

Alliances take a number of forms and go by various labels. Alliances may be contracts, limited partnerships, general partnerships, or corporate joint ventures, or may take less formal forms, such as a referral network. Richard J. Chernesky shows that virtually all strategic alliances fit into three basic classifications of either “trading”, “functional” or “dynamic” operating alliances.

A “trading” alliance is straightforward - nothing more than buyers and sellers forming a largely passive sales and distribution or export/import arrangement based on contractual terms.

A “functional” alliance integrates certain basic “functions” between the two parties by pooling efforts to attain specific goals and establish ongoing management
relationships. These functional alliances are usually used to pursue or improve research and development projects, share costs, provide geographical market access and, generally, enhance distribution or sales activities.

A “dynamic” alliance involves the “hidden” assets of the two parties in terms of the skills, knowledge and capacity necessary to deliver results. Examples of “hidden assets” are research and development capabilities, proprietary technology, organizational strength or market-based acceptance. In a dynamic alliance, selected hidden assets are integrated. However, in many instances, the parties do not know exactly what assets are going to be required because the structure of the alliance almost always evolves during negotiations and initial operations.

Accordingly, strategic alliances have also been characterized as “relational” contracting. Relational contracting is a very flexible arrangement emphasizing mutual collaboration in response to changes in business circumstances. It usually involves a fluid situation that emphasizes receptiveness to modification over time rather than to the detailed and inflexible front-end documentation of expectations. These alliances possess the common feature of ongoing mutual interdependence, a condition in which one party is vulnerable to another whose behavior is not under the control of the first. The overarching theme that seems to unite alliances is that “each needs the other’s abilities to advance their respective interests.”

In general, to create successful alliances, a company must understand when alliances make strategic sense and how to manage them for a business results. Alliances can be extremely useful in situations of great uncertainty and in markets with growth opportunities that a company either cannot or does not want to pursue on its own.

More specifically, the most common reasons for forming strategic alliances and achieve competitive advantages are as follows:

*Setting new global standards.* Entering into an alliance can be the best way to establish standards of technology in the sector.

*Confronting competition.* When a high-volume producer decides to attack a new geographic market, defense is difficult if it does not have comparable size. Alliance
between companies is a response which has often led to positive results. It is equally valid to attempt an attack on a leader that has consolidated its own positions.

*Overcoming protectionist barriers.* Alliances can allow companies to avoid controls on importation and overcome barriers to commercial penetration. Alliances can also be a way to respect the bonds posted by the “host” country regarding value-added local content and participation in the capital of local businesses.

*Dividing risks.* For certain projects, risks of failure are high, and even higher when investments are elevated.

*Economy of scale.* There are many alliances designed to divide fixed costs of production and distribution, seeking to improve volume.

*Access to a market segment.* In mature segments, a company often wants to develop in a market segment where it is not present through an agreement with another company.

*Access to a geographic market.* A strategic alliance is often a way to enter a market that is protected by (national) tariff and other barriers, or dominated by another company with particular competitive advantages.

*Access to technology.* Convergence among technologies is the origin of many alliances. It is increasingly more frequent that companies need to appeal to their competition in different sectors if they want to realize a product line.

*Uniting forces.* Some projects are too complex, with costs that are too high, to be managed by a single company (military supplier contracts, civil infrastructure construction).

*Bridging a gap.* If a company does not have the resources or capabilities necessary to develop a particular strategy, an alliance with one or more companies is the most logical solution. Making an alliance to gain access to resources and capabilities that are lacking internally is perhaps the most frequent motive leading a company to seek partners.

*“Anticipating a play”.* The advantages and risks of pioneering are significant. In many sectors, the first company to enter the market with a new product achieves advantages that are difficult for the competition to overcome. The company is the
first along the experience curve. It gets the best positions for distribution. It invests initial profit margins in the production process, distancing itself further from the competition. The strategic alliance can have the scope of utilizing the pioneering experience of one of the partners. If this experience is brought to the alliance, it confers the advantages on the other partners as well.

Besides competitive advantages, strategic alliances can have some disadvantages. Alliances are costly, not only due to cash leaving the company’s hands, but rather due to returns from which it could be denied. First, they involve the investment of managerial time resources in establishing the alliance, managing it, and resolving possible conflicts of interest between the partners over the functioning of the alliance. Moreover, alliances can create indirect costs by blocking the possibility of cooperating with competing companies, thus possibly even denying the company various financing options. For instance, an alliance with Ericsson in the area of cellular communications could reduce the likelihood of contracts with Nokia, thereby putting the company at risk that if Ericsson is weakened, so will be all the companies that depend upon it.

Alliances also expose the company to its partners, and the unique technologies that it has are sometimes revealed to its partner company, which could later become a competitor or could utilize the fruits of the venture or the know-how better than the startup itself. In addition, strategic partners may often lead the company in directions that serve the partner company better than they do the company itself.

Although a material part of the costs of alliances such as joint ventures may be forecasted during the negotiations for its establishment, in many cases the balance of power between the parties changes during the course of the venture’s life, and the parties to it may have a change of mind. For instance, many joint ventures that were signed before the stock market crises of 2001–2002 between public companies and startups never materialized due to the drop in the stock prices of some such public companies. The fact that some of the private companies had meanwhile raised capital and actually had become stronger than the public companies utterly changed the balance of power. Likewise, the non-raising of capital by the startup could motivate
the public company to try to renegotiate the terms of the venture, while taking advantage of the startup's weakness. A change in the competitive environment in the field could also affect the alternative cost of the venture.

A study of alliances indicated that out of every one hundred alliance negotiations, ninety will fail to even produce an agreement. Of the remaining ten that do result in agreements, five will fail to meet the partners’ expectations for the venture. Of the five that produce acceptable results, only three will survive for more than four years.

Alliances may terminate for any number of reasons. The collaborative relationship may break down. The alliance may accomplish its mission and therefore outlive its purpose. Partner strategies may change, eliminating the need for the alliance. In his paper “Strategic alliances” Richard J. Chernesky evaluate six the most frequent problem areas which lead to alliances’ failure:

1. Poor project management. Companies involved in alliances must continuously monitor how fast moving markets and advances in technology may modify the assumptions and expected outcomes that prevailed when the deals were signed. The trouble begins when executives underestimate how much time and energy must be committed to managing multiple partner alliances.

2. Strategic gridlock. Unanticipated conflicts in objectives, business plans and operations may cause a dramatic change in the viability of a particular alliance.

3. Losing control of basic strategy. In every alliance, the partners relinquish some control with the expectation of shared returns. If a participant unduly depends upon the alliance for growth, it can lose sight of its overall business strategy and fail to focus on its own business. One of the worst things that has happened with the strategic alliance concept is that a partner ends up creating a competitor.

4. Focus on benefits to partners. The failure of the parties to act in unison because of a focus on what the other participant is obtaining from the alliance.

5. Poorly defined goals. The failure to agree upon specific goals and objectives such as return on investment, market share, market expansion, cost containment, etc. often leads to unanticipated difficulties.
6. Poor partner choice. The failure to select the right partner can make even the best deal unsuccessful. The business attributes of General Motors' alliance with the Korean company, Daewoo, to produce the Pontiac LeMans were positive and highly attractive, but the differences in management style and corporate cultures eventually resulted in the strategic alliance being discarded.

To ensure the greatest likelihood of success, organizations contemplating forming an alliance need to develop a disciplined, structured and systemic strategic alliance process. (see figure 1)

In order to achieve a competitive advantage, the process of alliance management should be very people-oriented. One key to managing the process is the personal
relationship that develops between operating managers. When that relationship is based on trust and respect, differences (be they of substance or style) can be settled to the satisfaction of both parties. When the relationship between managers is less cordial, contracts and bureaucratic methods are needed to resolve relatively minor issues.

Once managers grasp the fact that an alliance is a process they build flexibility, responsiveness and process goals into the relationship. The process goals are based on the continual assessment and improvement of everything from the communication channels to the technology transfer process.

Cooperation involves both firms adapting to, and learning from, their partner’s operating style. The foundation of operating style is corporate culture, and the integration of culture is an important issue in alliances. There are two steps involved in integrating corporate cultures. The first is to identify the type of culture that predominates in each firm. The second is to integrate those cultures so that the best aspects of each are encouraged in the relationship.

In conclusion, strategic alliances can be a powerful tool for achieving a company’s strategic goals. Through cooperation and sharing of resources, “one plus one” may “equal three”. In order to improve the chances of success, companies must follow a careful, organized process from start to finish; from strategic conception to alliance termination. It is important to take the time to properly set the strategy for the alliance, to create the optimum structure for the alliance to flourish, to set clear rules of governance, and to monitor the results on a timely basis.

As a result, strategic alliance can provide a powerful competitive advantage in new markets, cost, speed, knowledge, and technology access. Following the above framework will provide an approach to developing successful strategic alliance which has the potential to improve the organization’s strategic position dramatically, perhaps even to transform the company. Strategic alliance offers the parties an option on the future, opening new doors and providing unforeseen opportunities.

Bibliography:
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