

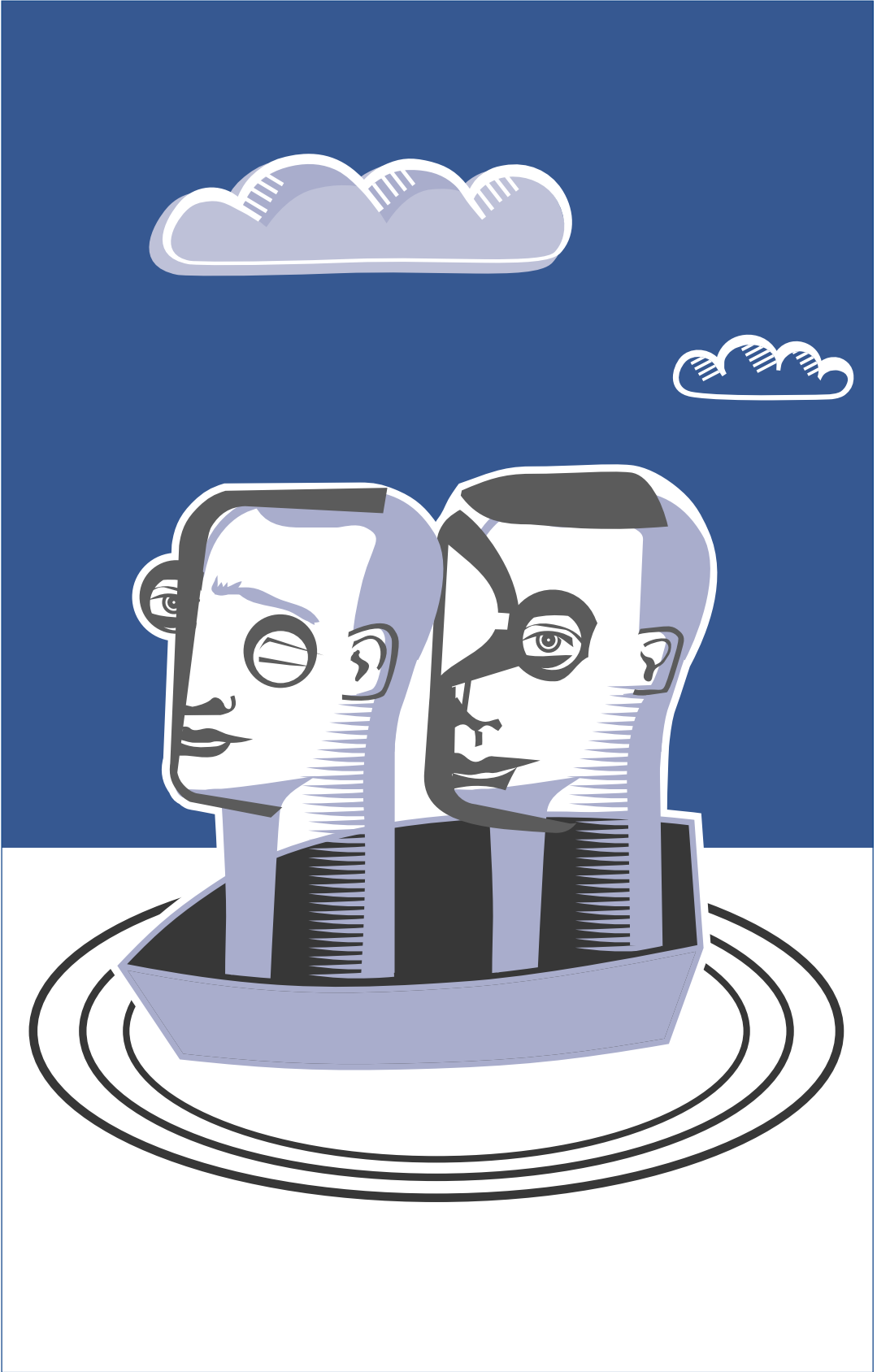
Prism

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Arthur D Little

Back to Basics



Partnering: The Rules of the Game

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Bigger is no longer better. The megalomania of the nineties with its excessive mergers, acquisitions and hostile takeovers has led to well known results. Alternative forms of collaboration are desperately sought. One form of cooperation gaining in importance is partnering as an alternative to M&As for local and global markets. Odenthal, Manning and Shimizu scrutinize the different scenarios and pre-conditions when partnering offers more perspectives than M&As.

The landscape of deal-making is changing. Companies have to let go their megalomania that pushed for mergers, acquisitions and hostile takeovers. Bigger does not necessarily mean better any longer, as the recent re-evaluations of mergers and acquisitions have revealed. Given the current problems companies like AOL/Time Warner or Allianz/Dresdner Bank are dealing with, it becomes obvious that the present and coming business environment is calling for alternative forms of collaboration. Partnering, often referred to as “strategic alliances”, “joint ventures”, “franchises”, “networks” and so on, is receiving a lot of attention as a flexible, efficient alternative to M&As for local and global markets.

Where it all came from: The Emergence of Partnering

Despite the current wave of interest in partnering, the phenomenon itself is not new. In the mid-1980s when companies were primarily interested in gaining access to new markets and achieving critical mass, only a limited number of contenders were involved in the partnering game. The mutual contributions were transparent and the risks distributed. Since the late-1990s, partnerships have no longer been forged on an on-off situational basis, but have become a strategic issue on today’s management agenda. Particularly in dynamic industries like telecommunications or electronics, the impact of partnerships turns out to be drastic: partnering applies as a powerful option for setting industry standards and rearranging markets. Partnering has not only gained in strategic importance, but has at the same time also become harder to manage as companies enter formations with numerous partners that make the structure more complex.

Arthur D. Little has observed that, in essence, six developments drive the increasing number of today’s partnerships:

Changes in the value chain

Nobody can predict the exact structure of tomorrow's value chain. Will it continue to rapidly change as in the past? The stakes are high. A company nowadays has to extend its strategic make-or-buy decision by another dimension: make or buy or partner?

Partnering in the "real" economy

After the excessive exaggerations during the internet-hype we are on our way back to normal. However, not all the efforts of the "new" economy were futile. Partnerships between the good old blue chip companies and the young and wild visionaries surviving the shakeout can be very promising these days. Each of the partners has complementary strengths that contribute to the business relationship.

From know-how to know-who

Knowledge orientation has its legitimate existence in today's business and has shifted the focus from know-how to know-who. Networking, social competence and global experience are becoming more important than specializing in a marked-off area. It's about knowing where to find the specialist rather than specializing in all kinds of different areas.

Limited room for growth

A lot of companies experience limits when looking for future growth opportunities. Organic growth opportunities are very limited due to market saturation and downsizing programs. M&A endeavors are nowadays often set back due to lacking capital or regulative requirements. One alternative remains: partnering.

Emergence of partner-networks to secure competitive position

More and more business models consider partnering as an integral part. The path to growth is increasingly leading to partner-networks where not only the network itself but also the size of the network matters. Networks in the airline industry, the biotech sector and the semiconductor industry illustrate this trend.

Financial benefits from partnering

A large number of companies are already currently generating a significant part of their revenues through partnering activities. Companies with experience in partnering show a higher return on investment (ROI) than other companies. Also, empirical studies show that over the past ten years, business organizations involved in partnerships among the top 2,000 companies worldwide have consis-

tently generated a ROI of 17 percent, which is a staggering 50 percent higher than the average.

Still, partnering is often critically viewed. Can partnerships really contribute to a long-lasting benefit for a company? And if so, how can partnering be institutionalized? The critical aftertaste is usually caused by a general, unspecific reflection. It does not, however, affect the increasing importance of partnering, as partnerships are rising in quantity and quality. Clearly the new generation of partnerships calls for sophisticated management approaches, far from recent “command and control” mechanisms.

Arthur D. Little’s Global Partnering Study

Growth perspectives are at the core of most partnering programs. Expansion of service offering, access to new markets as well as to new technologies and business know-how are key objectives. That is the main result of Arthur D. Little’s last global partnering study, carried out among more than 1,200 key decision-makers from all major industries in Europe, the US, and Asia. The great majority of the participants accept the value-creation potential of partnerships. 95 percent of the companies represented are involved in partnerships, and 69 percent plan to increase partnering activities in the long-term. 17 percent of these companies already generate more than 25 percent turnover through partnerships. The study also showed that companies in particularly dynamic sectors like telecommunications, information technology and electronics, media and pharmaceuticals give the highest importance to partnering. Their understanding of partnering is common to all industries: no one partner should be dominated by another and technological and financial risks are taken and managed jointly. For further information on the study please contact Rogier Engelsma at the Zurich Office (engelsma.rogier@adlittle.com).

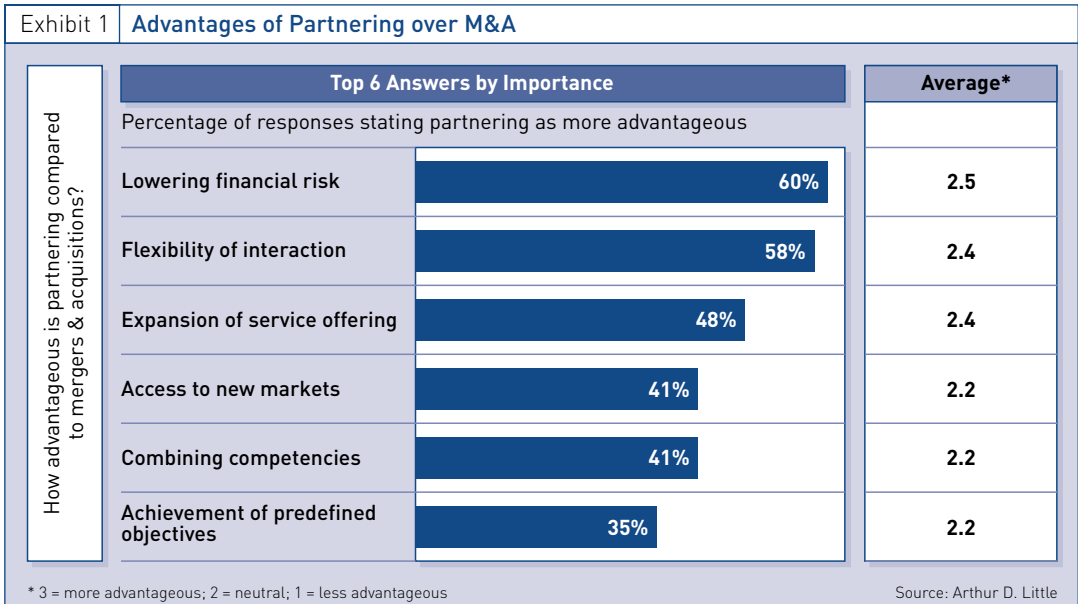
Think twice, before you Merge or Acquire

Companies have to let go the impulse for size and stop considering mergers and acquisitions as the only way of growing their business. More flexible forms of collaboration have caught the eyes of companies' decision takers as well as investors: save yourself (and your company) the high cost of integration, the possible flop (including negative headlines), and the pressure on your own stock. The stock markets have come to recognize this: partnering announcements generally boost stock prices. In around 70 percent of the cases where significant partnerships were announced participants' stock prices gained. Nowadays, a notable jump in stock price after an M&A announcement needs to be scrutinized a little more closely. Approximately half of the announcements were positively valued - but often for the seller and not for the buyer. More and more companies view partnering as an equal option for future developments and opportunities, and it is not perceived as a "preparation to acquisition" anymore.

According to Arthur D. Little's Global Partnering Study, the major advantage of partnering over M&A is that the financial risk is lowered. Without the exposure to financial risk and the need for extensive post-merger integration efforts, partnering enables knowledge to be locked into clear areas. Another advantage is the greater flexibility of interaction when partnering increases efficiency, lowers costs and supports creativity while cultural barriers, integration efforts and other paralyzing activities are left aside.

In combination with the currently prevailing pessimistic business environment, these advantages of partnering leave M&A activities thin on the ground. When push comes to shove, companies nowadays do not hesitate to withdraw and walk out of planned M&As at the very last minute. The latest example comes from the airline industry: easyJet dumped its initial plan to acquire Deutsche BA after failing to persuade pilots to accept flexible contracts and less involvement in decisions.

The strategic question, however, remains: when to prefer partnering over M&A? Arthur D. Little identified three



collaboration scenarios when partnering offers more advantages than M&As:

1. Where immaterial assets such as content are important. Here partnering enables simple use without integration costs.
2. When altering business models partnering enables easier and faster combination of capabilities as well as risk sharing.
3. When seeking to gain access to specific resources and when standard setting is crucial. Here partnerships often are less costly than multiple mergers and acquisitions.

Companies clearly do distinguish between partnering and M&A, and there are no signs that one alternative will completely replace the other in the near future. Instead, they will further grow as complements.

Teaming Up for Success - The Six Key Rules

Companies often refuse to team up with another company for fear of losing sovereignty and control. They should

think again. The partnering trends of the future have outlined the importance and the potential for value creation. But be prepared to take an alliance seriously or do not proceed. Very few companies are able to encompass the full value creation logic and can achieve their partnering goals due to a lack of structured and coordinated approaches in selecting and implementing partnerships.

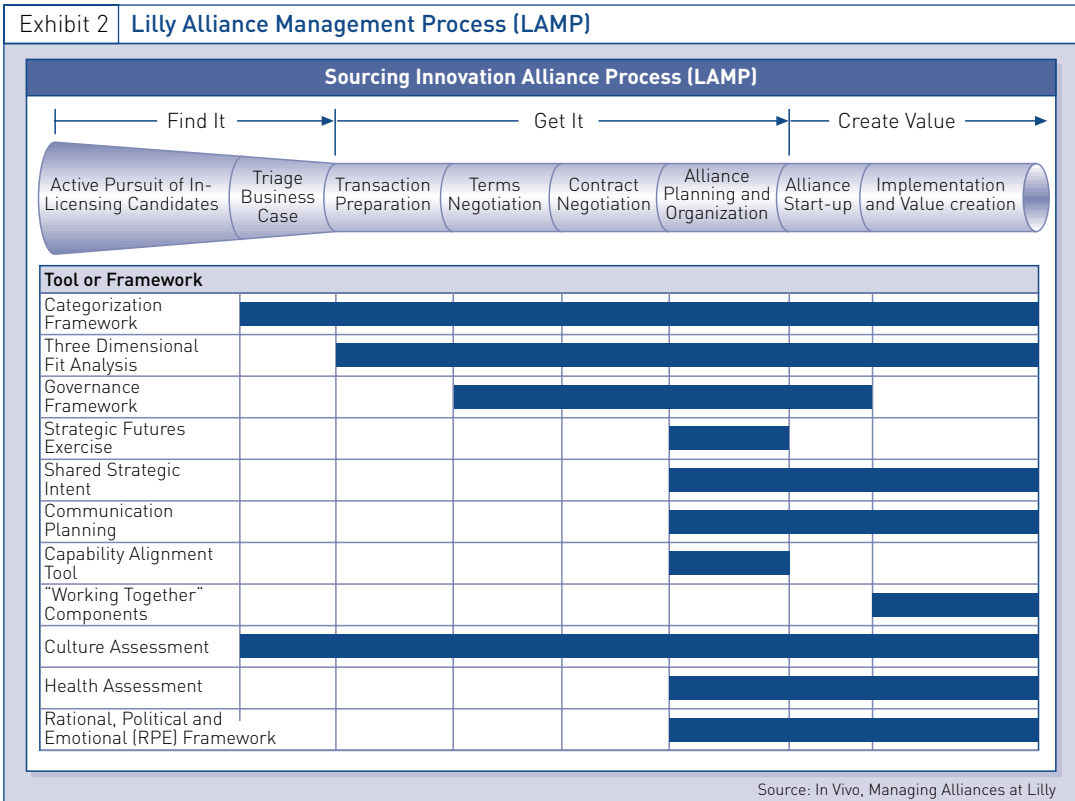
Despite the high priority companies give to partnering, most initiatives are still launched on a situational basis. Alliances require time and money, but they also require management. Companies fail to formulate their partnering ambitions and objectives in reference to their corporate strategy. They also fail to actively manage and shape their partnerships. It's not only about the "deal", there's a lot more to come once contracts are signed. Like any initiative, the success of an alliance begins with planning. At that stage factors like defining the goals and assessing potential partners are important. However, they should not be overemphasized at the expense of others like communication and collection of knowledge and experience. Lean but effective planning does matter as well as dedicated day-to-day operational management. So how can companies overcome the lack of experience? By understanding and adapting what we believe are the Six Rules for Successful Partnering.

*1. Strategy first,
Deal Making second*

Many companies have strategic partnerships, but do they have a partnering strategy? Alliances should only be built in the context of a company's corporate strategy. The objectives should be in line with the underlying business objectives. Any company should be able to exactly identify the contribution of every single strategic co-operation to the company's success. Too often, the "deal" itself is given the highest priority - instead of the strategy behind the partnership. Top management, in particular, often focuses on the deal itself and neglects the aftermath of the deal. Everyone is happy for a while once a company finds a good match. However, the honeymoon usually only lasts for a very limited time - after that business resumes. The reason: top management often loses interest after the deal and responsibilities are transferred to operational units. Strategy first, deal Making second, however, does not necessarily call for complex partnering strategies. It

means that companies have to be prepared for favorable opportunities, where the strategic framework needs to exist in advance, to support the strategic decision whether to enter a partnership or not.

One example of a company not only announcing strategic partnerships but actually pursuing a partnering strategy is the pharmaceutical company Elli Lilly. Due to the company’s strong focus on R&D, the partnering strategy is based on a decision to expand the existing R&D and marketing processes through entering strategic partnerships. This is primarily done with smaller companies engaged in the biotech industry. Core of the strategy is the intention to become the premier partner within the pharmaceutical industry. To achieve this goal, Elli Lilly rationalized and simplified the existing partnering processes and established an institutionalized process, called the Lilly Alliance Management Process (LAMP) that is now being used for all strategic partnerships. It consists of three ele-



ments: find it, get it, and create value. It covers the selection of a suitable partner (find it), the phase of negotiations (get it) and the actual execution and implementation of the deal (create value).

2. Keep an eye on the value creation of partnerships

How does your partnership create value and for whom? This is the eminent question that needs to be answered in order to enter or realign partnerships. How can partnerships generate value? Value is created in three ways: by teaming up with competitors, by bundling resources or by learning from each other.

Companies with identical or complementary offerings can team up in order to achieve critical mass or set standards. Value is created by the increasing competitive position and/or cost savings. An example for standard setting amongst competitors was the announcement of nine leading companies from the electronics industry (Hitachi, LG, Matsushita, Pioneer, Philips, Samsung, Sharp, Sony and Thomson) in early 2002 to jointly establish the specifications for a next generation optical disc video recording format called "Blu-ray Disc" with large capacity. The probable outcome of this new technology is a standardized format avoiding the chaotic processes in setting standards, which plagued the introduction of DVDs. In early 2003, the nine manufacturers began licensing the format. The first commercial Blu-ray products are expected to make their debut on a wider scale in 2004.

Moreover, companies bundle their unique and differentiated resources in partnerships in order to access new markets and/or shell out new products and service offerings by combining these specific resources. An example of specialization in the PC-industry is the partnership between Apple, Sony and Sharp in manufacturing the Apple Powerbook. Apple is using its experience in the PC area, Sony in the area of miniaturization of electronic equipment, and Sharp is a specialist in arranging and building electronic components. Particularly in the high-technology industry, companies strongly depend on other players due to the high complexity of products and services. The Japanese consumer electronics company Sony has turned its focus strongly on combining resources with other market players. Sony's PDAs, for example, are Palm powered.

Also Sony and Swedish telecom giant Ericsson decided to join forces in the area of mobile phones.

Last but not least, companies can learn from each other. By entering into partnerships critical knowledge and capabilities can be mutually exchanged. Knowledge gaps can be closed and/or new competencies can be developed in order to achieve competitive advantages.

Pharmaceutical giant Roche recently announced a partnership with the German biotech company Epigenomics in jointly developing new test procedures for improved cancer diagnosis. On the one hand, Roche can substantially benefit from Epigenomics' specialized testing method. On the other hand, Epigenomics can rely on and learn from Roche's leading global market position in diagnostics and from its ability to commercialize potential new techniques leaving a profit in the future.

3. Use a structured and dynamic approach

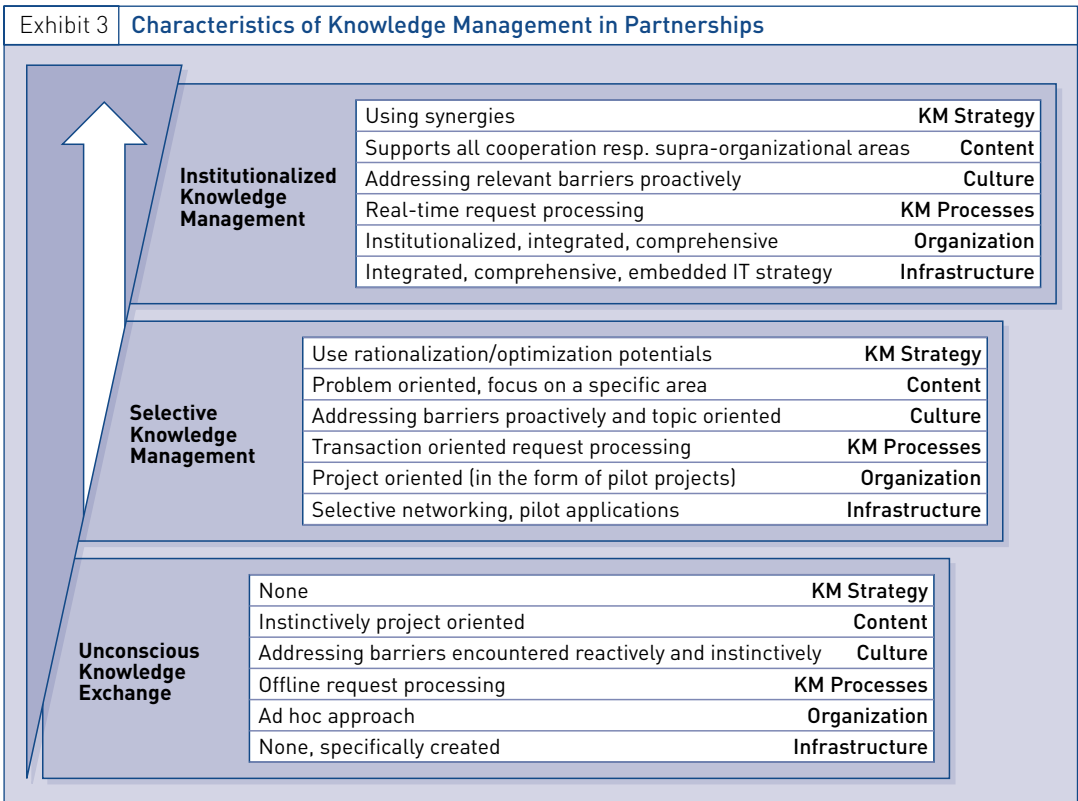
By nature partnerships are dynamic, open and in constant development. These characteristics prove to be advantages: their flexibility and ability to adapt are two of the main advantages driving developments. Flexibility and adaptation, however, places great demands on a company's management. There is a need for structure to ensure a systematic, logical and repetitive approach. Tasks, people, procedures and other challenges need to be coordinated and prioritized. How to do that? By using structure. You might think it's not applicable or too complicated? Wrong. Referring back to Elli Lilly's Alliance Management Process we can observe a structured way of partnering for real with its three generic phases Find It, Get It and Create Value (Exhibit 2). Other successful companies are also relying on process phases supported by various tools and techniques. However, such approaches are still rare. This fact is confirmed by the study: 55 percent of the respondents declared not to have a clearly structured and coordinated - an institutionalized - approach.

4. Communicate right and manage knowledge

Communication is one of the two most important issues once the decision for a coalition has been made. There are three different types of communication when it comes to partnering: internal communication within the company, communication between partners and communication with the outside world. These three levels need to be sepa-

rated by sending out different messages to the different audiences. One has to bear in mind that a company can never reach everybody and therefore will never get the complete buy-in and acceptance from all parties. Companies need to focus on selected target groups and within these target groups focus on key persons. For non-targeted persons expectation management is necessary. In reality this means a form of communication that prevents potential opponents from opposing.

The second important issue is knowledge management. It covers a whole range of tasks: gathering and distributing existing and new knowledge, trying to catch the implicit and explicit knowledge, and managing it with integrated Knowledge Management (KM). The critical point for successful knowledge management is a company's corporate and cooperation culture - it usually takes quite a while to change attitudes. A holistic alliance management should consider the implementation of an appropriate knowledge management within the partnership. Arthur D. Little here



recommends a stepwise approach, which on the one hand helps to realize quick wins, and on the other enables institutionalized knowledge management in the long run (Exhibit 3).

5. *Establish measurements of results*

Each partnering process must be permanently accompanied and monitored. This continuous performance measurement is fundamental to the ongoing management of strategic partnerships. The question remains when a company can rightly call its efforts a success. Success can generally be measured with achievement of objectives. That makes success relative to the formulated objectives that can vary case by case. In order to quantify success, however, you need to be able to measure the underlying objectives, e.g. by implementing parameters that track both the progress of partnering activities as well as the final degree of achievement. Management traditionally focuses on profitability as the key measure, but profitability is the outcome of measures. It is important to measure operations and inputs as well. E-Business software development company Siebel Systems for example has established a “Scorecard-Approach” to continuously measure the health of its over 750 alliances. The Alliance Scorecard quarterly or semi-annually evaluates multiple dimensions like financial shape, strategic fitness, operational fitness and quality of the relationship. Based on the results, Siebel takes steps to optimize its portfolio in close coordination with the involved parties.

6. *Manage partnerships as portfolio*

More and more companies enter multiple alliances, thus significantly increasing complexity. Today, the leading 500 companies worldwide are engaged in an average of 60 alliances. Companies frequently encounter the increased management complexity but often fail to prioritize or coordinate their portfolio. To support a reassessment process, a company should answer the following questions and act accordingly:

- Do the partnerships cover our future objectives?
- Do the engagements reflect the underlying partnering strategy?
- Does the current partnering portfolio contribute as much as possible as to achieve the defined objectives?

Answering these questions will lead to a portfolio management approach that can result in added value for day-to-day management and coordination. The approach facilitates comparisons between current partnerships, helps to identify potential bundling possibilities as well as highlights redundancies or gaps. Furthermore, it can help to identify future chances and simplify communication of partnering objectives to third parties.

Insights for the Executive: The upcoming Partnering Roadmap and the Fit for Partnering Program

Even though the number of failed partnerships is significant, we see the future of partnering arising in three distinctive developments, summarizing some of the trends mentioned:

1. Partnering on the strategic management agenda

Facing the growing pressure from the underlying business environment, more and more companies are calling for alternative long-term growth strategies to improve business results. Partnering is nowadays increasingly considered as a fundamental cornerstone of success. Through partnering, costs can be reduced and revenues increased. Already numerous companies are realizing significant cost savings by teaming up. Moreover, almost every company intends to walk the path to growth sooner or later. Organic growth is becoming increasingly difficult due to saturated markets and M&A is not always the right decision. M&A is furthermore largely driven by the economic shape and the involvement of large capital stakes.

2. Increased professionalism and institutionalization of partnering

A number of companies have recognized the importance and implemented a professional partnering approach. The mass lags behind. Only a few companies are able to capture the full value creation and to achieve their partnering goals. Lacking structured and coordinated approaches to selecting and implementing partnerships can be overcome by adapting the earlier described Six Rules for Successful Partnering. Companies are increasingly challenged to implement institutionalized solutions where partnering is anchored to the organization as a perma-

ment function. Roles and processes will have to be defined. “Alliance manager” will no longer be a fantasy job title. Partnering competence has become a distinctive factor for competition.

3. Tomorrow’s competition between partner-networks

The airline industry as the precursor has set the trend. Nevertheless in other industries like high-tech, telecom or biotech the emergence of network-based competition models is being seen. Shared expertise, strong market positions, standards and considerable cost saving potentials as the basic characteristics of partner-networks can strengthen dominance in a market substantially and affect competition massively. The competition between partner-networks will not develop as fast or be as penetrating in all industries as in the examples mentioned. However, according to the opinion of 1,200 companies interviewed in the Arthur D. Little Partnering Study, there’s a lot to come in terms of multiple alliance engagements and partner-networks within the next decade.

The question remains whether companies are ready or not, respectively where and how to improve best? To support our clients in answering this question Arthur D. Little has developed the Fit-For-Partnering Program addressing

Exhibit 4 Arthur D. Little’s Fit-For-Partnering Program			
League	Objective	Training Programs	
		individual	general
Expert	Optimize	<ul style="list-style-type: none"> • EEP™ • Portfolio Management • Performance Measurement • Knowledge Management • Risk Management • Conflikt Management 	<p style="text-align: center;"> Audit Opportunity Screening Review </p>
Advanced	Qualify	<ul style="list-style-type: none"> • Systematization & Standardization • Monitoring & Controlling • Knowledge Exchange & Learning • Tool-based Partner Management 	
Beginner	Understand	<ul style="list-style-type: none"> • Approaches & Methodologies • Best Practice & Partner Talk • Needs Analysis • Benefits, Costs, Implications • Pilot 	

the key challenges for companies having no, little or sophisticated experience with partnering.

We designed the listed training modules according to the needs of our clients. However, the individual situation is essential and differs. Beginners usually want to gain insight in partnering approaches and methodologies, best practices and experience from other companies before starting with a pilot. Companies with advanced partnering experience need to focus on standardization of procedures, monitoring and controlling of partnering activities, and - for instance - knowledge management. They qualify their approaches through tool-based partner management. Partnering with high partnering expertise strive for optimization. They apply our EEP-Program - Effectiveness & Efficiency in Partnering - in order to realize significant improvement potentials through challenging established partnering activities and procedures. Furthermore, they concentrate on selected improvement fields like performance measurement, risk management or conflict management.

For all representatives of the three leagues, we use the more general training modules audit, opportunity screening and review ensuring a company's fitness on a regular basis. During the audit module a company is confronted with the newest developments in the field of partnering in order to identify improvement opportunities. According to a partnership's complexity and maturity we run reviews of existing partnerships every four to six months revealing lessons learned and adjustment necessary. Continuous screening of opportunities implies the availability of an ideal partner in the company's environment.

The Fit-For-Partnering Program displays the main lesson most companies we are working with have taken so far: using cooperative intelligence upfront guarantees readiness for the game that is sometimes already called "war for partners". And good partners are limited.

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