Corporate alliances

Beware the iron fist in the velvet glove

Christopher Lorenz points out the danger of one partner acquiring skills or intelligence at the expense of the other

In the fast-moving competitive world of the 1990s, staying ahead will no longer be mainly a matter of the way you run your existing company, but how quickly you can change its shape to cope with shifting threats and opportunities. Few companies will be able to do this without "strategic partnering", whether their alliances are permanent, or, as in most cases so far, only temporary.

Such maxims have become increasingly popular among business academics, management consultants, business academics – and their clients – over the past couple of years, as more and more companies have rushed into international alliances.

In the past few months the spate has reached a new level, especially in Europe. Hardly a week has gone by without the announcement of at least one further alliance between major multinational companies. Many of the new partnerships (actual or proposed) are in electronics and electrical engineering – which has hogged most of the headlines this year thanks to the pulling power of names such as GE, GEC and Siemens – but there have also been plenty in cars, software, food, packaging, property or financial services.

What many enthusiastic new alliance partners have yet to realise, warns David Connell, a management consultant who has just made an intensive study of strategic partnering, is that it is no easy matter to deliver real commercial or strategic benefits from situations in which control is split between two or more of them.

Not only can the objectives and priorities of the various sides change over time, he points out, but the easiest partnerships to negotiate are sometimes those with the most significant "hidden agendas" – where one partner is using the alliance at the expense of the other to acquire a major new competence for its core business.

Connell, who works for the consultancy division of Deloitte Haskins & Sells, the international accountancy firm, draws these conclusions from an 18-month study of 20 cross-border partnerships between 45 companies in the United States, Europe and Japan. The study, which was completed before the current spate of deals in electronics and electrical engineering, will be published as a book in a few months' time*.

Connell's research into the challenges of collaboration has several considerable virtues, although it was less in-depth than a five-year study of 15 alliances carried out by a team of three leading international academics (see "Erecting Barriers", this page, January 9).

First, Connell pulls no punches about the pitfalls of alliances, especially the sort which merge parts of otherwise competing companies – as, for instance, in the case of some of the deals planned by Britain's GEC with GE of America and Siemens of West Germany.

Second, it distinguishes between different types of collaboration rather more clearly than much past research (though still not clearly enough), and suggests which varieties should be used in which circumstances. And third, it offers a lot of practical advice about how to structure the various types, right down to detailed questions of taxation, corporate identity, sales force integration, distribution and so forth.

Partial mergers "are a reflection of an inability by top management to come to term with changes . . . A straight disposal may actually be the more sensible approach"

While admitting that joint ventures are far from a new phenomenon, Connell emphasises that today's spate of strategic partnerships is much more far-reaching than most alliances in the past. These were merely "tactical" in that they enabled a company to achieve its sales objectives for individual, and generally minor, export markets.

Strategic alliances, by contrast, affect a company's overall competitiveness, says Connell – in technology, cost and/or marketing terms. And the way they are managed can affect the long-term trajectory of the whole parent company.

The Deloittes study does not cover licensing deals, which a few companies classify grandly as "joint ventures". But it does include another type of arrangement which most would not really consider to be fully-fledged collaboration: what it calls "vertical supply alliances", more familiarly known as "OEM relationships".

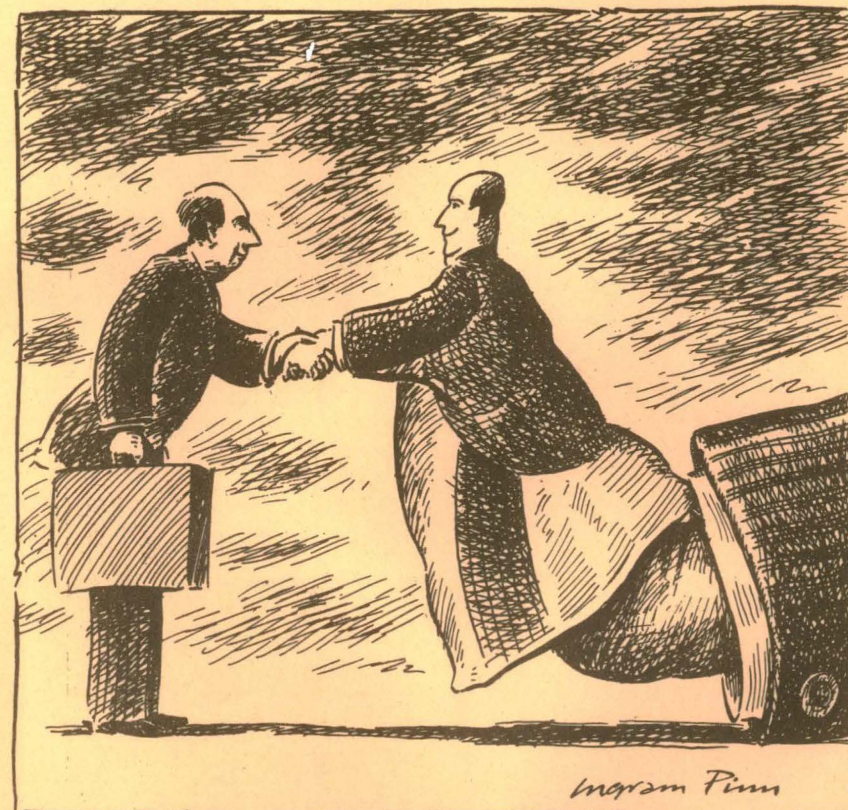
Under such deals one company supplies another with key components or sub-assemblies; examples include Matsushita/JVC's various arrangements with US and European companies to supply video recorders (either complete machines or their key components). Connell's "vertical supply" category also includes sub-contracted research and development, and alliances between manufacturers and their distributors.

His other groupings are: the creation of equity joint ventures to build new businesses (such as British Telecom and Dupont's opto-electronics venture); collaborative research and development (eg the Siemens-Philips "Mega Project" in semiconductors, and the Honda-Rover partnership in cars); the taking of investments in business partners (eg General Motors' stake in Isuzu of Japan, or Northern Telecom's in Britain's STC); and investment by large companies in innovative small ones (eg Monsanto's stake in Genentech's biotechnology enterprise).

Like any classification, Connell's "typology" of alliances is problematical in at least two senses: it inevitably fails to take full account of those which span several of its categories, as do several ventures which GE of America has around the world, for instance; and for the sake of brevity it combines under broad composite headings arrangements which should really be classified separately, such as joint ventures where ownership is shared equally versus those where one partner has clear majority control.

Nowhere is this more evident than in Connell's category of "partial mergers", involving only a portion of the parent companies' businesses. He includes 50-50 joint ventures (such as those between SGS and Thomson in semiconductors, and between GEC and Plessey in telecommunications), as well as ventures where one side predominates from the start, as with Whirlpool's 53 per cent stake in Philips' appliance business and the "merger", under majority Dutch control, of Leyland trucks and an offshoot of Daf.

He also includes arrangements where parity of control is intended from the start to be temporary: a topical case he discusses is the Franco-American computer alliance between Bull and Honeywell (with NEC of Japan as a smaller partner), where Bull has just purchased more than half Honeywell's original 42.5 per cent stake.



Most of the joint venture arrangements which GEC is planning with GE, and its deal with Siemens in telecommunications, would also fall into the same "partial merger" category, although their purpose, structure and modus operandi are likely to vary considerably.

In spite of these drawbacks in Connell's study, he has valuable advice for partial merger partners – both actual and potential.

First, he offers some general words of warning. As long as joint ownership continues, there will always be two or more separate major interest groups at board level which, in many cases, are in head-on competition in other parts of their business. And "immense integration problems" have to be dealt with if the partnership is to be successful.

Discussing partners' various possible motivations – which colour heavily the management of the relationship once it is created – Connell says that "partial mergers are used when both parties wish to improve their competitive position, but neither is prepared to divest completely (its) operations."

The reason for this may be a purely positive wish to achieve economies of scale. Alternatively, one partner may want to withdraw from the industry, but may face barriers – political or commercial – which would make this difficult to achieve in one move, especially if the company is a government-supported "national champion".

Third, a partial merger may provide "the only practical way of restructuring an overcrowded sector, eventually allowing the new business to be fully acquired by one of the parents or a third party . . ."

Fourth, there may be tax reasons why a disposal is difficult, for instance in the case of overseas subsidiaries of German companies. And fifth, partial mergers can provide a means of changing corporate direction gradually, releasing funds for major acquisitions in new areas before the final disposal is completed.

These are the logical reasons for partial mergers, Connell reports. But many of them "are really a reflection of an inability by top management to come to terms with changes which are forcing a new strategic direction for the company . . . A straight disposal might actually be the more sensible approach; a partial merger provides time for the emotional adjustment."

"In practice few partial mergers continue in operation with shared ownership for any significant time," says Connell. "Their usual role is to provide a vehicle for divestment by one of the partners, although neither party may envisage this when the merger is negotiated."

Most partial mergers can only be successful, he continues, if there is integration between each element in the partners' previously separate value chains – from research and development and purchasing right through to distribution and after-sales service. Above all, Connell concludes, the parents must find a way of handling their involvement which gives maximum autonomy to the new management while safeguarding their own interests. As with any form of parenting, "giving up control is perhaps the most difficult decision."

** Summary paper available from Jeremy Nagley, Deloitte Haskins & Sells, PO Box 207, 128 Queen Victoria Street, London EC4P 4JX.*