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A new kind of enterprise

You pays your money and you takes your choice

Punch, 1846

First the good news: there is a business strategy that can bring you 25 % greater share value than that of your competitors. And now for the bad news: 70 % of companies can't make this strategy work.

The strategy, of course, is partnering. The ability to create value through the skilful management of portfolios of business partnerships is an important source of competitive advantage. We maintain that it is one of the essentials of business success in the new millennium.

The trend reflects, not a sudden outbreak of corporate gregariousness, but a belief that, in today's fast-changing and ever more complex environment, companies must look beyond their own corporate boundaries and seek to create win–win relationships with other companies who provide complementary capabilities.

Constantly accelerating change in the business environment is all we can be certain of these days: this premise is now so widely accepted it has become a cliché. Some say the era of rapid, unpredictable change has been ignited by the growing intensity of global competition. Others see it as an inevitable consequence of technological convergence. Some are anxious about it. Others welcome it as a source of new opportunities for the agile and the alert.

However it is explained and perceived, the reality for practically everyone in this era of accelerating change is working with a bewildering, rapidly proliferating array of different possibilities, cultures, visions, agendas, opportunities

and threats. But there's no agreement about what to do. While we are being bombarded by the obvious fact of change, we are being deafened by a cacophony of different and frequently conflicting views about what it means and what its management implications are.

It is not just business either. The whole world seems beset by conflict and contradiction. Even established democracies are struggling to cope with the problems of youth violence, social fragmentation and ethnic isolation. Our faith in the old dream of integration and harmony is fading. We may wish it were not so, but we have to learn to live with the consequences.

Despite the constant, heroic attempts to reach across the old divisions and forge new partnerships to solve pressing social and economic problems, the divisions persist and the bridge builders and mediators are looked at, for the most part, with cynicism and apathy. People appear, if not content with all their difference and disagreements, at least under no great pressure to resolve or settle them.

While many company leaders still dream of integration and harmony, shifting market boundaries, growing customer choice, increased stakeholder pressure, the communications revolution and, above all, the resurgence of the high-speed, high-tech, high-risk and totally unpredictable e-business world are making the business of business much too complex for old, monocultural organizations to cope with on their own.

Large organizations are having to face the fact that the bureaucracies with which they once ruled their markets cannot handle the seething multitude of different and often conflicting voices, creeds, philosophies and agendas of modern business. The control their bureaucracies were designed to exert is slipping from their grasp, because the systems in their charge are becoming too complex and unpredictable.

There are two conflicting points of view on how organizations might respond to the loss of control, both of which are in action within the business community. The first is that the problem lies not with bureaucracy and control systems per se, but with their lack of sophistication. According to this view, the complexification of the environment has indeed outstripped the competence of existing control systems, but this is a technical problem – control can and will be reasserted, with the help of modern technology and a few minor modifications to the system. Control is desirable; the only problem is how to re-apply it.

The other, newer perspective questions whether 'control', in the old sense, even if it could be re-applied (which is doubtful) any longer serves

a useful purpose. This is such an alarming idea that it is rarely articulated in business and management debates, but it is hard not to see a tacit acceptance of it in the speed at which companies are forming partnerships. For, in adopting partnering strategies, firms are acknowledging that, in practice if not yet in theory, the need for control is less pressing than the need to create or extend networks of business relationships.

The flight from control

There are rich rewards for those who can make partnering work. A.T. Kearney research demonstrates that those companies that display excellence in partnering increasingly out-perform their peers in the stock market.[1] Companies with a history of successful partnership can derive 25 % greater increase in share value relative to the industry sector in which they operate. This performance differential has risen as high as 40 % over the last decade (see Figure 1.1).

But the downside is also significant for those who fail. Our research also tracked the share price impact of companies announcing partnerships and subsequent partnership success or failure. Using a sample of

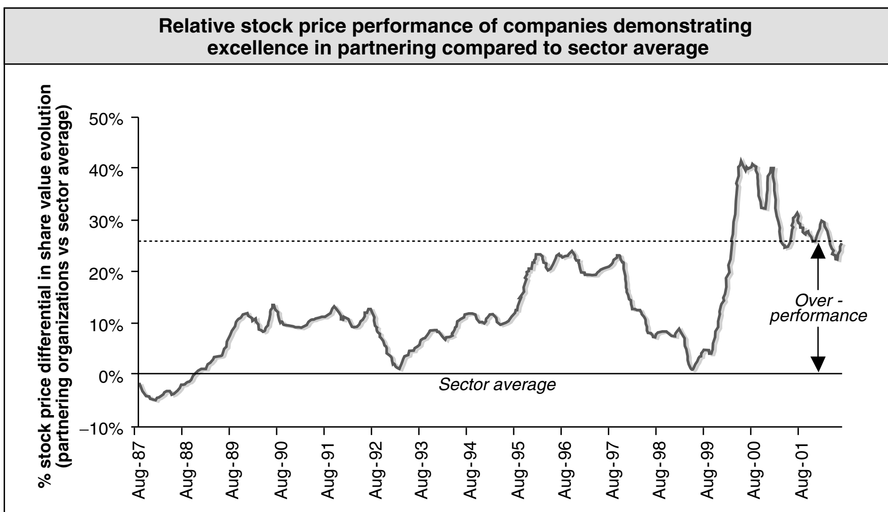

Figure 1.1 *The value of partnering excellence*
Source: A.T. Kearney research and analysis; Datastream data

'mega-alliances', those with a value greater than $500m, we tracked the evolution in market value of the companies involved both on announcement of an alliance and six months on. The growth in share value of companies participating in alliances that had shown some success at the six-month point showed on average a 5.3 % advantage relative to their industry sector. But those companies operating alliances that could not demonstrate any tangible benefit six months after announcement underperformed the share value growth of their sector by 11.7 % (see Figure 1.2).

Despite the risks involved, there is significant evidence that partnering is on the increase. Studies published by Booz Allen and Andersen Consulting in the 1990s[2] revealed a sharp increase in joint ventures, licensing agreements, collaborative research, technology exchanges and marketing alliances over the previous decade. US firms formed only 750 such partnerships in the 1970s, but by the mid-90s were forming thousands each year. The growth of alliances accelerated sharply in the second half of the 1990s and, by 1999, 82 % of executives surveyed expected alliances to be a prime

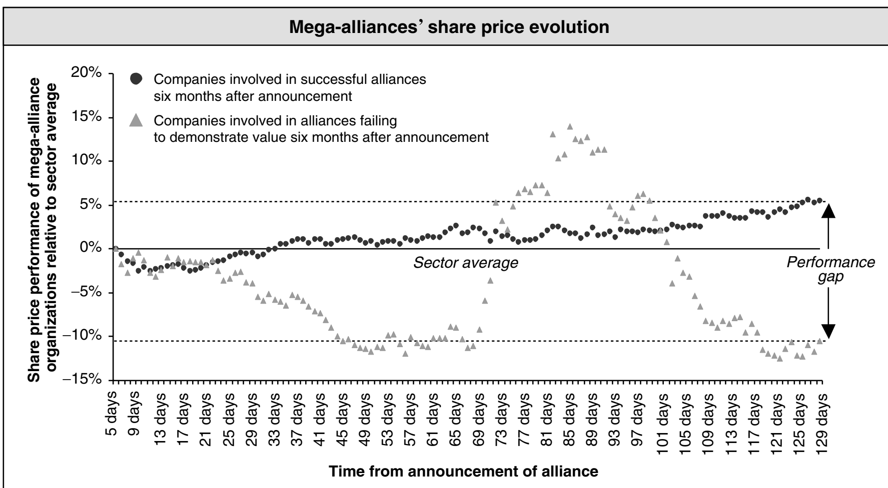

Figure 1.2 *The prize for success – and the price of failure*
Note: The peak at 85 days' post-announcement in the data of alliances failing to demonstrate value at the six month point is driven by the impact of dramatic share price increase of a biotech firm and its pharmaceutical partner against expectations of a therapeutic breakthrough. Results declined on news of poor drug trial results and questions regarding the pharmaceutical company's marketing skills.
Source: A.T. Kearney research and analysis; Datastream data

growth vehicle in the future. Analysis showed that, by 1999, alliances accounted for 26 % of the average Fortune 500 company's revenues, up from 11 % in 1994 and for 6 to 15 % of the market value of the typical Fortune 500 company.

Bankers were particularly zealous converts to the partnering philosophy and expected their companies to hold average portfolios of over 50 alliances by 2002, accounting for as much as 50 % of revenue.

These results were broadly confirmed by a 2002 Conference Board study which found that, on average, US executives expected alliances to account for 30 % of their revenues by 2004 and that European executives expected the figure to be nearer 40 %.[3]

But the risks remain considerable. The Andersen survey suggested that about 70 % of alliances fail and although the 15 most successful alliances created an estimated $72bn of shareholder value, the 15 least successful destroyed $43bn worth of shareholder value.

Alliance management

Whether or not you agree with the conclusion that the explosion in partnering since the mid-1980s amounts to 'a new chapter in the evolution of free enterprise',[2] it clearly poses new management challenges.

Networks of autonomous systems are far more complex, and less easily guided, than integrated enterprises. In an age when the shelf-life of knowledge can be shorter than the time it takes to capture, let alone make sense of it, they cannot be guided by a deliberate strategy-formulation process. A completely new kind of guidance system is required to handle the uncontrollability and complexity of partnership enterprise and the speed with which decisions now have to be taken.

The problem is that, in abandoning a system in which integrated enterprises managed their environments, firms come face to face with contradiction and paradox. How can they work with different cultures, experiences and values, while yet retaining their sense of self? How can they reconcile their commitment to their principles with the need to adapt their management styles and ways of doing business to each local context? How can they empower partners and other 'stakeholders' (including their own employees) to grasp opportunities without causing chaos? How can they share without risking exploitation or be open to influence without compromising their

principles? How can a firm achieve planned change when it lacks full control of its business? How can partners share 'visions' when they see things differently and see different things?

So far, most firms have ignored these dilemmas and treated partnerships in much the same way as acquisitions. They have partnered to strengthen their defences and concentrated on ensuring their partners are the right size and shape to be bricks in their battlements. They have failed to recognize that each brick dreams of being a castle in its own right and the essence of the partnering structure is not the bricks but the mortar which both separates and unites them.

Some have argued that to confine the partnering model to a purely defensive deployment is to deny its true potential and significance. Joseph Badaracco[4] describes the autocratic management style of post-war US companies as a creature of the medieval 'Citadel Paradigm' which must now be replaced by what he calls the 'City-State Paradigm' of Renaissance Italy:

> Against the broad sweep of the history of commerce and business organization, companies as citadels – clearly defined zones of ownership and control, surrounded by market relations – are the anomaly.

Others have predicted that partnering will emerge as the dominant strategic model in rapidly changing environments. Catherine Alter and Jerald Hage[5] argue that 'multi-lateral arrangements, among diverse organizations that band together to produce a single product', are emerging as a major new form of enterprise, because they adapt much more quickly and creatively to changing technologies and markets.

So business leaders have a choice – apply traditional management principles to the new partnership enterprises and risk disintegration or find ways to collaborate without control and risk chaos. Given the complexity of modern business environments, however, the fading of old frontiers between markets and industries, the emergence of the virtual 'marketspace' where partnering is endemic and the incessant struggle for competitive advantage, there is really no choice at all, because very soon 'going it alone' will cease even to be an option.

For all sorts of reasons, to do with technology, competition, politics and access to resources, it is becoming imperative in more and more industries to seek new knowledge and capability through partnering. It is the only way

to operate in the marketspace; it is fast becoming the best way to operate in an increasingly competitive and liberal marketplace, and it is the only way to detect and respond quickly enough to the wishes of increasingly diverse and capricious customers.

We will demonstrate in the next chapter, however, that this surrender of control is not necessarily a flight to chaos and destruction. Systems can be under control when no one is in control. The point is illustrated by the surprising similarities between the choice faced by air traffic controllers, as they try to add capacity to over-crowded air corridors, and the choice companies have to make between acquisition and partnership.

At present, air traffic controllers manage one segment of airspace each and 'hold the picture', by mentally adding vectors to their radar screens, with data on speed, headings and rates of descent or climb gathered by communications, navigation and surveillance (CNS) systems.

The only way to add to this system's capacity is to slice the air corridors into ever smaller segments. But because human controllers can only handle a limited number of aircraft at once, and spend a lot of their time managing the handovers into and out of their own sectors, this strategy is subject to diminishing returns and is now close to its limits on the busiest routes (hence the increase in delays and so-called 'stacking').

Everyone recognizes that the solution to the problem is to get computers to 'hold the picture' and have the controllers and pilots manage by exception. Computers can process data much more quickly than human beings can and thus reduce the 'separation' between aircraft deemed to be 'safe' closer to the physical limits imposed by an aircraft's wake and inertia.

There are two possible architectures for a computerized ATC system: ground-based central processing (a computerized version of the present system) or airborne, distributed processing, where aircraft get CNS feeds, communicate with each other and organize their own separation. This system is known as 'free flight' and airlines like the idea because it would be cheaper than a ground-based centralized system and would give them more flexibility and more control over their own costs.

Free flight is alarming for regulators, however, because safety is and must always be their paramount concern and it seems to fly in the face of basic prudence to abandon their central control and put the safety of passengers in the hands of some alleged, self-organizing process that emerges from the interactions of self-guided aircraft. Tests and simulations have shown that

free flight works, but a major, psychological barrier stands between it and widespread acceptance, both by the travel industry and the politicians who will ultimately have to sanction it.

The same fear of losing control stands between the partnering strategy and its widespread acceptance as the 'first choice' strategy for assembling the skills and resources needed to enter new markets. Since the evidence shows most acquisitions destroy value for acquirers' shareholders, acquisition must be seen as very risky, but it is not hard to see why, at the time a choice has to be made, it often seems to those making the choice to be much 'safer' than partnering.

But sometimes there is no choice.

Partnering purposes

The inspirations of partnerships are legion, but the strategic drivers that frame and inform the decision to partner can be classified under six main headings.

Technology

Partnerships were a common arrangement for exploiting new technologies long before James Watt and Matthew Boulton joined forces in the 18th century to develop and market Watt's separate condenser steam engine.

In modern times similar partnerships between innovative small companies and large companies strong in marketing and channels were being advocated as alternatives to licensing agreements at the height of the microelectronic revolution in the mid-1970s (Hlavacek et al.)[6] and a decade later, such David and Goliath partnerships were being proclaimed as a good way for small, high-tech firms to establish themselves abroad (Berlew).[7]

The way in which technological advance erodes traditional industry barriers also provides a powerful partnering impetus. AT&T, Motorola, Philips, Sony, Apple and Matsushita, for example, buried the competitive hatchet to become co-investors in General Magic, a small software firm that had established a lead in so-called 'personal intelligent communication' systems (Yoshino and Rangan).[8] Similar relationships are common in the modern pharmaceutical industry, where small firms lead in the development of gene therapies.

Strategy

Although the exchange of skills and resources and the desire for access to distant markets remain important inspirations, the case for partnering has since become much wider.

It has been promoted as a suitable response to periodic plate shifts in the world economy, such as the dissolution of the Soviet bloc, the integration of Europe, the opening up of China, the internet revolution, the globalization of markets, the convergence of consumer needs (Ohmae)[9] and as a useful tool for corporate re-structuring. In one variation on the last theme, a company sells a minority stake in a non-core business and forms a temporary partnership with the buyer by promising to sell the rest later. This allows a buyer to get to know the business it is buying more intimately than would otherwise be possible before paying the full price and offers a seller the chance to add value to the rest of its equity by ensuring a smooth, jointly managed transfer of control (Nanda and Williamson).[10]

Value chain optimization

Another theme of modern partnering is the idea that if traditional, market-based relationships between suppliers and buyers were transformed into more intimate alliances, both parties could benefit.

The idea was first promoted as a way to control a value chain that avoided the problems associated with vertical integration. It was cheaper and less risky, it was argued, to partner with, rather than buy, suppliers and, moreover, much could be learned from distributors about the needs of customers (Narus and Anderson).[11]

The argument was later generalized into a prescription to form value-adding partnerships (VAPs), groups of independent firms that collaborate to manage flows of goods or services along value chains. Johnston and Lawrence[12] described how McKesson, a US distributor of drugs, healthcare products and other consumer goods, was driven to develop a VAP by the business the major drugstore chains were taking from the independent stores McKesson served.

Some saw the interest in value and supply chain management as a recognition of the merits of the Japanese keiretsu (business society) system (Ferguson).[13] Others suggested western firms had already gone beyond the

keiretsu and developed a new form of enterprise in which groups of companies (linked together in umbrella networks, through different kinds of alliance, ranging from formal joint ventures, to loose, informal collaborations) coalesce and compete with each other.[5,14]

Politics

Political institutions and government agencies sometimes act as sponsors or catalysts of business partnerships. Japan's Ministry of International Trade & Industry (MITI) was an active sponsor of the successful attacks of Japanese companies on several major world markets over the past two decades and the European Commission was a promoter of both the Prometheus and GSM standard-setting projects.

Some have even argued that national and regional governments can and should sponsor partnerships between local companies, to 'organize' competition and thereby avoid suicidal head-to-head confrontations in world markets (Urban and Vendemini).[15] The 1996 agreement between Japanese and European microchip makers to 'organize' world trade in semiconductors was billed as a private sector initiative. It was known, however, that the European Commission and MITI approved of and helped arrange the meetings of representatives of NEC and Toshiba of Japan, Siemens of Germany and the Franco-Italian group, SGS-Thomson, that agreed the pact.

Setting standards

Partnering is also being increasingly used by groups of competing companies to establish or promote technical standards, such as the VHS video standard and Europe's GSM digital mobile phone system.

The commercialization of the internet is producing scores of such alliances and special interest groups. In wireless data (accessing online sources of data, such as the internet, through a mobile phone), Ericsson, Matsushita, Motorola, Nokia and UK handheld computer company, Psion, formed the Symbian partnership to promote Psion's EPOC operating system. In 1998, Ericsson, IBM, Intel, Nokia and Toshiba formed the 'Bluetooth' special interest group to promote a specification for cheap wireless communications and networking between PCs, mobile phones and other portable

devices and later recruited 3Com, Lucent, Microsoft and Motorola, plus over 1,000 smaller firms, to the Bluetooth cause.

The e-partnering imperative

Although there has been a handful of major acquisitions within the internet and e-commerce sector, there have been literally thousands of partnerships, joint ventures and other kinds of alliance. Indeed, it is fair to say that, by the beginning of the year 2000, partnering had firmly established itself as the dominant strategy for growth and market development in e-business.

There are several reasons for this. First, e-business is a far higher speed business than conventional business and partnerships can be formed far more quickly than acquisitions can be completed. Second, speed is vital in e-business, because Metcalfe's 'law of networks', which says the value of a network varies according to the square of its size, gives first movers a huge competitive advantage. Third, because the e-business environment is more volatile and much less predictable than that of conventional business, inter-firm e-business collaborations must be more provisional. Acquisitions lock companies into relationships. Partnerships are intrinsically temporary and can be abandoned much more easily when they cease to be beneficial. (You may find the checklist at Appendix A useful in stimulating discussion around which strategy best suits your circumstances).

Conventional prescriptions

It is one thing to be convinced of the merits of a partnering strategy and quite another to realize its full potential. For although the prospect of outstanding results from synergy and co-creation may be the inspiration for many partnerships, the experience is, all too often, of defensive behaviour and scepticism, leading to conflict and failure. Research by A. T. Kearney suggests that 50 % of strategic alliances and as many as 80 % of supply chain partnerships fail to add value.

It is not clear, either from the literature or from the graveyard of failed alliances, why the mortality rate is so high. Explanations vary, the critics disagree, injured parties lick their wounds in private and sceptics see the failures as evidence that the whole idea of partnering is flawed. Without a proven model for diagnosing partnership failures, observers have had to put them down to ill-defined objectives or cultural conflicts.

There is no shortage of advice as to what can and should be done to improve partnerships. Numerous books and articles have been published with lists of principles for identifying and remedying partnership ailments.[16,17,18,19,20] The experts have emphasized the importance of compatible values and visions, co-operative management styles, knowledge sharing and trust. This is all in tune with the perceptions and experiences of many involved in successful partnerships, but it is hard to disentangle cause and effect – to decide whether partners that apply these principles do so because they happen to get on or whether they get on because they have applied the principles.

Experts assume good principles produce good practice but they cannot prove it and it is often hard to escape the suspicion that the prescriptions stem more from the widespread belief that all organizational problems must have organizational solutions than objective observation. The prescriptions are essentially technical. Relationship issues are treated as problems to which there are generally applicable solutions. There is so much of this kind of advice about, and it is being applied with such enthusiasm, that it is easy to forget it all assumes the relationship is good in the first place.

It is important to choose partners carefully, of course, but trust cannot be guaranteed; it may or may not develop. Most partnering 'gurus' assume ideal relationships as a starting point for their prescriptions that are in most cases impossible to aspire to, let alone achieve. If all they can say when two or more very different corporate cultures come together to pursue joint objectives is that conflict is bad and harmony is good, they can say little that is of much practical use to most real partnerships.

Partnership enterprise

The new model of partnership enterprise that is emerging in the e-world and in some conventional industries too is very different from the conventional multi-unit enterprise and requires a different set of operating principles.

Managers realize that the old, integrated structure, with its hierarchy and functional silos, must be replaced by flatter, process-based architectures, extending beyond their corporate boundaries. But the new architectures have a style requirement. They demand a loosening of control systems, within and between firms, and this has brought issues of understanding and

perception to the fore which are more complex and more subtle than the issues managers of the 'old school' are used to dealing with.

The problems companies encounter in partnering are special cases of general management problems associated with relationships within as well as between organizations. Even organizations that have shunned the partnering strategy must confront the effects of downsizing on employer–employee contracts, the dilemmas associated with the desire to empower people, while continuing to control them, and the perceived need to formulate grand visions and develop winning strategies at a time when today's assumptions are so often belied by tomorrow's events.

Managers accept the need for new enterprise forms, with flat, or horizontal shapes, but there is as yet little understanding of the implications of the new architectures for management systems and styles. Enterprise shapes have consequences for management philosophies. You cannot change one without the other. Much that is sensible and valuable has emerged in the literature in recent years about the need for 'empowerment' and the role of leaders. But most of it is based on an outdated philosophy of management that misses the central point about organizations and enterprises: that they must continue to operate effectively, despite the fact that opinions about how things are and what should be done will always differ.

Even if harmony were useful in business relationships, it is not available these days and there is good reason to believe that attempts to achieve it can be harmful. The search for harmony to reduce conflict and promote trust in relationships is the wrong solution to the wrong problem, because if we insist on seeing all partnering problems in terms of trust and conflict, we must accept that they can never be resolved. We will have more to say about trust and conflict at the end of this book. That is where they belong. They are epiphenomena – consequences, not causes.

Trust, although to be hoped for, cannot be an expected precursor to partnering in a world in which prediction of any kind is, at best, superfluous and often downright dangerous.

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