

Strategic alliances: The control–trust dilemma

The airlines Air France/KLM, Delta and Alitalia jointly operate an alliance with gross revenues of \$10 billion. The alliance is based on an extensive contract that stipulates precisely the costs and revenues that are shared, which activities are part of the alliance and which are not and the responsibilities of the partners. A well-defined contract is not the only source of the alliance's success. The organizations involved have a long history of collaboration between them, have invested in personal relationships and have implemented a governance structure to manage the turbulence expected in the business of airlines. The alliance partners recognized that the contract could not foresee all future possibilities and, hence, developed a governance structure to guide and initiate change within the alliance.

Even more flexible was German supermarket METRO's coalition involving approximately 50 partners that aimed to build the supermarket of the future. The coalition's legal backbone is a very short memorandum of understanding. Still, the partners to METRO's Future Store Initiative were able to create one of the industry's strongest engines for innovation. The secret? No complex contracts were necessary because METRO selected partners that they knew and trusted. In addition, METRO created a compelling vision for the alliance with clear benefits for all. Consequently, partners were highly motivated to contribute and dispensed with the need for a myriad of complex control mechanisms.

In September 2009, Danone, the French food and beverage company, announced that it would sell its 51 percent stake in its joint venture (JV) with Wahaha, its Chinese counterpart. This sale ended a successful \$2 billion joint venture and a prolonged struggle between the companies. Danone accused Wahaha of breaching their agreement by copying the joint venture in other parts of China and keeping all of the profits. Wahaha claimed that Danone invested in its Chinese competitors, despite the fact that their collaboration was exclusive. For two years, the companies fought each other in court and engaged in extensive mudslinging before reaching what they called “an amicable settlement.”¹

In 2012, BP announced that it intended to sell its 50 percent stake in TNK–BP,² its joint venture with AAR, an investment vehicle owned by three Russian businessmen. The sale would result in BP losing one-third of its production, reserves and profits. The reason behind the proposed sale was a series of conflicts, among others over an attempt by BP to set up a joint venture with the Russian gas company Gazprom. According to AAR, this attempt represented a breach of their confidential shareholder agreement, which stipulated that such a deal should have been concluded via TNK–BP. The Gazprom deal fell through and TNK–BP’s British chief fled the country in fear of his safety. The dispute did not end there. The relationship soured and another deal by BP with the Russian state-owned oil company Rosneft to explore oil in the Arctic was contested in a Swedish court and halted. In the meantime, the joint venture became ungovernable after one of the Russian businessmen resigned from its board. During and after difficult negotiations involving Russian President Vladimir Putin in early 2013, the joint venture was sold to Rosneft for €40 billion. The secret shareholder agreement and the less than transparent Russian oil sector make it difficult to judge which party was wrong or right; regardless, significant interests were clearly at stake and the conflict did not help anyone’s business.

These four examples are of high-profile alliances. The last two show that even financially successful alliances may falter. More importantly, the examples show that owning a majority or 50 percent of the shares does not mean that a company is in control of its joint venture. The behavior of the partners (do they or do they not adhere to the terms of the contract?) and other contractual provisions (did Wahaha have the right to imitate the joint venture? Was the collaboration between BP and AAR exclusive?) are also very relevant elements of the joint venture structure. In fact, in these cases, these elements completely overrode the shareholding arrangements. The lesson is that the formal elements in the design of an alliance are not sufficient to ensure good governance; the predictability of the partner’s behavior must also be considered. METRO built

on this insight by aligning itself only with trusted partners. Air France/KLM recognized that alliances were more than contracts and, for that reason, invested in personal relationships. A good alliance design takes into account all such hard and soft elements.

However, balancing the hard and soft elements is a challenge. Because partners do not always behave in the manner desired, control mechanisms must be implemented. Too many control mechanisms make the alliance inflexible and smother creativity. Too few control mechanisms may undermine the clarity of the direction of the alliance and open up space for partners to behave in a manner that benefits their own interests, which damages the alliance. These cases show that alliances with many control mechanisms can be successful (the airlines) but may also fail (TNK–BP). Few control mechanisms and high reliance on trust (the Future Store Initiative) may result in success but leave the partners vulnerable to opportunistic behavior by their collaborators. Therefore, the key dilemma in designing alliances is balancing trust with control. Given specific circumstances, what is the right equilibrium between these two? Designing successful alliances requires answers to this question.

Why is alliance design relevant?

Alliance design is relevant because alliances have become a standard to organize businesses. An alliance represents a collaboration between at least two independent organizations aiming to achieve a competitive advantage that each cannot achieve on its own. An alliance is characterized by joint goals, involves some form of sharing of revenue, costs and risk between the partners, provides for joint decision making and is based on open-ended or incomplete agreements.³ These open-ended agreements are an important characteristic of alliances. Standard purchasing contracts are “closed”: company A delivers to company B a fixed number of products at a certain price. In alliances, closed contracts do not exist, and alliance contracts are open ended: they do not specify what each partner must do in every conceivable situation, simply because doing so is not possible or is too expensive.

Implied in this definition of alliances is that many forms of alliances exist. A basic distinction is between equity alliances and contractual alliances. Equity alliances involve a shareholding arrangement, which can be a minority share of one company in another, a cross-shareholding or a joint venture, which is a separate legal entity in which two or more companies hold shares. However, most alliances are contractual and the diversity of contractual

alliances is probably as significant as the number of alliances itself. In fact, this diversity shows the strengths of alliances and one of the major reasons for their popularity: each agreement can be perfectly customized to the specific needs of the partners. Simultaneously, typical alliance forms have emerged in practice, the most important of which are discussed in this book.

The increased importance of alliances has been documented extensively. In 2007, companies entered into 12 new alliances, and by 2011 that number had risen to 18. The total number of alliances has increased to such an extent that, in 2011, companies reported that one-third of their market value depended on them.⁴ The 2012 IBM CEO study found that almost 70 percent of CEOs partnered extensively.⁵ For the 21st century organization, having a smooth-running internal organization is no longer sufficient. Its external relationships also need to be effectively organized.

The reasons for the increase in alliances are the usual suspects. The speed of technological development has two effects. First, a company may no longer want to commit resources to only one technology because it runs the risk of betting on the wrong horse. Spreading risk through alliances makes more sense. Second, the existence of numerous technologies makes keeping track of all of them impossible, even for the largest organizations. Gaining access to these technologies through alliance partners enables companies to learn from others and, if necessary, integrate those technologies into their products. Increased competition is another reason for entering into alliances. By combining resources, companies may be able to face greater competition. Competition also forces companies to be world class in only a few products or services, and complementary products and services may be obtained through alliances. Customer demand is another driver of alliances. Customers are not primarily interested in the individual products offered by large IT companies such as SAP, Oracle, Microsoft, HP, IBM and Cisco. Instead, they want those products to work together in coherent solutions. For that reason, these companies have established alliances that ensure that their products are compatible. Alliances do not stop there. They also enable companies to jointly bring these products to market. Internationalization is also a driving force for alliances. Demand arises in a variety of markets across the globe, and entering markets on one's own is not always possible or desirable. Local partners are often instrumental to gaining a foothold in a new country. Finally, the alliance revolution has dynamics of its own. Companies develop new techniques for alliance management; they learn from one another and, in so doing, discover new opportunities for alliances.

Creating and maintaining alliances

Alliances help companies to realize numerous goals such as efficiency increases, access to new markets, hedging risks related to innovation, standardization and gaining market power. However, each of these opportunities requires a different form of alliance organization based on the specific goal of the alliance. The alliance lifecycle approach shown in Figure 1.1 ensures that alliances fit with a company's strategy and shows where alliance design fits in the overall alliance process.

Organizations need to define how alliances can help realize their business strategy. They need to clarify the areas of their strategy for which they want to use alliances over other mechanisms such as mergers, acquisitions or internal investments. Next, organizations need to determine the desired alliance portfolio. How many alliances are needed, in what areas and what resources will be committed to them? What are the most desirable alliance structures for the company? Are loose, short-term alliances called for or are long-term arrangements with a high level of integration between the organizations preferred? Based on these decisions, the partner selection process begins by seeking potential partners and selecting them. This process leads to a deal and an alliance business plan. This process also involves setting the vision, mission and strategy for each particular alliance. The partner selection phase usually ends with a contract. The alliance design brings all of the elements together; based on the

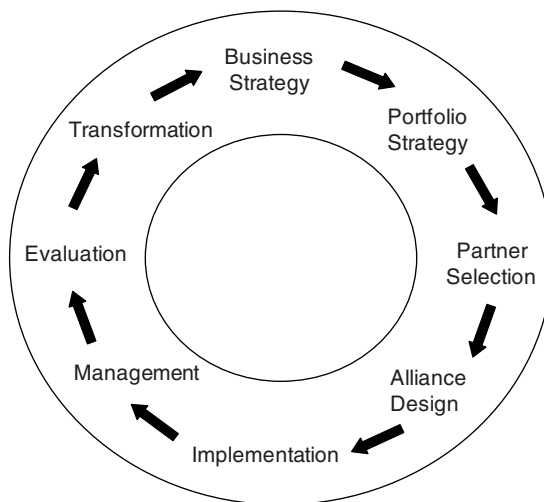


FIGURE 1.1: The alliance lifecycle

goal of the alliance and the business plan, a structure and governance process is developed that should be implemented in the next phase. After implementation, the alliance becomes operational and moves into the phase of day-to-day management. Day-to-day management does not imply that the alliance structuring is complete. Because of the open-ended nature of alliance contracts, all aspects of an alliance's operations must be regularly evaluated. The outcome may be that the alliance needs to change. A new alliance structure may be necessary to support further growth or to wind down after its objectives are achieved or the benefits fail to materialize. Both of these outcomes are relevant inputs for refining the business strategy.

Of course, this process is messier in practice. For example, in the partner selection phase, partners usually discuss the alliance design at a high level. Alliance design permeates the alliance lifecycle. Companies need to be aware of all of the possibilities for alliances in the early strategy-setting phases. The choice of partner may also affect the alliance design. For example, that companies entering into a second alliance with the same partner write contracts that are substantially different from their first alliance contract is a well-established fact.⁶ This practice is rooted in the fact that companies get to know one another and are able to fine-tune contracts more to the specific partner situation that they face. In later phases of the alliance lifecycle, changes in alliance structures are very common; therefore, an existing alliance design requires regular monitoring and maintenance. Thus, alliance design is integral to all alliance-related activities.

Control versus trust

Following from the definition of alliances, alliances face a number of specific challenges that a good alliance design must overcome. These challenges, which make alliance design different from the design of internal organization structures, are as follows:

- **Absence of hierarchy.** Companies have a chief executive officer (CEO) who ultimately has full control, whereas alliances are comprised of at least two companies that have to make decisions together. No single authority sits above these companies. Instead, the companies mutually depend on one another when decisions have to be made.
- **Dynamics.** Of course, organizations operate in a changing world and dynamics always affect any form of organization regardless of whether it is an alliance. However, the key point is that changes in the business environment will affect partners in an alliance differently. One partner may gain, whereas

the other may lose, which may create tension in an alliance. A solid alliance design is able to cope with such tensions.

- **Open-ended contracts.**⁷ Because of the space inherent in open-ended contracts, mechanisms need to be devised to manage the gaps. Joint decision making is imperative. However, lying behind that is also an attitude to compromise, to be flexible and to live and let live. A good alliance design fosters such an attitude in both partners and makes partner behavior predictable. The open-ended nature of an alliance contract is both an opportunity and a threat. The opportunity is that it enables the partners to deal with the dynamics in a much more flexible way than when a contract is set in stone. The Future Store Initiative is a great example of this opportunity. Its open design greatly enhanced creativity. The threat lies in the fact that partners' needs and interests are seldom perfectly aligned. At any point in time, one partner in an alliance may see an opportunity to advance its interest at the expense of its partner. The Danone–Wahaha break-up is a case in point.
- **Temporal nature.** Alliances tend to be temporary. Figure 1.2 shows the average alliance lifetime in three industries. In each of these industries,

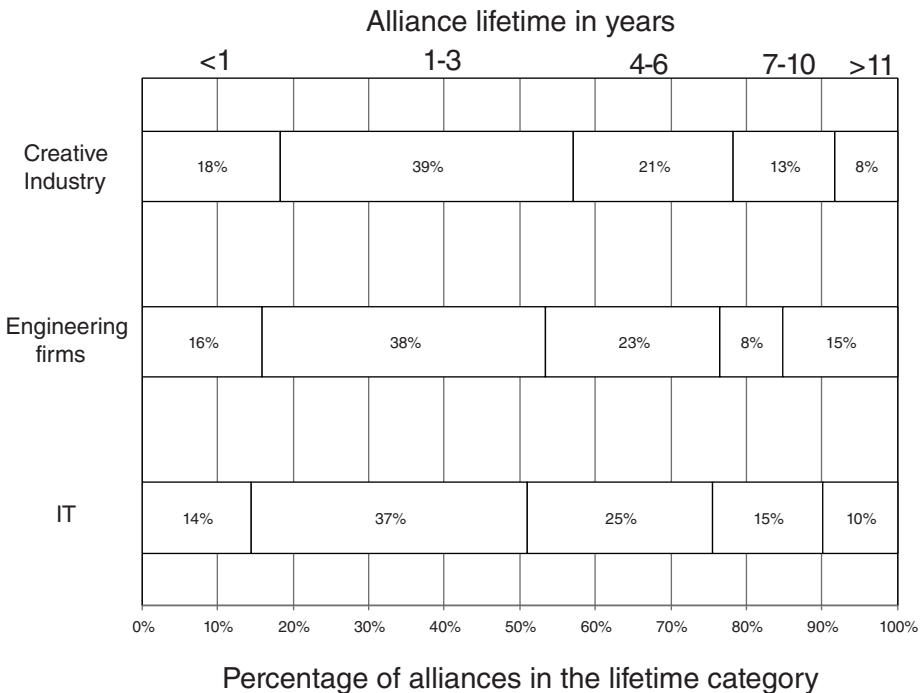


FIGURE 1.2: The average lifetime of alliances (2012)⁸

more than half of the alliances did not exist for more than three years, and three-quarters of the alliances did not make it past a six-year lifetime. Because alliances can be disbanded when they no longer serve their purpose, they can become self-defeating: they may be set up to benefit from a temporary opportunity, but the temporary nature of the opportunity may cause companies to avoid committing the required resources. In addition, a fear of the alliance being disbanded may prevent companies from entering into them altogether. For example, that certain customers are hurt by the end of an alliance or that certain patients no longer receive treatment in the case of health care organizations are real threats. However, good exit provisions can usually remedy such situations and need to be incorporated in the design of an alliance.

- **Company differences.** Companies' differences in structures and cultures need to be bridged in an alliance. Eliminating these differences is usually not feasible, but processes can be implemented to manage them. In the alliance between Sara Lee/DE and Philips, the corporate structures were an obstacle. Sara Lee/DE's organizational structure was based on geography, whereas Philips had product divisions. The companies implemented specific mechanisms that worked around the obstacles. The horizontal collaboration between the partners therefore did not suffer from the vertical pressures inside each of the partners.

These alliance-specific elements must be taken into account when designing an alliance. A variety of mechanisms can be implemented to address these elements. Think about decision-making procedures, conflict resolution mechanisms and the use of communication structures. The next chapter discusses the building blocks of alliance design in greater detail. These building blocks are not standard: each can be implemented in a variety of ways. Each alliance has its own unique structure, which is why some alliance managers claim that "if you have seen one alliance, you have seen one alliance." Even though this statement is true, concluding from it that nothing more can be learned from studying individual alliances is a mistake. This statement clearly does not carry that message. Although each alliance is unique, many common characteristics exist among alliances to allow us to learn from them.

For example, to address the specific characteristics previously mentioned, companies can adopt one of two basic approaches when designing their alliances: the control view and the trust view. Table 1.1 summarizes the two views by reviewing the assumptions behind each view, how they define the key challenge for alliance design and their effect on the prescriptions provided for how alliances should be designed.

TABLE 1.1: The control and the trust approach to alliance design

	Control	Trust
Alliance assumption	• Partners look out for their own self-interests • Conflicts of interest are likely to arise	• Partners benefit from a common interest • Joint growth and development ensure long-term alignment
Alliance design challenge	• Prevent opportunism	• Build social capital
View on alliance design	• Target driven • Value appropriation • Rule based; detailed contracts • Extrinsic motivation • Strong senior management control	• Vision driven • Value creation • Principle based; norms and values • Intrinsic motivation • Senior management as coach

The control view:⁹ taming opportunism

The control view makes the assumption that partners in an alliance join the alliance because of their self-interest. Therefore, they will see the alliance as a vehicle to promote their own good, without much regard for their partner's interests. The most important challenge in designing alliances is to create safeguards against opportunistic behavior. This view of alliances was epitomized by a controller of a pharmaceutical company, who described his job in an internal alliance conference as: "I am here to protect us from our partners."¹⁰

Opportunism in alliances may come in different forms. Often, such actions are small, such as investing slightly less time than the partner does, thus shifting some of the burden to the partner. Sometimes such actions are significant, as in the case of Danone and Wahaha. This view of alliances underlines American writer Ambrose Bierce's definition of an alliance in international politics from his notorious *Devil's Dictionary* as "the union of two thieves who have their hands so deeply inserted in each other's pockets that they cannot separately plunder a third." The possibility that a partner will engage in opportunistic behavior and free-riding based on self-interest defines the control view of strategic alliances.

When designing an alliance, this view leads to an emphasis on using formal mechanisms in alliance design. The first element is defining commonly agreed on targets with a partner to ensure that both partners are on the same page regarding what they want to achieve. Making these targets measurable is the

first safeguard against conflicts of interest. Clear definitions of targets is important, and an extensive planning and control system that measures deviations from the plan, reports progress and highlights areas for improvement directly follows the target-setting process. Targets may also be set for the inputs that both partners have to deliver to the alliance to ensure that investments are reasonably shared.

The focus on targets immediately raises the question of how the benefits will be shared once a target is achieved. Control-based alliances tend to have detailed value appropriation mechanisms in place, clarifying exactly which revenues and costs belong to whom. This clarification is achieved by the use of many detailed rules to govern the alliance. Elaborate contracts are implemented to cover as many eventualities as possible. An alliance may be open ended by definition, but the control view sees incomplete contracts as a negative. The contractual space needs to be reduced as much as possible to ensure that – in case of a conflict – the solution to that conflict is completely clear. Senior management up to the board level needs to deal with any remaining space during the course of the lifetime of the alliance. Therefore, senior management is closely connected to the alliance and provides it with active guidance. If necessary, they will even intervene in alliance operations to ensure that the company's interests are well looked after.

To stimulate both sides to collaborate, their targets are connected to bonuses and pay-offs based on alliance performance. Thus, control thinking extends to the individuals that comprise the alliance. People are rewarded when they behave in accordance with alliance targets. In short, alliances highly rely on extrinsic motivation: sticks and carrots guide the alliance in the right direction, not the personal responsibility that someone feels to contribute to the alliance. Structures and systems are in the lead.

The trust view:¹¹ building social capital

Whereas the control view departs from the self-interest of partners to join an alliance, the starting point for the trust view is common interest. Although two sides of the same coin, the implications for alliance design are profound. The shift in focus from conflict prevention to joint growth entails a completely different view on alliance design. As long as partners are able to identify new opportunities for growth and development, partners' interests will be aligned and the collaboration should be stable. To continuously identify these new opportunities, companies must get to know each other, be willing to share their

ideas and insights openly and foster a dynamic culture in the alliance. Doing so requires a high level of social capital; that is, people need to know and trust one another. In the trust view, the challenge is to design an alliance that fosters the social bonds between organizations that are needed to build that social capital.

One way to build these bonds is by developing a joint vision for the alliance. Rather than setting narrow targets, the concept is that companies discuss a broader set of issues when creating a joint vision than when limiting themselves to merely setting targets. Developing the vision for an alliance demands that organizations exchange their views on long-term developments in their market and how the alliance fits into those views. These discussions enhance mutual understanding and provide greater certainty to a partner's intentions, thus reducing the chance that a partner takes unexpected actions.

The emphasis on growth and development also leads to an emphasis on value creation. By learning and innovating, an alliance can continue to add value to its partners. The well-known distinction between sharing and growing the pie applies. In the control view, the emphasis is on sharing the pie; in the trust view, the emphasis is on growing the pie. If the partners can ensure that the pie continues to grow, a natural incentive exists for partners to stay in the alliance and to avoid behaving opportunistically and killing the goose that lays the golden eggs. Sufficient value is created for everybody to earn a living.

Because too many rules stifle innovation and creativity, trust-based alliances do not define detailed regulations for what should happen under certain circumstances. Instead, they focus on behavior, such as how the partners should behave when something happens that requires their joint attention. In the design of alliances, such an approach leads to an emphasis on norms and values that support mutual adjustment. An increasing number of alliances implement codes of conduct to that effect. Instead of detailed rules, the concept is that an alliance is more flexible when it is based on certain principles that dictate how partners deal with one another, rather than attempting to cover every possible option in a lengthy contract.

This type of thinking also has an effect on the level of the individuals working in alliances. Instead of attempting to align their behavior using targets and bonuses, the trust approach attempts to create a psychological contract with an individual. Through an appealing vision of what the alliance can mean in its market, employees are positively motivated to contribute. Fun, recognition and meaningful work tie the partner companies together through its employees. The

Future Store Initiative had such an appealing vision: building a supermarket of the future that made room for a variety of new ideas and experiments generated energy in the partnering companies and their employees. The project was fun to work on.

If an alliance succeeds in building social capital in this way, elaborate planning and control processes are not needed. When both sides to an alliance automatically do what is in their joint and individual interests, the alliance should run smoothly. Senior management involvement can be limited to a coaching role. For example, they can help remove barriers to the alliance or think along with alliance managers about next steps.

In short, the trust approach builds on the informal elements of alliance design. It is able to do so given the emphasis on growth and development that should guarantee that the alliance is not only beneficial to the partners at its inception, but also continues to add value over time.

Balancing control and trust

Obviously, the previous description is somewhat black and white in nature. Many shades of gray exist in between. However, that all alliances end up in the middle is certainly not true. In fact, some alliances clearly depart from one perspective and have completely different alliance designs than when the opposite point of departure is taken. A clear difference exists between, for example, the KLM–NWA alliance discussed later in this book in which the control view is predominant, and the primarily trust-based Future Store Initiative.

Both alliance types are successful. Control is not necessarily better than trust or vice versa. Some people have an instinctive preference for one or the other. Accountants and lawyers tend to like the control approach; entrepreneurs usually have a preference for the trust approach. However, the real issue is to find the right design in the right situation. Thinking that everyone will always be intrinsically motivated to contribute to an alliance is as equally naïve as believing that having a good contract in place will in itself ensure the success of the alliance. The point is to custom design an alliance.

Control and trust may strengthen each other. A discussion about all of the issues that may call for greater control can help strengthen the understanding between the partners. Clarity on each other's perspective regarding the alliance may help build trust.¹² Trust may make it easier to share concerns and, as a result, formal

rules may be agreed on to alleviate these concerns. In this way, trust may strengthen control. The concepts of control and trust may be intuitively clear but their practical application is less straightforward.

Each approach has its limits. Although having a high level of trust may sound ideal, the downside may be that the attention paid to the goals of the alliance may diminish when a partnership becomes too intimate. Groupthink may lead alliance partners to ignore or downplay changes in the environment, putting the alliance at risk. A formal control mechanism ensures that alliance partners ask the right questions about their business and help maintain their focus on the goals. In contrast, placing too much emphasis on control may undermine employees' identification with the alliance and the mutual adjustments necessary for effective alliance operations. Processes, procedures and contracts do not make an alliance. People need to be willing to invest in the alliance, which requires that they form a psychological bond with it. When people identify with the goals of the alliance, the alliance will operate more smoothly.

The cases presented later in this book show that defining the conditions that determine whether control or trust is called for is possible. For now, each approach clearly has its limits. An overly heavy emphasis on control will reduce flexibility and creativity in an alliance. It may induce people to focus on the rules instead of the goals. Moreover, the costs of governing the alliance will be high. In contrast, significant emphasis on trust may lead to a loss of focus and lower operational efficiency, and may provide no explicit mechanism to correct free riding and opportunism. In an alliance that aims to create economies of scale, trust may be ineffective. In alliances aimed at innovation, control will be counterproductive. Therefore, one of the most fundamental questions that needs to be answered when designing an alliance is: What is the right balance between control and trust given the specific aims this alliance seeks to achieve?

Common mistakes

Many things can go wrong when designing strategic alliances. Some mistakes prove difficult to eradicate. Table 1.2 provides an overview of the mistakes that occur frequently in practice. Each of these mistakes is reviewed.

Lumping lust

The first mistake listed occurs frequently in partnerships with public organizations and is not uncommon in the private sector. Some organizations lump

TABLE 1.2: Common mistakes in designing alliances

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- Lumping lust: adding goals to an alliance, leading to a loss of direction
 - 51 percent fever: the belief that a majority gives control
 - Set in stone: keeping to an agreement that is past its sell-by date
 - Inbox indigestion: communicating through emails and letters, instead of at face-to-face meetings
 - Lack of a joint design: leaving the work of designing the alliance to one of the partners, to a third party or to deal-makers
 - JV junkies: having a preference for joint ventures even if not the optimal form
 - Expertise arrogance: believing that one knows better, even in the area of one's partner's expertise
 - Equity addiction: using equity stakes to create commitment
 - Internal incentives: forgetting to adapt internal incentives to fit the alliance
 - Shaky steering committees: nominating people to the alliance steering committee or alliance board who do not have a stake in the alliance
 - Committee confusion: creating a plethora of committees to deal with any conceivable problem
 - A mess for less: selecting a lower cost governance structure or a faster process, resulting in a structure that does not meet the alliance's need
 - Myopic management: focusing on a governance structure that works well today but is not future-proof
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together many different goals into a single alliance. For public sector organizations, doing so may sometimes be logical because they have a broader responsibility to society and may want to achieve several, possibly contradictory, goals through a single alliance. Because aligning goals on a single issue is often difficult enough, adding different goals makes coming to an agreement almost impossible. Even if agreement is possible, the different goals make governing the alliance difficult because each goal may require a particular balance between control and trust. Therefore, the preferred option is for the same partners to create several independent alliances than a single large alliance with a variety of goals.

51 percent fever

Another common mistake is the notion that a 51 percent stake in a joint venture or having the majority of votes in an alliance gives an organization more influence. This notion ignores the simple fact that it takes two to tango in an alliance. When one partner consistently overrides the other, the other partner will sooner or later start free riding or become unhappy, which may eventually lead to the dissolution of the alliance. Moreover, the 51 percent fever may not be as rele-

vant from another perspective. In the NUMMI joint venture between General Motors and Toyota, GM owned the majority. However, Toyota was not focused on control but on learning about the American car market:¹³ that knowledge proved more valuable than GM's 1 percent advantage. An alliance manager once said, "when the other side demands 51 percent, the alliance will likely be very profitable for us, because that party will give up much knowledge for it to get to that 51 percent." This is not to say that there may be no reason for one partner to have more shares or greater voting rights than others. For example, one partner may have to invest more in the alliance than the other or may be able to avoid tax issues through a higher stake. However, when gaining control is the main reason to demand 51 percent, the alliance is likely to be unstable.

Set in stone

A further mistake is to believe that all agreements are set in stone and that such a situation is correct. The dynamics of alliances imply that any agreement needs to be adapted sooner or later. Holding on to agreements that were developed in different market circumstances may significantly damage an alliance's development. In addition, holding on to an agreement that is clearly detrimental to one of the partners does not make sense, for the same reason as previously explained. The partner will begin to view the alliance negatively and act accordingly. Obviously, starting legal procedures will not remedy the situation. Agreements are necessary and provide a basic framework; however, more important to adhering to a contract is thinking about how changing an agreement will be managed. Contracts may diverge substantially from reality. For example, in the KLM–NWA relationship, the operational integration went far beyond the initial legal agreement.

Inbox indigestion

This is an intriguing phenomenon that reflects the notion that communication with a partner is best carried out by sending emails instead of engaging in face-to-face meetings. Amid the pressure of day-to-day work, this phenomenon may easily occur but usually leads to misunderstandings. Although saying that good communication is a key success factor for alliances is a cliché, the statement is no less true. In face-to-face meetings or phone calls, issues get clarified and resolved much quicker. Experience shows that, in practice, good communication is difficult to realize, despite the fact that everybody recognizes its significance.

Lack of a joint design

Leaving the design of the alliance to the partner, a third party or non-operational individuals is another mistake. The development of an alliance design should always be done by a group of people that includes individuals who will ultimately have to work with the design, for three reasons: knowledge, relationship and speed. Knowledge pertains to the fact that the person who will be responsible for the alliance will need to know why it was structured as it was. That person will likely be knowledgeable about the business of the alliance. Therefore, he or she can bring operational knowledge to the design team, reducing the risk that a design will not work in practice. Second, joint design of the alliance helps develop the relationship between the partners in the alliance. The process that the managers have to go through increases their understanding of each other's business and of each other as individuals. The third and final advantage is speed. When the people in the alliance also help to design it, the speed of implementation will increase because they know what the alliance has to do from day one. Handover from the design team to the implementation team is not needed. Separating people who "make the deal" from those who have to execute it is, without a doubt, one of the worst and most expensive mistakes made in practice, and one of the most common. Frequently, lawyers, business developers or purchasing managers make the deal and then toss it over the wall to alliance managers, which is the perfect recipe for delay, misunderstanding and contracts that are out of touch with reality.

JV junkies

Organizations with little experience in alliances always have difficulty understanding how contractual alliances work. Therefore, they frequently prefer the clarity of joint ventures because at least they understand that they have a stake in something. This choice of a joint venture is a mistake for a number of reasons. First, joint ventures are not usually as clear-cut as they seem to be and that joint ventures are simple is an assumption that is not supported in practice. As a rule, joint ventures require agreements that are as detailed as contractual alliances. Second, joint ventures involve extra costs in terms of investment in shares, reporting requirements and managerial oversight. Contractual alliances also have costs but are usually less expensive during use. Third, setting up a joint venture is time consuming. Particularly in fast-moving markets, the time needed to incorporate the joint venture is time that the partners may not be able to afford to lose. Disbanding joint ventures is also difficult. Contracts are easily disbanded when both partners agree; joint ventures do not fall into this

category because they contain assets that need to be disposed of and people who need to be let go. Although joint ventures may have clear benefits in certain circumstances, they should not be the default choice.

Expertise arrogance

This phenomenon causes a partner to make decisions regarding, or to meddle with, the other partner's expertise. Although consensus decision making is a good practice in alliance management, it should not be extended to the other partner's competences. For example, in an alliance between home appliance producer Philips and coffee producer Sara Lee/DE, the understanding is that Philips decides on the machine, whereas Sara Lee/DE focuses on producing the right coffee mélanges. Clearly, the results would be suboptimal if they behaved otherwise.

Equity addiction

Chapter 6 discusses solid reasons for engaging in equity deals. Gaining extra commitment from a partner is not one of them. If a deal needs to be sealed by an equity investment for only this reason, the business plan is probably not solid enough to solicit automatic commitment. Equity stakes should not be used solely to create commitment. The vision and a sound business plan should be sufficient for that. If a feeling exists that cross-equity stakes are necessary only to increase commitment, the business plan may not be compelling enough.

Internal incentives

By their nature, alliances affect the internal organizations of the partners involved. This aspect of alliances is often overlooked, particularly with respect to governance and target setting processes through which numerous difficulties may arise. For example, a conflict of interest may arise if managers of a company are rewarded based on their sales performance yet the alliance aims to increase the margin of both companies. In that case, managers will dedicate their resources to increasing sales instead of investing in high margin alliance projects. Alternatively, alliance managers from one company may have monthly targets but managers from the other company may be evaluated based on annual targets. Such a situation leads to completely different dynamics. The best approach is to align the internal targets of the managers involved with those of

the alliance. Doing so is not easy because bonus plans and compensation structures within companies tend to be rigid.

Shaky steering committees

The composition of the highest committee in the alliance, the alliance steering committee or alliance board, requires careful attention. Frequently, individuals are nominated for a position on that committee because of their hierarchical status. Alternatively, sometimes individuals on that committee do not have real power to push through decisions in their own organizations. A useful steering committee should include individuals with business and budget responsibility in the areas relevant to the alliance. Although a neutral third person representing the alliance interest may be helpful, a link to the business is a necessity for a steering committee to be effective.

Committee confusion

Committees and working groups in alliances are important design elements. Common problems with these elements include too many committees, making coordination across them impossible; unclear scoping of committees, leading to either overlap or things falling between the cracks; and using ceremonial committees that have no real say in the alliance but are there to please stakeholders. Another problem may occur over time. When an alliance runs into problems, the partners may feel the need to add a committee to solve that problem. Doing so may lead to committee creep and a growing number of committees. Broadening the scope of an existing committee or reviewing and redesigning the committee structure altogether may be a better approach. However, before doing so, the first step is a review of the alliance's strategy and goals to determine whether they are still valid. This approach prevents reorganization without focus on the goals.

A mess for less

Some companies are tempted to reduce costs when designing their alliances in one of two ways. They may opt for a cheaper structure, such as a supply relationship, when a more complex structure would work better. The clearest example is the manner in which American car companies used to work with their suppliers versus Toyota's alliances with its suppliers. Research shows that

the more expensive governance structure that Toyota implements with its partners generates more value in the long run, in contrast to the purchasing attitude that American car companies had in the 1990s.¹⁴ Focusing on cost savings instead of value generation is an important pitfall. Another way to cut costs is to create shortcuts in the partnering and alliance design process, which usually leads to badly implemented deals.

Myopic management

Alliances are inherently dynamic, which is why a good alliance design should facilitate change. However, at the outset of an alliance, the natural inclination of many managers is to organize for the current situation. Such short sightedness may lead to a variety of provisions in an alliance that may work well today but may be irrelevant tomorrow. Therefore, a solid alliance structure involves a clear process for changing and adapting the alliance to new circumstances that were not foreseen at the outset.

Notes

- 1 *New York Times*. 2009. Danone Exits China Venture after Years of Legal Dispute, 30 September.
- 2 *The Economist*. 2012. Twilight for BP in Russia?, 9 June, 58–59.
- 3 Gomes-Casseres, B. 1996. *The Alliance Revolution*, Cambridge, MA, Harvard University Press; Williamson, O.E. 1985. *The Economic Institutions of Capitalism*, New York, The Free Press.
- 4 Duysters, G., A.P. de Man, D. Luvison and A. Krijnen. 2012. *The State of Alliance Management: Past, Present, Future*, Canton, MA, The Association of Strategic Alliance Professionals.
- 5 IBM. 2012. *Leading Through Connections*, IBM Institute for Business Value.
- 6 Ryall, M.D. and R.C. Sampson. 2009. Formal contracts in the presence of relational enforcement mechanisms: evidence from technology development projects, *Management Science*, 55, 6, 906–925.
- 7 Williamson, O.E. 1975. *Markets and Hierarchies: Analysis and Antitrust Implications*, New York, The Free Press.
- 8 These figures are based on unpublished research conducted with Alexander Alexiev, Marc Bahlmann and Brian Tjemkes, all at VU University.
- 9 The theoretical background of this discussion is derived from transaction cost theory, agency theory and industrial organization. For more information, see: Bain, J.S. 1968. *Industrial Organization*, John Wiley; Eisenhardt, K.M. 1989. Agency theory: an assessment and review, *Academy of Management Review*, 14, 1, 57–74; Jensen, M.C. and W. Meckling. 1976. Theory of the firm: managerial behavior, agency costs, and capital structure, *Journal of Financial Economics*, 3, October, 305–360; Williamson, O.E. 1975. *Markets and Hierarchies: Analysis and Antitrust Implications*, New York, The Free Press; Williamson, O.E. 1985. *The Economic Institutions of Capitalism*, New York, The Free Press.

- 10 Thanks to Dave Luvison of DeVry University for sharing this quote with me.
- 11 Sumantra Ghoshal primarily developed the theoretical background of this discussion. For further reading, see: Bartlett, C.A. and S. Ghoshal. 1993. Beyond the M-Form: toward a managerial theory of the firm, *Strategic Management Journal*, 14, 23–46; Ghoshal, S., C. Bartlett and P. Moran. 1999. A new manifesto for management, *Sloan Management Review*, 40, 3, 9–19; Ghoshal, S. and H. Bruch. 2003. Going beyond motivation to the power of volition, *MIT Sloan Management Review*, 44, 3, 51–57; Ghoshal, S. and P. Moran. 1996. Bad for practice: a critique of transaction theory, *Academy of Management Review*, 21, 1, 13–47; Nahapiet, J. and S. Ghoshal. 1998. Social capital, intellectual capital and the organizational advantage, *Academy of Management Review*, 23, 2, 242–266. Stewardship theory also provided some elements for this discussion, specifically Davis, J.H., F.D. Schoorman and L. Donaldson. 1997. Toward a stewardship theory of management, *Academy of Management Review*, 22, 1, 20–47.
- 12 Vosselman, J. and J. van der Meer-Kooistra. 2009. Accounting for control and trust building in interfirm transactional relationships, *Accounting, Organizations and Society*, 34, 267–283.
- 13 Gomes-Casseres, B. 2009. Nummi: What Toyota learned and GM didn't, *HBR Blog Network*, September 1, <http://blogs.hbr.org/now-new-next/2009/09/nummi-what-toyota-learned.html>.
- 14 Dyer, J.H. 2000. *Collaborative Advantage*, Oxford, Oxford University Press.