Is Your Strategic Alliance Really a Sale?

by Joel Bleeke and David Ernst

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Increasingly, senior executives who wish to expand their company's product, geographic, or customer reach consider alliances to be the strategic vehicle of choice. In the past five years, the number of domestic and cross-border alliances has grown by more than 25% annually. But the term *alliance* can be deceptive; in many cases, an alliance really means an eventual transfer of ownership. The median life span for alliances is only about seven years, and nearly 80% of joint ventures – one of the most common alliance structures – ultimately end in a sale by one of the partners.

It's dangerous to ignore the trend. If a CEO does not realize that an alliance will probably end in a sale, he or she may be betting the company without knowing it. If the endgame is not anticipated, what begins as a strategic partnership can lead to an unplanned sale that erodes shareholder value. What's more, since an alliance does not generally receive the same intense public scrutiny that an acquisition or a divestiture does, the board and shareholders may also be unaware of the true risk.

By contrast, an alliance can be a good acquisition or divestiture vehicle if its evolution is planned. That's why thinking through whether an alliance might lead to a sale is critical. Such evaluation can help companies avoid disastrous partnerships and unanticipated sales of important businesses. It can help managers choose corporate partners that will advance their organization's long-term strategic plan. And it can help reveal opportunities in which an alliance may be used as a low-risk, low-cost option on a future acquisition.

Based on our experience with more than 200 alliances in various phases from initial negotiations through termination, we have developed a way for managers to diagnose whether an alliance is likely to lead to a sale and to devise an appropriate strat-

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DRAWINGS BY ELWOOD H. SMITH

egy – to assess bargaining positions and the risks of unplanned outcomes, and to plan for the partnership's evolution. The alliances we've studied span a broad range of industry and service sectors and include 49 strategic partnerships between some of the largest companies in the United States, Europe, and Asia that we have tracked since 1989. Although our experience base includes many types of alliances, this article focuses mostly on situations in which both or all companies bring major business interests to the deal, a separate entity is created (for example, a joint venture), and the partners share risks and financial rewards.

Alliances between competitors with similar core businesses, markets, and skills tend to fail.

Avoiding Self-Deception

The reason senior managers may not take the time to think through the evolution of a planned alliance is that they may already believe they have their company's long-term interests well in hand. They may think their reasons for forging an alliance are grounded in the strongest of strategies. But, caught up in the thrill of the chase or the intensity of negotiations, many managers deceive themselves. If you find yourself uttering one of the following statements, beware! Your alliance may lead your company toward an unplanned divestiture.

"We're better off partnering with X than competing against it in our core business." The strategic flaw here is using "acquisition thinking" rather than "partnership thinking" – choosing partners that are direct competitors rather than complementary allies. Alliances between competitors with similar core businesses, geographic markets, and functional skills tend to fail because of tensions between the partners. Conflicts emerge or intensify as both parties expand into the same markets. In fact, the success rate for alliances involving potentially overlapping core-product markets is only about one in three. (We consider an alliance successful if both parties achieve their strategic objectives and earn a return equal to or greater than their cost of capital over the life of the partnership.)

"By joining forces with another second-tier company, we can create a strong company while fixing our problems together." The idea that two weak companies can combine to form a strong unit is appealing, but such ventures usually fail to strengthen the position of either partner. Instead, the alliance sinks because of the very weaknesses it was supposed to fix. Even worse, should one or both of the corporate parents decide to divest, the partnership can complicate a sale.

"We need a strong partner to improve our skills." Alliances can and should be regarded as opportunities for organizational learning. But when the primary purpose of a partnership is for the weaker company to improve its skills, the venture will usually fail. In such cases, the top-level managers involved have generally not paid enough attention to the business logic of the deal – that is, how the partnership will create value. Often, the partner seeking to learn is unable to contribute sufficiently to the alliance.

"By partnering with another company in our industry, we can access its new products and technologies while minimizing our investments in core products and technologies." This mind-set is common in globalizing industries such as telecommunications, computers, and airlines – or wherever weaker players face declining market share and profitability because of new, low-cost competitors. But using an alliance to compete in scale-driven industries can be a recipe for disaster, especially if the company is trying to replace products or technologies that are critical to its core business. Over time, the weaker company is rarely able to match the stronger company in creating new technologies and products, and the imbalance typically leads to a sale, often for little or no acquisition premium.

"We can use an alliance to raise capital without giving up management control." A venture based on this premise works only if one of the partners is a largely passive investor that does not seek involvement in the business in return for its financial stake. In industries as diverse as biotechnology and steel, when a manager looks to a partner for capital, the deal tends to be unbalanced from the start. In effect, the weaker partner sells its capabilities in return for capital. Moreover, that partner is generally forced to reduce its stake over time because the stronger partner must fund future investments.

Assessing Risks

The key to understanding whether an alliance is likely to lead to a sale – and which company is the likely buyer – is to project how the relative bargaining power of the partners will evolve. Relative bargaining power depends on three factors: the initial strengths and weaknesses of the partners, how those strengths and weaknesses change over time, and the potential for competitive conflict.

Initial Strengths and Weaknesses. Ask yourself the following questions: What specific business strengths – such as products, technologies, market access, and functional skills – does each partner have, and which of those elements is most important for the venture's long-term success in the marketplace (for example, blockbuster drugs in pharmaceutical alliances)? Which partner controls the customers that will be served by the venture? Which company will fill more of the venture's top management positions? Which partner is more able and willing to invest in the alliance, based on profitability, cash on hand, and the strategic importance of the business?

Those starting positions determine the value of the bargaining chips that each partner brings to the table. When the balance of power is tilted from the start, the stronger partner is usually the eventual owner. In the alliance between Meiji Milk Products and Borden to sell premium dairy products in Japan, Meiji originally controlled the relationships with the retail outlets, and Borden supplied the products. When the partnership was phased out between 1990 and 1992, Meiji retained control of the distribution and manufacturing facilities and introduced its own products in the premium ice cream, cheese, and margarine segments. Borden subsequently exited the Japanese market after its sales and market share declined.

How Strengths Change over Time. Even if bargaining power is balanced at the outset of an alliance, strengths may change within a few years, creating a massive shift in bargaining power and leading to an unanticipated sale. In the initial stages of industry development, for example, the product and technology provider generally has the most power. But unless those products and technologies are proprietary and unique, power usually shifts to the party that controls distribution channels and customers. And if the industry becomes a scale-driven commodity business, the key to success becomes process-design capabilities. Consider what happened to a U.S. chemicals company – a world-class producer of industrial coatings – that formed an alliance with a Japanese organization. After a few highly successful years of alliance, the Japanese company proposed a buyout. It had learned the production-process skills originally supplied by the U.S. organization, and it still controlled the relationships with key customers. The U.S. company had no choice but to divest.

Other factors also contribute to shifts in power. For one, partners that put most of the senior managers into the key functions of an alliance are likely to see their strength grow even if they start out as shareholders with a minority equity stake. For another, the ability to invest in an alliance over time often becomes increasingly important after the deal is done; the parent that invests more usually gets greater decision-making power and an increased equity stake. The parent's relative capacity (and appetite) to invest is especially important because alliances generally require more capital than planned for: if the alliance is successful, capital is needed to expand; if it underperforms, capital is needed to meet shortfalls in cash flow.

Finally, bargaining power is strongly affected by the balance of learning and teaching in an alliance. A company that is good at learning – and that structures the alliance in such a way that it can access and internalize its partner's capabilities – is likely to become less dependent on its partner as the alliance evolves.

Potential for Competitive Conflict. When direct competitors whose product and geographic positions overlap try to forge an alliance, conflict is inevitable. Often the parties will reach a stalemate on important issues, such as which markets to target, which products and customers to emphasize, or whose factory to close. To resolve the conflicts and capture the benefits of scale in such cases, the partners usually move toward complete integration by a full merger or an acquisition – or they simply dissolve the alliance.

In contrast, the potential for competitive conflict and the risk of an unanticipated sale are minimal when each partner brings distinctive qualities to the table – for example, different geographic, product, and functional positions. When each company builds on the other's qualities rather than trying to fill gaps in core businesses or markets, the venture's strengths together equal more than the sum of the

> The key to understanding whether an alliance is likely to lead to a sale is to project how bargaining power will evolve.

Seller Beware

To understand the potential disadvantages of selling a company after it already has become part of an alliance, consider the seller's position in a straightforward acquisition. The seller gets paid for 100% of the business on day one. What's more, if a number of potential buyers are vying for the company in a competitive public auction, as is often the case, the eventual winner generally pays the seller a premium of as much as 50%. The seller's shareholders clearly benefit.

By contrast, consider the situation the seller faces in an alliance setting. An alliance partner that becomes the ultimate buyer has intimate involvement and knowledge of the business, and can estimate the likely synergies that will come from the acquisition with much greater confidence. In contrast to the buyer in a straightforward acquisition, who pays for the full business on day one, an alliance buyer often gets to defer paying for the business until the end of the alliance. Potential buyers can also limit their financial risk by structuring the partnership in such a way that they have an option to terminate it, such as a put option to exit the alliance after a trial period in which they can assess the value of their partner.

As a result, many companies that wind up selling the business to an alliance partner are unable to capture the full value of the business for their shareholders. Because the buyer's bargaining power tends to increase over the course of the partnership, the buyer often gets the lion's share of the synergies from the alliance without having to pay a full acquisition premium. Other potential buyers are likely to be deterred by the difficulty of unwinding the alliance, so the seller is usually unable to orchestrate a bidding process to drive up the acquisition price.

parts. Pepsico and Lipton, for example, have combined their very different strengths to produce and market canned iced tea. Lipton brings its expertise in the tea business; Pepsico brings access to beverage distribution channels. In theory, Pepsico could provide the product, but Lipton has built the franchise and brand awareness that it needs to retain significant control over customers. Bargaining power thus remains balanced; the alliance can endure because each partner controls its own turf.

Managing the Risks of an Evolving Alliance

By analyzing initial strengths, how they change, and the potential for competitive conflict, it is possible to map a particular alliance and anticipate or protect against a future sale of the business. We've found that alliances generally fall into one of six categories, which we've named based on their probable outcomes: collisions between competitors, alliances of the weak, disguised sales, bootstrap alliances, evolutions to a sale, and alliances of complementary equals. It's critical to know which of those paths an alliance is on because all but one carry the risk of an unanticipated sale, which can be a major blunder for the partner that ends up divesting. (See the insert "Seller Beware.")

In fact, the first two types – collisions between competitors and alliances of the weak – almost always fail and should be avoided. The next two – disguised sales and bootstrap alliances – pair strong companies with weak companies, and, although they are risky and usually result in a sale, they can benefit both partners if properly structured and managed. The last two – evolutions to a sale and alliances of complementary equals – pair strong companies with strong companies, but only the latter generally lead to ventures that are both successful and enduring. We'll describe all six types in detail.

Collisions Between Competitors. Managers typically choose direct competitors as partners because such alliances tend to create great short-term synergy through consolidation of overlapping product and market positions. The illusory attraction of an alliance as opposed to an acquisition is that control can be shared with neither party giving up power, while the synergy can be captured and split between each one. But when both partners want to expand their core businesses based on the same set of geographic and product opportunities, conflict is the rule, not the exception.

For example, take the joint venture formed by a U.S. company and an Asian competitor to market point-of-sale terminals in the United States. The partnership led rapidly to conflicts over how to tailor and sell the Asian partner's products in the U.S. market. The partners, both selling their own point-of-sale terminals in the United States through the joint venture, couldn't resolve those issues, and the venture reportedly lost as much as $20 million annually. After three unprofitable years, the Asian partner bought out the U.S. partner's 49% stake to gain control over decision making. With the conflicts resolved, the Asian partner was able to increase the unit's performance, achieving a reported market share of more than 20% in target segments.

Another example is the alliance between General Electric and Rolls-Royce in jet engines, which ended in 1986 amid charges that Rolls-Royce had introduced a directly competitive engine. The lesson is that direct competitors with a high degree of overlap tend to be among the worst alliance partners. Managers should consider either acquiring such competitors or partnering with companies that focus on different businesses or geographic markets.

Alliances of the Weak. In this kind of partnership, two or more weak companies band together in the hope that their combined forces will improve their positions. Generally, however, the weak grow weaker and the alliance fails. Often a third party acquires the pieces.

The bottom line: if you can't succeed on your own, an alliance with another weak company won't make things any better. Unfortunately, many clusters of alliances are being driven by weakness, not strength. The airline industry provides a telling example. By the early 1990s, alliances had proliferated among players in this globalizing industry. Yet many of the deals involved linkages between weak players – for example, unprofitable U.S. airlines and flag carriers of smaller European countries. Many of these investments have already resulted in significant write-offs, and several alliances have unraveled.

Alliances of the weak often begin when weak companies join to try to compete in scale-intensive businesses. But when things get rough – as our research shows is often the case in the first three years of any alliance – neither partner has the requisite capital, management resources, or flexibility to provide much help. Usually, the demands for scale – and capital – outpace the abilities of weak partners to invest, and they are too busy trying to fix their core business to devote sufficient attention to managing their partnership.

When the time comes to call it quits, the logical next step is to try to sell to a stronger company with the resources to effect a turnaround. But many companies trying to divest after an alliance has been formed realize much less value than if they had conducted an outright sale in the first place. Potential buyers are often deterred by the difficulty of dissolving an alliance; what's more, competitive assets – skills, customers, and products – may have eroded in the interim. A better strategy for a weak company is to divest outright or to refocus the business and then think about an alliance.

Disguised Sales. In this type of alliance, a weak company joins a strong company that either is or will be directly competitive. Usually the weaker player remains weak and is acquired by the stronger player. Such ventures tend to be short-lived, rarely lasting more than five years.

In the real world, alliances are frequently pursued as a second-best strategy when management is unwilling to sell a weak company. Yet shareholders usually would be better off if the company were sold at the outset. When weak companies believe they must hook up with a strong company, they need to recognize the risk that the alliance will end up as an acquisition. Such an awareness requires "divestiture thinking," not "alliance thinking."

> It's critical to know which of six paths an alliance is on: all but one risk an unanticipated sale.

For starters, potential sellers should seek partners that would be the best buyers later on. Those partners are more likely to be potential competitors than complementary partners, because direct competitors are best able to maximize synergy. They should have ample cash for investment and acquisition. In the Siemens/Allis-Chalmers venture in power equipment (Siemens Allis Power Engineering), Siemens viewed the business as a core strategic area, had strong technology, was willing to invest, and wanted to expand in the United States. Allis-Chalmers had distribution, sales, and manufacturing capabilities but limited capital to invest in developing new technologies and products. Given that combination, says one Siemens executive, it was no surprise that "in the back of everyone's mind was the notion that when and if the venture ended, Siemens would be the likely buyer." By 1982, four years after the alliance was formed, Siemens had raised its stake to 85%. The full buyout occurred in 1985. Siemens subsequently made additional acquisitions to build a business with more than $1 billion in U.S. sales.

It is also critical for sellers to recognize that their bargaining power will decline over time and to negotiate explicit exit provisions that ensure fair value in the event of a sale. Those provisions must lock in the value (or the formula for calculating it) at the outset. The usual approach – delaying negotiations about valuation until a sale is imminent – is not sufficient to protect the weaker company's shareholders, because bargaining power is likely to shift to the stronger company over time.

Allis-Chalmers realized the importance of exit clauses in its joint venture with Siemens. According to Hans W. Decker, a former vice chairman of Siemens in the United States, "The exit clause, which specified that Siemens had the right to acquire the venture at a specific pricing formula in the event of termination, was the most important item in the agreement. If we talked about the joint venture agreement for three months, we talked about the exit clause for two months." In another case, when a company in the industrial-coatings business formed a joint venture with a likely buyer, they negotiated a buy-sell price in advance based on the initial value of the business plus 50% of the synergies that they estimated would result.

When a sale is likely, the alliance should be structured so that the business that is to be sold is easily separated. In the Siemens/Allis-Chalmers joint venture, Siemens created a stand-alone entity by locating the alliance's headquarters in Atlanta, Georgia, rather than Milwaukee, Wisconsin, where Allis-Chalmers was based. The idea is to define clear boundaries for the venture relative to the parent organizations in terms of the assets, activities, and people that will be involved. The fewer remaining entanglements (such as transfer pricing arrangements for services provided by the parents), the easier the sale.

We generally advise against entering into a bootstrap alliance unless it is impossible to fix or sell the business.

Bootstrap Alliances. This type of alliance is often tried but rarely works. A weak company partners with a stronger (and often complementary) company and attempts to use the alliance to improve its capabilities. For the weaker partner, this strategy is the equivalent of drawing to an inside straight in poker. Usually the weak partner remains weak and is acquired by the stronger partner. In the few cases where the strategy succeeds, the partnership develops into an alliance of equals or the partners separate after the weak partner has become able to compete on its own.

We generally advise against this strategy unless it is impossible to fix or sell the business. Making a bootstrap alliance work is a daunting task: it entails a systematic learning program and the ability to learn; a partner with the right skills that is willing to teach and will not become an acquirer; and a window of several years to execute the strategy. One example of a successful bootstrap alliance is that between Rover and Honda. Rover began as an unprofitable state-owned enterprise and improved to the point where British Aerospace, Rover's parent, could sell 80% of the unit to BMW for £800 million (about $1.2 billion). Could British Aerospace have sold Rover for a similar sum without the capability building that the alliance allowed? We doubt it. But through the alliance, Rover increased its productivity, cut its defect rate by more than half, and reduced its product development cycle from six and a half to four and a half years.

Weak partners entering a bootstrap alliance must recognize that the deal may lead to a sale and that the stronger partner will have more bargaining power. Therefore, like weak partners in disguised sales, they should structure exit provisions to ensure fair value in the event of a divestiture.

The design of the partnership is also crucial in a bootstrap alliance. Weak partners should structure the deal so that they retain control over one or more major business elements, like customer relationships. They should also ensure that the capability gaps are limited to a few key areas.

In addition, weak partners should consider designing the alliance around a series of skill-building activities. And the structure of the deal should support the learning agenda. For example, Thomson Consumer Electronics of France, in its alliance with JVC, sought to improve its skills in the precision manufacturing and assembly required to produce high-quality VCRs. (The alliance was initially formed in 1982 by JVC, Thorn EMI of the United Kingdom, and Telefunken of Germany. Thomson subsequently purchased Telefunken, and Thorn divested its stake in the venture to Thomson and JVC.) An important early step for Thomson was to identify a series of discrete, achievable steps to build its capabilities. First, it focused on developing assembly skills. Then its efforts graduated to manufacturing components, manufacturing complete VCRs, and later, building capabilities necessary for designing and producing a new VCR model.[1]

In this case, JVC licensed its designs to the joint venture, which had significant manufacturing facilities in Germany and the United Kingdom. JVC committed to increasing the value of VCR components produced by the joint venture in Europe and to assisting Thomson in setting up and managing a separate Thomson-owned component-and-subsystem supply plant in France. Most of the joint venture's employees were from Thomson, and workers in the Berlin plant were rotated to nearby Thomson production lines to promote skills transfer.

Government protection can also increase the chances of success for the weaker partner in a bootstrap alliance, especially if stronger companies are forced to transfer technology to gain access to the market. For example, U.S. telecommunications companies are generally prohibited from outright acquisitions in Eastern Europe, allowing Eastern European telecommunications players to build their networks and capabilities without the risk of an unwanted acquisition.

The Six Types of Alliances

Collisions Between Competitors. These alliances involve the core businesses of two strong companies that are direct competitors. Because of competitive tensions, they tend to be short-lived and fail to achieve their strategic and financial goals. Most collisions between competitors end in dissolution, acquisition by one of the partners, or a merger.

Alliances of the Weak. Two or more weak companies join forces, hoping that together they will improve their positions. But the weak usually grow weaker and the alliance fails, followed quickly by dissolution or acquisition by a third party.

Disguised Sales. In these partnerships, a weak company combines with a strong company, often one that is or will become directly competitive. The weaker player remains weak and is acquired by the stronger player. Disguised sales tend to be short-lived, rarely lasting more than five years.

Bootstrap Alliances. A strong company and a weak one often form this type of partnership, but it rarely works. The weak company attempts to use the alliance to improve its capabilities. Usually the weak partner remains weak and is acquired by the stronger partner. In the few cases where this strategy is successful, the partnership develops into an alliance of equals or the partners separate after the weak partner has achieved the ability to compete on its own.

Alliances between a weak and a strong company usually fail.

Evolutions to a Sale. These alliances start with two strong and compatible partners, but competitive tensions develop, bargaining power shifts, and one of the partners ultimately sells out to the other. However, these alliances often succeed in meeting the initial objectives of the partners and may exceed the seven-year average life span for alliances.

Alliances of Complementary Equals. This type of alliance involves two strong and complementary partners that remain strong during the course of the alliance. These mutually beneficial relationships are likely to last much longer than seven years.

Combining Complementary Strengths Creates Value

Partner *Strength...* +	**Partner** *Strength...* =	**Joint Objective**
Pepsico *marketing clout for canned beverages*	**Lipton** *recognized tea brand and customer franchise*	To sell canned iced tea beverages jointly
KFC *established brand and store format, and operations skills*	**Mitsubishi** *real estate and site-selection skills in Japan*	To establish a KFC chain in Japan
Siemens *presence in range of telecommunications markets worldwide and cable-manufacturing technology*	**Corning** *technological strength in optical fibers and glass*	To create a fiber-optic-cable business
Ericsson *technological strength in public telecommunications networks*	**Hewlett-Packard** *computers, software, and access to electronics channels*	To create and market network management systems

Evolutions to a Sale. These alliances start with two strong and compatible partners, but competitive tensions may develop or bargaining power may shift, and one partner ultimately sells out to the other. However, such partnerships often deliver value to both parties and may exceed the seven-year average life span for alliances.

Sometimes power is so evenly balanced at the outset that these ventures may appear to be alliances of complementary equals, and it can be difficult to tell which partner is likely to emerge as a buyer. Neither partner, for example, may know enough initially to manage the business alone even if it could buy it. There usually are clues, however, that indicate how bargaining power may shift. The key is to examine what business strengths each partner plans to contribute, which partner supplies most of the senior managers, which is willing to invest more, and how the ratio of learning to teaching is likely to unfold. For example, take two large and equally successful pharmaceutical companies that formed a joint venture to distribute a specific product in the United States. The alliance lasted ten years yet was clearly perceived as an evolution to a sale, even in the beginning, because one of the partners held the key product patents. And, in fact, that partner did eventually buy out the other, following the terms of a predetermined buyout clause.

Industry evolution can also provide some insights: if a company is in an industry in which power is shifting from products to customers or core processes, and that company provides the products, the alliance may very well be an evolution to the company's sale.

Because these alliances are based on initially balanced contributions and can last a long time, they require a different approach to structuring than the alliances we've discussed. First, the partners should share an interest in structuring reciprocal and fair exit provisions that protect each one's strategic and financial interests. It is more important to devise formulas for dividing the future value of the venture fairly than it is to protect each partner's initial contribution.

Second, the partners should structure the alliance so that the contributions made and the value received are reviewed regularly and an appropriate balance is maintained. For example, Honeywell typically builds in sunset clauses to force renegotiation of its alliances every five years or so. Flexibility can be enhanced if the partners agree on the underlying principles for resolving conflicts and agree to honor them if the technical or legal arrangements prove to be unfair. Flexibility is also needed to allow partners to broaden or narrow the scope of the alliance to meet market requirements or to resolve any conflicts that might emerge.

Third, partners in evolutions to a sale need to be clear about their strategic intent. If one party wishes to be the eventual buyer if the venture ends up as a sale, the initial structure should reflect that desire. Would-be buyers need to invest heavily in the venture – with both people and capital. They also should make sure that the alliance allows for a favorable balance between learning and teaching. In the 1950s, for example, U.S.-based Pfizer formed a fifty-fifty joint venture with Taito, Japan's leading sugar producer, to enter the Japanese pharmaceutical market. Taito provided a Japanese beachhead, but Pfizer retained the patents on key drugs. Over time, Pfizer built up its own knowledge of the Japanese pharmaceutical market and eventually bought out the venture, becoming one of the largest foreign pharmaceutical companies in Japan.

One interesting note: many U.S.-Japanese alliances are evolutions to a sale, and generally the Japanese partners become the buyers. A study of joint ventures in Japan by McKinsey & Company's Tokyo office indicated that two-thirds of the ventures between Japanese and foreign companies operating in Japan had been sold to the Japanese partner upon termination. In part, that is because Japanese companies tend to focus more closely on absorbing their partner's capabilities.

Japanese companies are also more likely to acquire their ventures because their primary reasons for entering into alliances are strategic, not financial. When we surveyed 90 executives from 25 large Japanese companies, the vast majority (more than 80%) indicated that gaining the skills to enter new businesses and improving the strategic position of existing businesses were the main reasons for forming strategic alliances.

Alliances of Complementary Equals. This partnership path is the only one that can lead to a marriage for life. It involves two strong and complementary partners, and both generally remain strong for the duration. These alliances almost always last much longer than 7 years. In fact, the hallmark of such ventures is that neither partner could (or would rationally wish to) buy and manage the business. Dow Corning is more than 50 years old, Fuji Xerox is more than 30, and Siecor – an alliance between Siemens and Corning – is more than 15.

Such alliances are based on true collaboration in which both partners build on each other's qualities rather than trying to fill gaps. Often the partners have different product, geographic, or functional strengths. (See the exhibit, "Combining Complementary Strengths Creates Value.")

In the Siecor alliance, Siemens and Corning brought together their complementary capabilities in telecommunications and glass technology to build an independent joint venture that has gained a leadership position in the fiber-optic-cable business. Because both partners see the alliance as an important and profitable business, neither has desired to exit it. Both hold important patents on which the venture relies, so their bargaining power has remained relatively equal, and the risk of an unplanned divestiture is low.

In alliances of complementary equals, governance is critical. While the initial contract must be solid to get the venture off to a good start, it is not the key to success, because the terms of the deal usually change so much over time. The real challenges are to build in flexibility, maintain the balance of contributions, and ensure clarity of leadership. If governance is well planned and managed, the alliance will promote independence, fairness, and trust; each partner will prosper under equal equity ownership. And, as with all alliance types, the exit provisions should be carefully thought out – just in case. Managers should focus on assessing the future value of each company's stake and of the alliance as a whole: if the partnership is successful, the initial values will soon become obsolete.

Ultimately, the challenge in all alliances is to decide whether to try to keep the strengths and contributions in balance or to accept that the balance of power will inevitably shift and to plan accordingly. Failing to ask the right questions before closing a deal can lead to one of the worst decisions a manager can make: committing to an unanticipated sale of the business – often without prior board approval and for far less than the business would fetch in an open auction. In the heat of negotiations, rolling an alliance forward to examine its evolution may seem like a distraction. But given the high stakes, it is well worth the time and effort.

1. Yves Doz and Gary Hamel, "The Use of Alliances in Implementing Technology Strategies," in *Managing Technology and Innovation for Corporate Renewal*, ed. Yves Doz (Oxford: Oxford University Press, forthcoming).

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