The Way to Win in Cross-Border Alliances

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In the face of newly opening markets, intensified competition, and the need for increased scale, many CEOs have put the formation of cross-border alliances on their agendas for the 1990s. To international managers, the strategic benefits are compelling: alliances are an expedient way to crack new markets, to gain skills, technology, or products, and to share fixed costs and resources. Yet a lot of the war stories suggest that alliances are all but doomed to failure, and CEOs setting up cross-border alliances or dealing with early problems find little is systematically known about how to make alliances succeed.

To better understand cross-border alliances and what it takes to make them work, we examined the partnerships of 150 top companies ranked by market value (50 each from the United States, Europe, and Japan). The 49 strategic alliances that we studied in detail varied widely in size, location, industry, and structure. Some were established to speed entry into a new market, others to develop and commercialize new products; still others to gain skills or share costs.

Our analysis found that although cross-border alliances pose many challenges, they are in fact viable vehicles for international strategy. While two-thirds of cross-border alliances run into serious managerial or financial trouble within the first two years, many overcome their problems. Of the 49 we analyzed, 51% were successful for both partners. Only 33% resulted in failure for both.

How can managers maximize their chances of success in these ventures? What wisdom can be derived from the experiences to date? Here are a few of our findings:

- Arguments over whether cross-border alliances or cross-border acquisitions are superior are beside the point; both have roughly a 50% rate of success. But acquisitions work well for core businesses and existing geographic areas, while alliances are more effective for edging into related businesses or new geographic markets.
- Alliances between strong and weak companies rarely work. They do not provide the missing skills needed for growth, and they lead to mediocre performance.
- The hallmark of successful alliances that endure is their ability to evolve beyond initial expectations and objectives. This requires autonomy for the venture and flexibility on the part of the parents.
- Alliances with an even split of financial ownership are more likely to succeed than those in which one

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partner holds a majority interest. What matters is clear management control, not financial ownership.

- More than 75% of the alliances that terminated ended with an acquisition by one of the parents.

All of these findings have implications for creating and managing successful cross-border alliances.

Related Businesses, New Geographic Markets

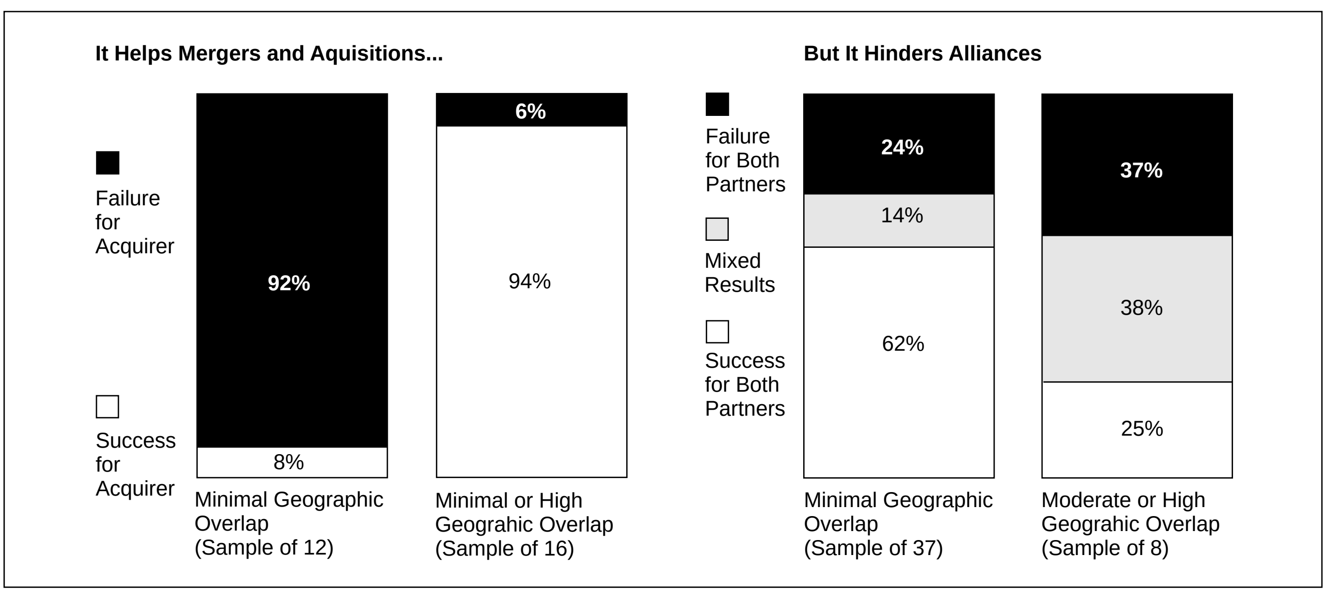
Both cross-border alliances and cross-border acquisitions are good vehicles for international strategy and have similar success rates (51% and 57% respectively). But that doesn't mean they are interchangeable. When used to expand core businesses, both cross-border alliances and acquisitions work well. But for expanding existing businesses into new geographic regions or for edging out into new businesses, cross-border alliances work better.

When moving into new geographic markets, managers should try to structure alliances to capitalize on the distinctive geographic positions of the partners. Some 62% of the alliances that involved partners with different geographic strengths succeeded (see the exhibit, "Does Geographic Overlap Help or Hinder Cross-Border Alliances?"). This is very different from the finding for cross-border acquisitions: the success rate was just 8% when the acquirer and the target company did not have significant overlapping presences in the same geographic markets.

Crédit Suisse-First Boston, a joint venture formed in 1978 to expand both companies' positions in the Eurobond market, shows the benefits of using alliances to leverage complementary geographic strengths. First Boston provided access to U.S. corporate issuers of bonds and possessed the skills for structuring new financial vehicles like convertible Eurobonds. Crédit Suisse provided the capability to place issues with investors in Europe. This combination allowed the joint venture to assume a leading role in the rapidly growing Eurobond markets in the early 1980s. (The joint venture was bought out by Crédit Suisse in 1988 after First Boston began to experience financial problems, which were partly due to increasing competitiveness in the Eurobond markets.)

To build the position of core businesses in existing geographic markets, managers should use acquisitions instead of alliances. For acquisitions focused on existing markets, the success rate was 94%. For alliances in which partners had overlapping geographic positions, it was 25%. When both partners have a presence in the same geographic markets, alliances often lead to competitive conflicts. In one cross-border venture to manufacture and sell telecommunications products in the United States, one of the parents continued to sell a competing product line through a separate sales force. In theory, the

Does Geographic Overlap Help or Hinder Cross-Border Alliances?



two sales forces were targeting different customer segments, but because they were poorly coordinated, they ended up competing against each other. Within two years, the venture was acquired by one of the parents, and the sales forces were combined.

In the few instances in which companies have tried to use acquisitions instead of alliances to diversify abroad, they have had trouble withstanding the financial and operational strain. Not surprisingly, most companies pass up the challenge of making an acquisition to enter a new business overseas. Of the 28 cross-border acquisition programs in our study, 22 were focused on geographic expansion of core businesses; in 13 of the 16 successful programs, the acquirer already had a substantial presence in the target countries and was expanding a core business.

Managers should avoid acquisitions outside the core business, especially in new geographic markets, because they are extremely challenging and often fail. Take, for example, the British service company that acquired a Canadian electronics manufacturer to try to become a global player in the office automation industry. The Canadian company, a large second-tier player, was under intense competitive pressure: demand was soft, prices were falling, and competitors were merging to gain economies of scale. Under the new parent, the Canadian company took several steps, including rationalizing manufacturing operations to cut costs and spinning off a small subsidiary. But the U.K. company, with little direct experience in the North American market, was unable to make the needed improvements in distribution and sales, which had been weak before the merger. The new parent also had no manufacturing facilities in North America and so was unable to expand volume to drive down costs. Finally, after absorbing five years of operating losses and losing a considerable amount of senior management's time, the parent decided to divest the business at a fraction of its purchase price.

Unlike cross-border acquisitions, cross-border alliances can work well for moving into new or related businesses. Corning's well-publicized joint venture with Siemens to produce fiber-optic cable is an example of a successful move into a related business. The Siecor joint venture, started in 1977, succeeded for many reasons. For one thing, the parents brought complementary skills and capabilities. Corning had developed and patented processes to manufacture high-quality optical fibers. Siemens had capital, scale, and worldwide distribution of telecommunications cable. Siemens also brought the manufacturing technology and equipment to produce cable from fiber. The alliance had distinct advantages over an acquisition. It allowed the creation of an enterprise focused on commercializing fiber-optic cable, and it relieved some of the financial pressure by dividing the investment. Moreover, neither company had to recoup an acquisition premium.

Equal Strength

It stands to reason that alliances between two strong partners are a safer bet than alliances between two weak partners. But many strong companies actually seek smaller or weaker companies to partner with in order to control the venture. Weaker companies often seek a strong partner to get them out of trouble or to build their skills. Our analysis suggests that these strategies do not work well because the "weak link" becomes a drag on the venture's competitiveness and causes friction between the parents. Alliances in which one partner is consistently strong in the functions it brings to the venture while the other is not strong succeeded only one-third of the time. Similarly, alliances between two financially strong performers or between a strong and an average performer (based on industry averages for return on equity and return on assets in the five years preceding the alliance) had a success rate of 67%, versus 39% for alliances involving two weaker players.

When one partner is weak, managing the alliance seems to be too great a distraction from improvements needed in other parts of the business. When unbalanced partnerships do succeed, it is usually because the strong partner brings the capability that is crucial to the venture; it pulls the weaker partner along for a while before acquiring it or finding another partner.

One U.S. pharmaceutical company underestimated the importance of having a strong joint venture partner when it paired with a relatively weak Japanese player. The U.S. company had a large share in its domestic market, a good portfolio of drugs, and strong R&D capabilities. Seeking to expand its position in Japan, it partnered with a second-tier company with a large sales force rather than one of the leading Japanese pharmaceutical companies, which might have had products that competed more directly.

The joint venture failed for several reasons. First, the sales force of the Japanese company was poorly managed and was unable to meet its targets for distributing the drugs of the Western partner. Second, over time, the Japanese partner was simply unable to push drugs that had been successful in other markets through Japan's development and approval process. It did not have insider contacts to guide the approval process, and it lacked the management resources and the capital to invest in commercialization. Even the excellent products and top-tier position of the Western partner could not compensate for its partner's shortcomings.

Most alliances formed chiefly to build the skills of a weaker partner meet with failure or mixed results. Only when the alliance has a solid business rationale other than self-improvement and a viable combined business system that draws on strengths from each partner can skills be transferred successfully.

Consider a joint venture between a weak European auto company seeking to improve its manufacturing effectiveness and a strong Japanese auto manufacturer. The Japanese manufacturer, which wanted to produce a new compact car for the European market, was to provide design, body parts, and manufacturing technology—areas in which it excelled. The European partner was to provide capacity in an existing auto plant and local management. The European company was, however, financially strained and distracted by problems in its other car lines, and management was unable to give the new venture the time and energy it required. The venture ultimately failed, selling only 20% as many cars as projected.

How We Defined Success

To be considered successful, an alliance had to pass two tests: both partners achieved their ingoing strategic objectives and both recovered their financial costs of capital. Progress on the strategic objectives was based on market share, sales volume, new product development, or other criteria specific to the alliance. Our evaluation of financial and strategic success relied heavily on access to unpublished financial results and on interviews with company insiders and industry experts, as well as public information.

For acquisition programs exceeding 20% of the acquirer's market value, we assessed whether the acquirer was able to maintain or improve its return on equity and return on assets. For smaller acquisition programs, we conducted interviews and assessed financial results to determine whether the return equaled or exceeded the companies' cost of capital.

We should note that these financial criteria for success are distinctly American. Most Japanese and many European companies have longer term, less financially oriented means for judging their purchases.

Although skills transfer should not be the primary purpose of a joint venture, it often occurs naturally, and if the partners both bring specific strengths, both will benefit. In the GM-Suzuki joint venture in Canada, for example, both parents have contributed and gained. The alliance, CAMI Automotive, Inc., was formed to manufacture low-end cars for the U.S. market. The plant, run by Suzuki management, produces the Geo Metro/Suzuki Swift, the smallest, highest gas-mileage GM car sold in North America, as well as the Geo Tracker/Suzuki Sidekick sport utility vehicle. Through CAMI, Suzuki has gained access to GM's dealer network and an expanded market for parts and components. GM avoided the cost of developing low-end cars and obtained models it needed to help revitalize the lower end of the Chevrolet product line and to improve GM's average fuel economy rating. And the CAMI factory, which promises to be one of the most productive plants in North America once it reaches full capacity, has been a test bed for GM to learn how Japanese carmakers use work teams, run flexible assembly lines, and manage quality control.

While it is important that partners have complementary skills and capabilities, an even balance of strength is also crucial. This is especially true in product-for-market swaps. When one partner brings product or technology and the other brings access to desirable markets, there is often a certain amount of suspicion. Each partner fears that the other will try to usurp its proprietary advantage. Such fears are hardly unwarranted, since many prospective partners are competitors in some business arenas to begin with. A European chemical company formed a venture with a large Japanese company to produce and market its product to food manufacturers in Japan in the early 1980s. Within less than ten years, the Japanese partner had absorbed the production process technology and become its partner's biggest threat in the United States and Europe.

While it is effective for partners to bring complementary skills to the table—strong R&D paired with well-developed manufacturing processes, innovative products paired with solid and established distribution and sales capabilities—the strongest alliances exist when each partner brings both products and an established market presence in different geographic markets. The Toshiba-Motorola alliance is an example of getting the balance right: Toshiba brought expertise in DRAMs and access to Japan; Motorola brought expertise in microprocessors and access to the U.S. market. These alliances seem to have a more stable balance of power because neither partner relies solely on the other for technical expertise, products, or market entry. Fully 75% of the alliances serving at least two major markets—Europe, Japan, or the

United States—succeeded. Only 43% succeeded when the venture focused on a single market—when, for example, one company traded products for its partner's access to customers.

Autonomy and Flexibility

The flexibility to evolve is a hallmark of successful alliances. Flexibility allows joint ventures to overcome problems and to adapt to changes over time. If they are to evolve, alliances also need the capacity to resolve conflicts. A partnership is best able to resolve or avoid conflicts when it has its own management team and a strong board with operational decision-making authority.

Flexibility is important because it is inevitable that the objectives, resources, and relative power of the parents will gradually change. Even the most astute parent companies cannot anticipate these trends and other events that will occur during the life of the alliance. Somewhere along the line, joint ventures are likely to find that their markets are shifting, new technologies are emerging, or customers' needs are changing. Also, the strategies, skills, and resources of the parents may change. And once alliances are up and running, they often discover new opportunities like a new market for their products or a new way to leverage their expertise.

Flexibility is also needed to overcome problems, which many alliances encounter in one form or another early on. Some 67% of the alliances in our sample ran into trouble in the first two years, and those that had the flexibility to evolve were better able to recover. Many joint ventures have trouble meeting their initial goals, often because the expectations or projections at the outset were overly optimistic. An R&D venture to develop a new plastics-recycling process was unable to meet cost targets because the partners had seriously underestimated the investments required to commercialize the new technology. And the president of an automotive joint venture reflected on his similar experience this way: "If I were doing it over again, I'd insist on a more rigorous feasibility study. It is easy to be optimistic. Because of the reputation and experience of our parent companies, we figured we could get our automotive system specified in customers' cars rapidly. Not so. In the eyes of the customer, we were a new supplier of a safety-critical product and had to undergo seven or eight stringent engineering tests and validation steps with improvements and corrective action at each step. This took a minimum of two years with each customer. That's not to mention the fact that the investment levels were much higher than we expected."

The link between flexibility and success is strong. Nearly 40% of the alliances in our sample gradually broadened the scope of their initial charter. Some expanded into new geographic or product markets, others required major investments. Of those alliances that had evolved, 79% were successful and 89% are ongoing. In contrast, of the alliances whose scope remained unchanged, only 33% were successful and more than half have terminated.

The CFM International venture created by GE and Snecma in 1974 to collaborate on the development of jet engines is among those that evolved and flourished. The two companies initially focused on jointly developing and manufacturing the CFM56 engine, with 20,000 to 30,000 pounds of thrust. Subsequently, the two partners expanded their collaboration to spread the costs of developing a wider range of engines, including the larger CF6 series of engines. By 1991, the alliance had booked orders and commitments for more than 10,000 engines worth about $39 billion.

Similarly, GMF Robotics was set up in 1982 by GM and Fanuc to develop robotics for the auto industry. The venture has gradually broadened its focus and now sells robotics to nonautomotive customers in industries like food processing and computer manufacturing. And Toshiba and Motorola, building on an existing relationship, agreed in 1986 to create a joint venture to manufacture microprocessors and memory chips in Japan, and they continue to discuss other ways of expanding on their initial agreement.

Unlike the GM-Snecma, GM-Fanuc, and Toshiba-Motorola alliances, one joint venture between a U.S. and a foreign company to serve the minicomputer market in the United States did not deviate from its original plan and suffered because of it. The joint venture was conceived largely as a sales organization to sell to the U.S. market minicomputers designed and manufactured by the parent companies. The sales-oriented joint venture quickly fell behind in adapting products for the rapidly changing needs of banking customers in the United States. Friction quickly developed between the partners, and, ultimately, the venture floundered and was bought out. In hindsight, the joint venture might have recovered had its scope been expanded to include product development, manufacturing, and sales for a broader range of minicomputer products the parents offered.

Negotiating every aspect of the alliance in excruciating detail and spelling out the rules in legal documents will not guarantee healthy evolution. But there are ways to build in flexibility, namely by giving the alliance a strong president, a full business system of its own (R&D, manufacturing, marketing, sales, and distribution), complete decision-making power on operating issues, a powerful board, and a sense of identity. As the president of a successful U.S.-based joint venture put it, "The best way for parents to make a joint venture work is to give it the resources it needs, put someone they trust in charge, and leave him or her alone to do the job."

Parent companies typically retain responsibility for decisions about equity financing and overall governance structure, but operating decisions are best made by managers whose sole focus is the joint venture. This kind of hands-off approach requires that the parent companies structure and perceive the alliance as an entity in and of itself and not as part of either ongoing business. Ensuring that the alliance does not need to depend on either parent for basic operating functions reinforces the separateness and also simplifies coordination of those activities.

Giving the alliance strong leadership further encourages autonomy. Managers of successful alliances embrace their authority and build employee loyalty to the joint venture rather than to the parent companies. Such loyalty is not always easy to cultivate in light of the fact that key employees usually are drawn from the parent companies and are likely to return there. But strong leaders can win the support they need to operate as a freestanding business. Early on in the Toshiba-Motorola alliance, for example, engineers were reluctant to share semiconductor production technology with people who just months before had been their competitors. When senior management realized what was going on, it met with mid-level managers to convince them that the relationship was good for both parent companies overall, even though each specific area might not be benefiting.

Establishing a high-powered board is important.

Sometimes alliances slip from top management's attention, which may be understandable since they are not really part of the parent companies' everyday operations. In other cases, lack of a strong board for the venture creates delays as key decisions are passed up and down the parent organizations' chains of command.

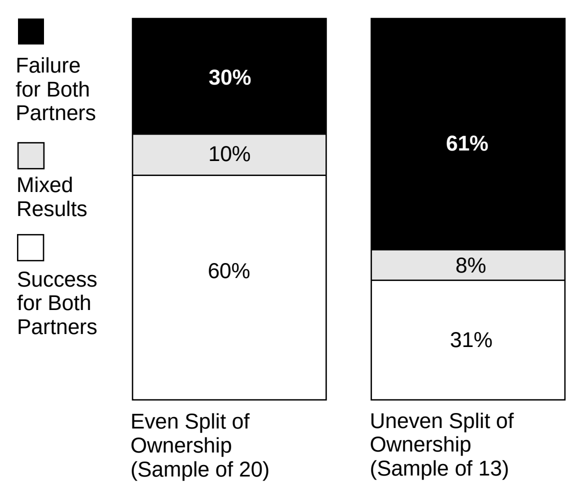
There are some exceptions to the rule about managerial autonomy. When joint ventures are formed to share R&D costs, for instance, R&D parents often need to stay closely involved to ensure that the R&D program fits with their customer needs and manufacturing capabilities. And when alliances are formed to coordinate activities performed by the partners at different stages in the value chain, the coordination may best be done directly between the parents without creating a separate joint venture organization. In these cases, a different rule applies: the responsibilities of each party must be clearly defined.

In the fifty-fifty venture between Petroleos de Venezuela (PDVSA) and Veba Oil, for example, PDVSA provided 50% of the crude oil supply, while Veba provided the other 50% and took clear responsibility for downstream refining and marketing. In Boeing's partnership with Fuji, Mitsubishi, Kawasaki, and Aeritalia to produce the Boeing 767, a separate joint venture entity was not created, and Boeing held overall control for coordination and management. These alliances would not be viable businesses without critical functions of the parents.

Fifty-Fifty Ownership

In structuring alliances, the issue of financial ownership should be separated from managerial control. In contrast to the conventional wisdom that fifty-fifty ownership spells failure because of stalled decision making, alliances with an even split of financial ownership are actually more likely to succeed than those in which one partner holds a majority interest (see the exhibit "Fifty-Fifty Alliances Are More Likely to Succeed"). When one parent has a majority stake, it tends to dominate decision making and put

Fifty-Fifty Alliances Are More Likely to Succeed



(Joint ventures only; excludes parent-to-parent equity stakes and nonequity alliances.)

its own interests above those of its partner, or for that matter, of the joint venture itself. Both partners tend to be worse off as a consequence.

The autonomy and flexibility most alliances need are easiest to achieve when neither parent's investment outweighs the other's. Our evidence shows that joint ventures with an even split of ownership have a higher success rate (60%) than those in which one partner holds a majority stake (31%). For one thing, when ownership is even, it is more likely that the joint venture will be set up as a separate entity with its own strong management. But fifty-fifty ownership is important for another reason: it builds trust by ensuring that each partner is concerned about the other's success, or in the words of Stephen Levy, former head of Japan operations and a board member at Motorola, "Each partner has a stake in *mutual* success."

When ownership is uneven, one parent typically exercises control, sometimes in ways that are not in the minority partner's interests. One majority partner shifted excess employees to the venture. When the bloated payroll contributed to cash flow problems, the partners had a showdown. Eventually, the minority partner gained more say in operating decisions, but only after threatening to withdraw from the venture.

Alliances that are not fifty-fifty can, of course, succeed. One way to boost the odds of success is to realize that the alliance is a win-win situation rather than a zero-sum game. In the 49 alliances we analyzed closely, only 3 resulted in success for one partner and failure for the other. In "unfair" alliances, both partners typically fail since the poorly compensated partner has little incentive to follow through on commitments. Indeed, it is particularly important to protect the interests of a minority partner. This is exactly the philosophy of the quickly expanding TRW-Koyo Steering Systems joint venture, which was established to serve Japanese transplant automakers in the United States. Although TRW owned 51%, Arvind Korde, president of TRW-Koyo Steering Systems, treated it as if it were a fifty-fifty partnership. In Korde's words, the earmark of the venture's success was that, "At times, both TRW and Koyo thought I was too sensitive to the other partner."

Termination by Acquisition

Most alliances terminate, even successful ones. We found that, of the ventures that terminated, more than 75% were acquired by one of the partners. Yet companies don't always prepare for the eventual ending of their alliances, and some are caught off guard when the other partner is in a better position to buy it. If the seller didn't anticipate such an outcome, the acquisition can compromise its long-term strategic interests. Says the CEO of a global communications company, "One of the most important elements of global strategy is the balance between intermediate-term and long-term initiatives. Joint ventures may fill intermediate-term needs but may also mortgage the long-term global future."

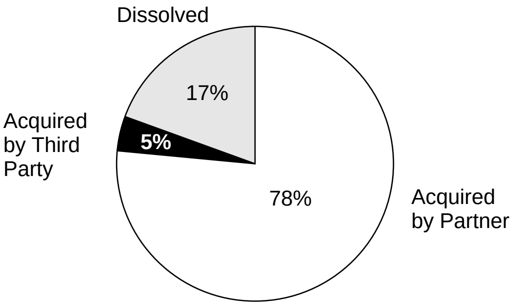
Alliances often terminate after meeting the partners' goals. Two Western-Japanese alliances—Sandoz-Sankyo and Bayer-Takeda—demonstrate the point that termination is not equivalent to failure. Both Sandoz and Bayer left their ventures after having achieved their goal of establishing independent businesses in Japan; both are ranked among the top 25 players in the Japanese pharmaceutical industry. Their Japanese partners, both of which are among the largest Japanese players, also benefited by gaining access to strong-selling drugs their Western partners had developed.

By 1990, when Sandoz and Sankyo agreed to dissolve their alliance, Sankyo was selling 22 Sandoz drugs, which took in ¥82 billion in revenues. Sandoz and Sankyo are continuing to cooperate with each other and are planning a phased withdrawal over four years of five key Sandoz drugs from Sankyo's sales channels. Sankyo is also helping Sandoz build its marketing force by sending personnel to Sandoz's Japan operations.

Similarly, Bayer, which owns 75.6% of Bayer Yakuhin, a joint venture in which Takeda owns 14.6% and Yoshitomi Pharmaceuticals owns 9.8%, recently dissolved its 80-year sales agreement with Takeda in order to sell Bayer-brand pharmaceuticals through its own channels. Takeda had previously sold an estimated ¥60 billion worth of Bayer drugs annually on a consignment basis.

Some joint ventures end less amicably and fairly. Shifts in the parents' geographic position, functional strengths, and technological position can make one parent emerge as the "natural buyer" (see the exhibit "Alliances Are Usually Acquired by a Major Partner"). By the time that happens, it may be too late for the seller to protect its interests. Take, for instance, the alliance between two specialty chemical companies. One was to provide product formulas and manufacturing know-how; the other was to provide marketing and distribution to its existing industrial customers. Over a ten-year period, though, the "sales" partner was able to improve on the basic process technology to tailor products to its customers. Then in a clear position of strength, since its people had the customer relationships and knew the

Alliances Are Usually Acquired by a Major Partner



(Sample of 18 terminated partnerships.)

Partnership	Start Date	Acquired By	Acquisition Date
Asahi-Dow	1952	Asahi	1982
Merck-Banyu	1953	Merck	1983
Crédit Suisse-First Boston	1978	Crédit Suisse	1988
Toshiba-Rank	1978	Toshiba	1980
Fujitsu-TRW	1980	Fujitsu	1983
Du Pont-Philips (PD Magnetics)	1981	Philips	1988
Fiat-Rockwell	1981	Rockwell	1987
Mitsubishi-Verbatim	1982	Mitsubishi	1990
VW-Seat	1982	VW	1990
Sony-CBS (Digital Audio Disc Corporation)	1983	Sony	1985
Siemens-Telecom Plus International	1984	Siemens	1987
NatWest-Banca March	1985	NatWest	1989
Nestlé-Rothman	1986	Nestlé	1988
Fujitsu-GTE	1987	Fujitsu	1988

technology, it offered to buy out the business. The "technology" partner, faced with the threat that its partner would go it alone anyway if it refused to sell, divested its share. The seller made a handsome profit but ended up with zero position in a major market and little chance of reentering in the future.

Often the natural buyer is the company that is most willing to invest to build the joint venture. Here companies that have deep pockets and look to strategic results, not financial returns, as the measure of success are at an advantage. It is important that alliance negotiators understand the differing goals and perspectives of potential partners as they form cross-border ventures. Western managers in particular often fail to balance the attractiveness of Japanese capital with the possibility that Japanese partners may become buyers of the business. Japanese companies are often able to pay more for their acquisitions because they have a lower cost of capital and longer time horizons for investments. But our research suggests that Japanese companies do not earn back even their *own* relatively low cost of capital in two-thirds of cross-border acquisition programs. And a survey of 90 mid-level managers at 25 leading Japanese companies found that 85% of the respondents thought that entering new businesses or improving the position of existing ones is more important than financial gain. This is in sharp contrast to the profit orientation of many Western executives.

These factors suggest that Japanese partners are often well positioned to buy the joint venture. Indeed, a separate study by the McKinsey & Company Tokyo office including more than 700 alliances between Japanese and non-Japanese companies indicated that Japanese partners have been the acquirers in approximately 70% of the terminating alliances.

One steel joint venture between U.S. and Japanese partners is typical. Over time, the U.S. investors have been unwilling to sink additional capital into modernizing factories, but the Japanese have been, and their stake has grown with each additional investment. As the business continues to require additional capital, the U.S. partner is likely to be reduced to a distinct minority.

The tendency of Japanese companies to be buyers of their ventures can be good news for Western partners that want to improve position or develop products before divesting a business. But it may make for a troubled relationship: if the Western company is looking for an early return, it is likely to seek the largest, hence most threatening, Japanese players as partners and rely on them to manage the venture. The venture may be profitable, but the Western partner's contribution to the business may shrink over time, and the Japanese company might eventually buy its partner out.

If, however, the non-Japanese partner continues to contribute in a significant way, the joint venture can grow and change. One example of a successful and enduring U.S.-Japanese alliance is Fujitsu-Amdahl. Fujitsu initially brought capital and manufacturing skills to the party, while Amdahl brought expertise in mainframe design and architecture, as well as an established local name in the United States. Since 1972, Fujitsu has increased its equity stake in Amdahl to about 44% but has agreed not to increase its ownership beyond 49.5% through April 1994. With

Manager's Choice: Expand Abroad or Diversity at Home?

Expanding at home in core businesses is often the most appealing growth strategy. But in many mature industries, it is not an option. Managers are left with the choice of diversifying at home or expanding abroad. On the one hand, most CEOs remember the "sins of the seventies"—the rash of acquisitions conglomerates made in a wide range of unrelated businesses, which left a legacy of poor business performance. On the other hand, given the added challenges of managing across borders, many managers are reluctant to make cross-border acquisitions or alliances.

In fact, we found that expanding through cross-border alliances or acquisitions is often a much more attractive option than diversifying by acquiring domestically. Cross-border alliances and acquisitions have a success rate of somewhat better than 50%, compared with the success rate of about 25% for home-country diversification programs.*

Why? In cross-border alliances, partners can avoid acquisition premiums while combining their strengths to target core or related businesses. And most cross-border acquirers focus their sights on core businesses, where there is more opportunity to add value than in related businesses.

*Data on domestic mergers and acquisitions are from a 1986 McKinsey study of 200 top companies.

Fujitsu's help as a financial backer and component supplier, Amdahl has been able to meet the rising ante to develop new mainframe machines, and its rank among U.S. computer companies has risen from nineteenth in 1980 to thirteenth in 1990.

Companies can retain the option to buy the venture by holding a 50% or greater stake. In addition, they should be actively involved in the ongoing operation of the joint venture. And they should be sure to place people in positions where they can learn the critical skills the venture needs to operate independently. There are reasons, though, to choose to be the seller. If, for instance, a company is exiting a business, a joint venture allows the eventual buyer to learn the business before taking it over.

Intellectual property rights and proprietary technologies are ticklish areas in an ongoing alliance, but they become even more sensitive when the partners separate. Legal protections go only so far. Successful alliance partners tend to use several different structural tactics to meet this challenge. First, they isolate sensitive technologies from the venture. For example, GE modularized the production of high value-added engine-core components to protect its know-how from Snecma. Similarly, Boeing retained control of overall design and assembly of key components in its alliances with Mitsubishi, Fuji, Kawasaki, and Aeritalia.

Second, some companies centralize contact points between the joint venture and the parents. This is relatively easy in highly centralized companies—like Japanese businesses—but poses a challenge in more open and decentralized organizations, like many in the West. Third, fixed costs that are so high they must be shared and complementary staff make it hard for either partner to succeed without the other. Both Toshiba's and Motorola's strategic position would be damaged if either terminated the alliance because the two companies have such a high level of interdependence in the form of shared factories, shared distribution, and complementary specialized skills.

Strategic alliances are tough to pull off, but they are often necessary. Greenfield strategies take a long time, acquisition targets aren't always available, and simpler approaches like licensing may not be responsive enough. While every alliance is unique, there is a lot to be learned from the lessons of existing partnerships.

But managers need to remember that alliances by their nature are laden with tensions. No matter how well structured they are, most alliances get into trouble at one point or another. Strong companies make attractive partners, but they also present a competitive threat over time. The objectives and styles of parents will differ. Neither fifty-fifty nor majority ownership is a guarantee of fair or good management decisions. And as the venture grows, tensions will arise between the parents and between each parent and the venture.

These inherent tensions require more flexibility on the part of the parents than many other business strategies. Alliance managers should not only structure the alliance to minimize these tensions but also be prepared to rebalance the alliance—or exit smoothly—when it gets into trouble. Meeting the requirements of change, after all, is the main requirement for success in alliances.