Coffee and one way to Boston

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More service companies are forming alliances
For room service, call Pizza Hut
Should you share your brand or your assets?
But sometimes car fumes and breakfast don't mix

PARTNERING IN SERVICE BUSINESSES is now so widespread that it is almost taken for granted. Passengers travelling on United flights anywhere in the world are offered Starbucks gourmet coffee in a dual-branded cup. Baskin-Robbins ice-cream shares premises with Denny's family restaurants. Mail-order merchant L.L. Bean provides Federal Express delivery to its customers. United Airlines and Lufthansa coordinate their airline schedules and frequent flyer programs and place their logos side by side in international advertising campaigns.

In an expanding array of service businesses, managers are discovering that alliances can be an effective way to strengthen brands and improve economics. These alliances come in a smorgasbord of flavors: co-branding, co-marketing, code-sharing, licensing and distribution arrangements, strategic outsourcing, and more. Yet despite the attractiveness and popularity of partnering, our work with numerous service businesses suggests that as many as half of all these alliances are failing to live up to expectations, delivering neither a competitive boost nor higher profits. Partnering is turning out to be much more difficult than many companies anticipated.

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An analogy can be drawn with the pitfalls and success factors in cross-border alliances.* Many of the same conditions apply to successful service alliances. The companies taking part should agree on objectives; they should offer complementary strengths; they should agree in advance on a detailed business plan and on how the alliance will be managed; and, because alliances need to adapt to changing circumstances, they should build flexibility into their agreement. But because of the importance of brands and the complexity of many delivery systems, service alliances also involve some distinctive challenges of their own.

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As these alliances ripple through industry after industry, managers confront three critical questions: How do service alliances create value, and do they make sense for my business? What types of service alliance should I consider? And, most important, what do I need to think about in developing a partnering strategy and managing an alliance?

Why partner?

Service companies first acquired a taste for alliances in the late 1980s, when stiffer competition forced them to rethink their strategies. In the United States, airline deregulation, for instance, led to sustained price competition and overcapacity, from which the industry has yet to recover. In the quick-service restaurant business, most of the prime sites had already been taken, costs were rising, and fierce competition between existing players drove down returns in what had previously been a vibrant segment.

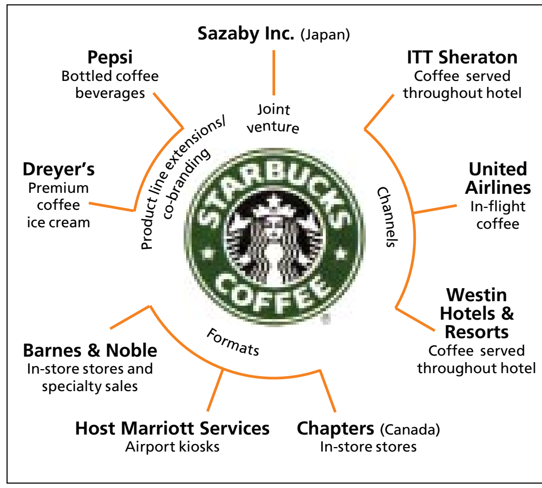
As many service businesses matured, sluggish demand, rising consumer expectations, and outdated cost structures exerted new pressures on companies that had once enjoyed rapid and profitable growth. In response, most players sought temporary relief through cost-cutting. However, the more far-sighted realized they needed to find fresh ways to improve and differentiate their services in order to create superior value for customers and shareholders. Alliances emerged as an answer.

The appeal of a service alliance is that partners retain their independent brands – and, in most cases, their financial control – while they simultaneously raise revenues or cut costs. Revenue grows when partners improve the services they offer and reach more customers. Cost savings are achieved by sharing assets or elements of the business system, or by capturing operating efficiencies through the outsourcing of certain activities. The challenge is always to ensure that the coupling of the service delivery

* *See* Joel Bleeke and David Ernst, *Collaborating to Compete,* John Wiley, New York, 1993.

systems supports – and preferably enhances – the operating efficiency and effectiveness of each partner's core concept.

Starbucks: Brand-building partnerships



Take the alliance between Pizza Hut and Choice Hotels International (corporate parent of Comfort Inn, Quality Inn, Econolodge, and other chains). It enables hotel guests to order a pizza that is delivered at no extra cost to their room. In this arrangement, everybody wins. Choice Hotels, whose brand hotels typically have no in-room dining facilities, improves the quality of its service, while Pizza Hut gains customers among hotel guests who might otherwise eat elsewhere. These guests represent a large, attractive customer segment that is geographically focused and hence economic to serve. While orders are currently placed by phone, it is possible to envisage a guest's television screen offering an electronic menu linked to the local Pizza Hut – an efficient way of boosting both sales and customer service.

Two modes of alliance

Most service alliances have certain fundamental characteristics in common. First, at least one of the companies needs to make changes in its delivery system. Second, the customer's perception of the brand offering will alter as a result of the alliance. Third, the relationship between the partners is exclusive to some degree. Finally, there are shared risks and benefits.

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These common features aside, the extent to which allying service companies will choose to integrate their delivery systems and collaborate on day-to-day business will vary. The loosest form of alliance may seem little more than a new delivery channel; the more complicated appears tantamount to a merger. To make sense of the latter variety, it is helpful to group alliances into two broad categories: brand sharing and asset sharing.

Brand-sharing alliances are characterized by some kind of joint service offering, but limited operational integration. They might involve co-marketing, co-branding, or a distribution or licensing agreement. They focus on increasing customer benefits. Because business system integration is low, brand-sharing alliances usually deliver only minor cost efficiencies. The main attraction of a brand-sharing alliance is that it allows partners to sweeten their product offering with a minimum of incremental investment.

Citibank's agreement with American Airlines, whereby Citibank credit card holders can accumulate American frequent flyer points, is a good example. By exchanging information electronically and performing some joint marketing, both companies have increased the appeal of their products with a minimal amount of coordination. So simple was the concept that it has since been copied by virtually every credit card company.

Asset-sharing is a more complicated form of alliance in which the partners maintain distinct product offerings, but share some assets in the business system – often real estate, but sometimes computers or even aircraft. Whereas brand-sharing alliances seek to raise the quality of the service offered, asset-sharing alliances place more emphasis on reaping cost efficiencies, though opportunities to earn extra revenue do exist.

In the arrangement between Citgo gas stations and 7-Eleven, the partners share real estate costs. Looking to improve its financial returns, Citgo realized its retail space was an underutilized asset. Like other convenience store chains, 7-Eleven wanted more cost-effective distribution points. By establishing outlets in Citgo stations, it gained access to new real estate and attractive locations. Whenever customers take advantage of one-stop shopping (or succumb to impulse buying), extra revenue is generated for both partners.

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Examples of asset-sharing alliances dot the landscape. Innovative gasoline retailers are branching out beyond convenience stores to partner with fast-food, car-wash, and dry-cleaning companies. McDonald's has teamed up with Wal-Mart to sell Big Macs in the latter's stores. Leading quick-service companies like Taco Bell and Dunkin' Donuts regard gas stations and other new distribution channels as among their most attractive opportunities for future expansion.

Some asset-sharing partnerships go further still, linking product offerings and delivery systems so intimately that they begin to look more like mergers than alliances. These mega-alliances can offer high returns for service businesses, as witnessed by the airline industry, where carriers worldwide are scrambling to maintain profitability in a brutally competitive market.

British Airways and USAir were pioneers of the mega-alliance. British Airways was looking for access to the US market to feed its global routes, while USAir needed a capital infusion and global routes to offer its American customers. Both carriers wanted to improve their fixed cost base. In their alliance, the two companies have presented a common face to customers, with dual-branded advertising, integrated frequent flyer programs, and code-sharing on connecting routes.

This much is now common practice in loose affiliations throughout the industry, but the USAir and British Airways alliance goes much deeper. The two carriers now have common hub operations, maintenance facilities, and city ticket offices. Cost savings and increased revenues from these and other synergies are reported to total over $100 million a year.

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Other airlines have followed this lead. Northwest Airlines and KLM, United Airlines and Lufthansa, and Continental Airlines and Alitalia are all moving in a similar direction. A 747 recently flew from Newark to Rome with Continental's colors on one side of the plane and Alitalia's on the other, symbolizing just how far the two carriers are integrating their offerings. Seeing such partnerships as a golden opportunity to transform performance, other service companies are being tempted to follow suit. As well as raising revenues and cutting costs, such alliances can also open up new avenues for geographic growth and market penetration.

Nevertheless, the tighter partnerships, combining as they do the most difficult aspects of alliances and mergers, carry high risks. Although the allied companies integrate large portions of their businesses and have to behave like a single merged company in some of their operations, they retain their individual brand identities and, in some cases, independent financial and operating control. As a result, there will always be a strong cultural tendency to resist sacrificing individual brand or company interests for the sake of the alliance.

It can prove extremely difficult and costly to unravel the relationship should the partners decide to go their separate ways

There are other challenges, too. The key performance measure for the integrated delivery system is improved profit. Individual brands should be more economically viable together than alone, although each must continue to contribute to overall company performance. Integrating delivery systems is challenging enough, but finding out which businesses are making or losing money is also complicated. Since the performance of the individual businesses is masked, management control is diminished. Friction about how to share the costs and benefits of an alliance is common, and when the relationship deepens to the point of becoming a pseudo-merger, it can prove extremely difficult and costly to unravel should the partners decide to go their separate ways.

Given that ensuring sufficient operational cooperation between brands is such a tall order, it is not surprising that companies involved in these mega-alliances tend to swap equity stakes as a means of cementing their partnership. Yet in the light of all the risks, an outright merger or acquisition, if feasible, would often be less complicated and just as rewarding.

Alliance advice

Few companies entering an alliance grasp the magnitude of the challenge they are undertaking. On the surface, forming an alliance might appear to be a straightforward way of enhancing a business. But the reality is different. A new alliance demands precisely the same energy, focus, and hard analytics that mergers do. And, as with mergers, there are critical noneconomic factors that must be understood and managed in order to maximize the partnership's chances of success.

Fortunately, however, service companies contemplating an alliance can learn from the pioneers. Experience suggests some practical approaches to developing partner strategies and managing service alliances.

Developing partnering strategies

Fine-tune the fit of partners and brands. Savvy managers will fine-tune their choice of partner, taking into account such details as demographics and customer usage patterns to ensure a good fit. A gasoline retailer located on a busy commuter route, for instance, would do better to consider allying with a company that serves "breakfast on the go" than one associated with lunch-time eating. And for the breakfast chains, gas stations located on the inbound side of the road are likely to be a better bet than those on the homeward side.

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It is vital that partnering companies have compatible brand images, even if they are in completely different businesses. The co-location of discount stores Dart Drug and Trak Auto may lead to cross-buying, but placing a luxury chocolate shop next to McDonald's won't. And partnering with a company whose concept or delivery is second rate is a surefire way of eroding years of hard-won brand equity.

All this might sound like common sense, but mismatches are made with disturbing frequency, especially in cross-industry alliances where the partnering companies may understand less about each other's industry position, day-to-day operations, and brand equity. Companies need to be clear on the particular skills, service, and qualities they are seeking in a partner. Any management team considering a service alliance should ask itself: What are the key attributes of an optimal partner? If there is a lack of consensus or specificity in the answer, that company is heading down a risky road.

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Companies must also consider how an alliance might affect their own brand. However loose the alliance, there will be sufficient operational overlap to put each partner's customers, service offering, and brand reputation at least partly at the mercy of the other's. In the Starbucks alliances with United Airlines or Sheraton, for example, a stale cup of coffee could disappoint a customer and tarnish the appeal of the combined offering.

Ensure that the joint product offering in a brand-sharing alliance will remain distinctive for long enough to earn back the costs of implementation. Because most brand-sharing types of alliances are relatively simple to enter into, a successful idea can be easily copied, leaving all concerned with no competitive advantage. L.L. Bean's alliance with Federal Express is a case in point. Guaranteeing express delivery was a clear source of differentiation until Lands' End followed by establishing an alliance with UPS. The explosion in credit card/airline alliances also came about when a winning concept spawned a flurry of imitations, raising both customer expectations and marketing costs across the board.

Recognize that the risks and benefits in an alliance are often disproportionate. Few passengers would go so far as to switch airlines if the coffee served on board were improperly brewed, but a premium brand like Starbucks could be seriously damaged. Starbucks is therefore highly dependent on the service provided by United. The partner with less at stake may also be the one with most of the day-to-day operating control; moreover, the partner that is less at risk in an alliance (or that has least to gain) is the one least likely to invest the resources needed for the alliance to work smoothly. An uneven balance of benefits and commitment between partners can sabotage an alliance's effectiveness unless expectations and operating guidelines, especially those related to quality, are agreed in advance.

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Partners in asset-sharing alliances tend to have more balanced interests, but they are still vulnerable, as the high degree of operational integration means that each will inevitably influence the other's service. A gasoline retailer might well attract new customers by inviting a breakfast caterer to set up shop on site. But it might also lose loyal custom if pressured commuters resent having to wait in line at the pump while the driver of the car in front lingers inside deciding what kind of muffin to buy. Equally, the restaurateur's regular customers might object to having gasoline fumes mingling with the aroma of their morning coffee.

Ensure that the bundled offering will enhance customers' perception of value and provide a service that they cannot easily or economically put together for themselves. In their eagerness to align, some companies have overlooked this basic rule. The Allegis link-up between Hertz, United Airlines, and Intercontinental Hotels in the 1980s failed to meet expectations because travellers preferred to book their own combination of car, airline, and hotel, and could do so easily over the phone or through a travel agent. Technological developments such as the Internet are increasingly enabling customers to do this kind of bundling themselves with the minimum of effort.

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Managing an alliance

Prepare as for mergers. Before concluding an agreement, managers on both sides should ask themselves: Suppose we had already signed the alliance agreement. How would we resolve the ten toughest decisions that need to be taken? Even the most casual of alliances requires planning and commitment on a level with that needed for a full-scale merger.

Partners that fail to determine early on what the mechanisms will be for developing strategy, making key organizational decisions, and assigning financial accountability in the newly merged culture will face a bitter struggle to define these issues after the alliance has taken shape. Neither partner will have full control, or the power to force decisions after the deal. New alliances therefore demand an enormous amount of initial negotiation and pre-planning. Preparations should include an assessment of the source of the economic value in the relationship and realistic plans of how to capture it.

Once the wheels have been set in motion for forming an alliance, both companies must take quick and effective action to manage the transition. The strategic vision must be communicated right from the start. Employees need to know what is happening and why. The strategic benefits that the change will bring ought to be clear, as should the employee benefits that will accrue from enhanced competitive performance.

Don't underestimate the importance of cultural factors. Companies that single-mindedly focus on the bottom line almost always end up in trouble, for a myriad of cultural factors also shape the eventual success or failure of a partnership. Even in loose affiliations, partners are likely to find that one culture dominates, and employees on the "weaker" side may well resist change. While these cultural factors are only to be expected in a takeover, such reactions are seldom anticipated in alliances. Yet the motivation, attitude, and skills of the employees at the interface with customers determine much of the quality of the service offering – and companies entering alliances are placing their service in the hands of two employee groups instead of one. Lack of enthusiasm on the part of employees is virtually guaranteed to kill a service alliance.

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Budget the time needed to make the alliance work. Alliances take up management time at both senior executive and operating levels. High-quality joint teams will have to be set up to track the alliance just as the implementation of a merger is tracked. Companies must be prepared to rethink the situation continually – and to change their plans and negotiate as necessary.

A weekly monitoring process is usually required at first, although it can be time-consuming and difficult to arrange. All alliances involve some reconfiguration of power and influence, so frequent communication is essential in negotiating the differences in objectives, style, and thinking that arise. A rule of thumb that has emerged from discussions with alliance managers is that communication will consume at least twice as much management time for each alliance partner as would be needed for an independent initiative.

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Build in conflict resolution and decision mechanisms. At the outset, partners should agree on operational procedures to help them keep control of their service offering, protect their brand image, and avoid conflict. Starbucks, for example, might want to control the delivery of coffee beans to planes to ensure they are fresh, and retain the right to board planes from time to time to check the quality of the coffee being served. And in its agreement with Sheraton, Starbucks' quality code requires that coffee be thrown out after sitting for 90 minutes. Still, it is best that partners acknowledge that unforeseen conflicts are bound to arise, and will have to be dealt with.

Thriving partnerships tend to be those where expectations have been fully discussed at the outset, and where mechanisms for decision making and conflict resolution have been designed into the alliance. Such mechanisms might include taskforces that support the alliance and report to a clearly defined management structure, and checkpoint meetings to review progress and resolve problems. Solutions often demand flexibility in adjusting the alliance's managerial and operating practices as both sides learn from their experiences.

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Consider exit options. The number of service alliances that are currently underperforming suggests that partners may well want out several years down the road. Before placing its customers and brand equity in the hands of another company, a prospective partner must try to envisage what might happen if the alliance had to be restructured or disbanded. In asset-sharing alliances where companies have intertwined their delivery systems and infrastructures to the point where they are inseparable, the only exit strategy may be for one or both of the partners to sell.

Even loose alliances can cause damage when they disintegrate. An airline that loses its limousine service partner might have difficulty replacing it promptly with a reliable alternative, disappointing passengers who have come to expect a limo ride as part of the airline's product. And if rivals all offer a similar service, the airline's competitive position will be weakened.

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Forcing itself to think through these exit options helps a company ensure that the risk/return assumptions underlying its alliance strategy are sound, and that the alliance is structured in a manner that best protects its brand equity and other corporate assets.

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The current wave of alliances sweeping through financial services, entertainment, healthcare, and other service businesses will persist. To compete more effectively, companies are seeking partners that will enhance their service while sharing costs, skills, and access to markets. The successful service businesses of the future may well enter dozens of collaborations and generate much of their revenue, growth, and brand equity from a network of alliances. Their challenge will be to develop the capabilities they need to manage these alliances and integrate them into the strategy-making process.

In the meantime, prospective partners would be wise to think before they rush into tangled relationships. In the cautionary words of Friar Laurence from *Romeo and Juliet:* "They stumble that run fast." Q