Not by **M&A** alone

David Ernst and Tammy Halevy

Sometimes alliances make more sense than mergers or acquisitions.

As high-tech companies wrestle with the coming wave of restructuring, executives should consider the full range of deal options: not just mergers and acquisitions but also alliances and joint ventures. In some cases—when companies are unwilling to sell or acquisition premiums are too high—alliances are the next best thing to a merger. In other cases, they are actually preferable to M&A. Experience from a range of sectors shows that high-tech CEOs and CFOs should consider several types of transformational alliances.

First, when parent companies want to stay involved in a business but need to gain scale to compete, they may unite business units into a joint venture; Sony and Ericsson, for example, combined their mobile-handset units to take on Nokia and Motorola. (Other examples include Spansion, which combines the flash memory businesses of AMD and Fujitsu, and Renesas Technology, the $8 billion combination of Hitachi's and Mitsubishi Electric's semiconductor operations.) Joint ventures face many of the same integration challenges found in large-scale mergers, and the partners must cope with the added problems of shared ownership. Nonetheless, joint ventures can generate synergies equal to 50 to 75 percent of the value of the contributed businesses, both through increased revenues from a stronger product line and through cost reductions due to scale. Marathon Ashland Petroleum—a profitable joint venture that generated $450 million in net income in 2002 by operating refineries and retail stations—is a successful example of this type of alliance in a mature industry.

Companies should also consider joint ventures and nonequity alliances to share risks and costs when entering new markets or think about investing in next-generation research or manufacturing. Several semiconductor companies, for example, have joined forces to develop a next-generation manufacturing process technology. This trend will strengthen as costs rise for the coming generation of chips. Similarly, many chemical and petrochemical companies have created joint ventures to share the costs of major new plants and to develop novel technologies. Union Carbide and AlliedSignal, for instance, combined their skills more than 15 years ago to launch UOP, a joint venture that develops process technology for the oil-refining, petrochemical, and gas-processing industries. It has since grown to become the world's largest process-licensing organization, with reported annual revenues of more than $800 million.

Alliances are also a useful way to reduce exposure from or investment in noncore or commoditizing parts of the value chain. In some cases, these alliances will take the form of outsourcing and offshoring arrangements. Others will create new customer–supplier relationships by helping customers to shed noncore assets and suppliers to increase scale, as happened when NEC entered a joint venture with SVA for thin-film-transistor liquid color displays. The joint venture in China permits NEC's liquid-crystal-display (LCD) business in Japan to focus on innovation and customization, while all volume production, development, manufacturing, and sales will be handled through the joint venture. As technology companies outsource their more complex activities, they will resort to more complex kinds of financing, to joint ventures with buyout options, and to other creative partnership structures that mitigate risk.

When technology players reach for scope to provide integrated solutions, they'll look outside their sandboxes and form alliances with complementary businesses, as happened with pharmaceuticals and biotechnology as well as with banking and insurance companies. Indeed, as the volumes of data generated by biotech research have created a need for specialized hardware and software, IBM has developed a portfolio of bioinformatics alliances with companies including Monsanto and Applied Biosystems.

Some of these alliances will be "marriages for life." In other cases, alliances and joint ventures will be used appropriately as a way to provide a transition out of a business when an outright sale isn't feasible or attractive. Boards and executives will need to choose their strategies and partners carefully, keeping in mind a deal's likely evolution. But given the forces at work, managers should avoid jumping to the conclusion that a merger or acquisition will solve the challenges they face. By considering all types of deals, they are more likely to find the one that makes the greatest long-term strategic and financial sense.

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