Strategic Alliances:
Finding the Hidden Leverage for Success

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Mergers... joint ventures... strategic alliances... businesses are increasingly relying on these activities for strategic advantage. All too frequently, however, the potential benefits fail to materialize. While much attention is focused on the financial and contractual aspects of an alliance, we believe that the key to organizational partnerships lies in a different arena. Increasingly we are convinced that the success of such alliances depends on the „human factors" – the ways that people think and interact. And we have gained practical insight into both the hurdles that impede cross-organizational alliances and the processes necessary for their success. But first, let's step back and take a „big picture" look at how alliances work.

A Systemic View of Alliances

Ironically, the degree to which human issues can undermine an alliance is directly proportional to the potential benefit of the partnership. This relationship makes sense if we consider why cross-organizational endeavors are attractive. Despite the important differences among mergers, joint ventures, partnerships, and alliances, all four are based on the assumption that there are benefits to closer working relationships with other organizations.

In a young business, performance may be directly related to the company's ability to perform core *tasks*, such as manufacturing a chip with a low percentage of rejects. However, once the product can be reliably constructed, the company can achieve greater benefits by improving the manufacturing function as a whole than by pursuing further production efficiencies. Imagine, for example, a highly efficient production line that nonetheless operates at a loss because poor production scheduling leads to shortages of raw materials and excessive personnel costs. Imagine a sales organization in which the salesforce has developed superb selling skills, but where orders are routinely mishandled. In these and other examples, improving the *coordination of tasks in a function* will yield greater benefits than fine-tuning each task separately.

Analogously, as functional effectiveness increases, the greatest opportunity for corporate performance improvement will come from *cross-functional integration.* Organizations worldwide are recognizing how departments that strive for their own optimal performance can combine to produce sub-optimal results for the business. A marketing function that achieves record-breaking revenues through customer promotions can nonetheless drive down overall profits through the extra manufacturing and distribution costs required to support those promotions. Similarly, marketing groups can inadvertently damage a company's image by making promises to customers that the R&D group cannot meet. Finance departments that institute hiring freezes to reduce costs can cause greater expenditures through the use of outside contractors.

In each case, the opportunity lies in coordinating and optimizing a larger system. Interestingly enough, the focus of management improvement trends in this century follows a similar pattern, from task efficiency to functional excellence to cross-functional integration. The logical next step is to conquer *cross-organizational boundaries,* i.e., to align independent companies in the pursuit of joint goals.

While these alliances are a relatively new phenomenon, they can benefit considerably from the experience companies have had learning to work cross-functionally. It is fair to say that the issues experienced in moving from functional to cross-functional excellence apply to cross-organizational efforts – except that the difficulties are exponentially larger. Why so? *The fundamental challenge in integrating parts of a system is creating alignment among individuals and groups who see the world differently – who have different goals, norms, perceptions, and priorities.* The farther apart the groups, die more different their perspectives, and thus the greater the challenge in bringing them together.

The significance of these varied perspectives depends on the degree of innovation to which the alliance aspires. The simplest kind of alliance creates cost reductions through increased scale; an example might be a group of clinics that join together for purchasing discounts. This kind of alliance requires minimal change on the part of the participating organizations, and thus organizational differences aren't a critical issue.

A more ambitious aim is to improve operational effectiveness through closer coordination between businesses. For example, a consumer-products manufacturer that integrates its systems with its distributor's can optimize loading and shipping operations. This kind of integration creates some challenges for the participating organizations, but since the innovations occur within established functions, there usually exist processes and expertise to manage the changes.

The greatest difficulty occurs when alliances attempt to develop significantly new ways of conducting business. Simply put, the greater the strategic benefit of an alliance, the greater the challenge of cross-organizational integration and the more critical the attention to human factors.

To understand the role human factors play in strategic alliances, let's look at the key obstacles to cross-organizational relationships.

Key Obstacles

Cross-organizational relationships must overcome three principal kinds of hurdles: coping with increased complexity, aligning contrasting orientations, and combining cultures.

Coping with Increased Complexity. The newly combined organizational system is by definition significantly more complex than either of its component entities were alone. Furthermore, no individual or group has experience working with the combined entity. Many organizations whose greatest skill is at the functional level find it difficult enough to manage the cross-functional repercussions of their own activities. These groups have not learned to think systemically and are thus beset by the unforeseen consequences of actions in other parts of the organization. Even organizations that have mastered cross-functional thinking will find it challenging to manage cross-organizational „ripple effects." The strong tendency to focus on maximizing gain for one's own organization can seriously undermine the broader effort.

Aligning Contrasting Orientations. Organizations' orientations can vary in terms of focal length (short-term vs. long-term), philosophical emphasis (strategic vs. operational), and integration of goals.

Short-Term vs. Long-Term Focus. The delicate balancing act of addressing short-term needs while investing in the long term is never easy. However, through experience most businesses learn to walk that tightrope. Unfortunately, in an alliance each partner must consider how its short-term actions will affect the other's long-term success. The greater the potential benefit in an alliance, the more the participants' short-term and long-term fortunes are coupled. Often actions that make perfect sense in the short term end up producing the unintended consequence of undermining the long-term value of the relationship.

For example, a Fortune 500 office products manufacturer sought to have greater influence and merchandise share with its independent dealers without incurring the cost of an owned dealer network. It developed a potentially powerful alliance concept. Selected dealers, while maintaining financial independence, would make a commitment to represent this manufacturer's products exclusively. In addition, these dealers would upgrade their facilities and services to complement the manufacturer's high-end image. In return, the manufacturer would offer sophisticated business advice and services to the dealers, including attractively priced credit. The net cost to the manufacturer was much less than acquiring the dealerships, and the dealers stood to benefit from the business expertise and financing of a major corporation.

At the time, Innovation Associates, a unit of Arthur D. Little, was consulting to the senior management team of the manufacturer. Among other work, we were exploring the implications of the alliance through computer simulations of future operations. We developed a simulation that allowed independent decision-making by the manufacturer and the dealers. The management team divided into the two roles. All went well when the business environment in our scenario was friendly. But when the teams were faced with a simulated market downturn, the results were sharply different. The immediate reaction of the „manufacturer team" was to protect its current margins by raising prices to the dealerships and cutting back on dealer support programs. The „dealership team," faced with declining profits, reduced investment in their facilities and in local marketing programs. In the simulation, the long-term effects of these actions hurt both groups – and generated significant ill will. Despite this preview of possibly negative consequences, the manufacturer chose to proceed with the alliance as planned. Unfortunately, the simulation results were mirrored in the real world, and the alliance concept fell far short of its potential.

Strategy vs. Operations. Individual organizations can sometimes function effectively despite having divergent operational and strategic goals. However, the success of an alliance may depend on the degree to which these very different orientations are integrated. Alliances frequently form because of the theoretical strategic advantage of envisioned joint capabilities. However, once the alliance is in place, those theoretical capabilities must quickly become real – and successful. Otherwise, the alliance is likely to fall apart.

Why are human factors such a critical element in integrating strategy and operations? Because in most organizations different groups are responsible for these two perspectives, and these groups do not combine their respective knowledge when making decisions, The strategic thinkers may have a clear picture of the long-term business opportunities, but will tend to underemphasize the difficulties of actually implementing new capabilities and the ways that alliance activities might hurt the existing organization. On the other hand, the operational team, motivated by incentives to improve current performance, will focus on the implementation challenges and will be less aware of/ interested in the strategic possibilities. Thus an all-too-frequent scenario for an alliance is that senior managers enthusiastically create a grand vision while „leaving the details to be worked out by others." The subsequent operational decisions cause tactical improvements that don't add up to the strategic potential.

Differing Goals A prevailing management paradigm is to „divide and conquer." We expect to reach high-level goals by achieving multiple, parallel sub-goals – e.g., by independently maximizing revenues and minimizing costs to generate maximum profits. This is a major cause of the phenomenon described earlier – locally optimized performance with sub-optimal results overall. In addition to problematic business results, this approach causes an increasingly myopic orientation – each group concerned with its own goals, which are viewed as the key to organizational success. Gradually these subgoals stop being the means to an end and become the end itself. Once a group unconsciously assumes that its goals are paramount, several undesirable tendencies may develop. At best, the group will make choices with little thought to the impact on other areas. At worst, there may be significant conflict between groups. (This is so common that newly appointed managers routinely inquire whether they are faced with „warring tribes!") Clearly, warring tribes cannot achieve the seamless integration needed to create strategically significant innovations.

Exacerbating the difficulty is the real likelihood that the alliance partners will have different goals – and that neither partner will appreciate the implications of the differences. In one alliance we helped facilitate, between a manufacturer and its key distributor, each organization's profits were driven by fundamentally different factors and measured in different ways: one by volume and the other by return on capital. This difference had never been understood and appreciated, causing years of tension and conflict between the parties.

Remember: the difficulties in a strategic alliance are the same as those within individual organizations, only exponentially more complex. It is advisable for all organizations – and essential for cross-organizational alliances – to replace the paradigm „divide and conquer" with „connect and comprehend."

Combining Cultures. Companies that come together with a clean slate (i.e., with no negative preconceptions) but have different cultures may quickly find that the variations in their behavioral norms will create a breeding ground for mutual misunderstanding, poor follow-through, and eventual distrust.

In one joint venture between a major consumer-products manufacturer and a small, innovative drug developer, cultural differences quickly caused conflict between the participants. The manufacturer had a well-established hierarchical culture. There were strict behavioral norms, appearances counted, and promotions depended on being the prime mover behind successful endeavors. The drug developer was a young company whose independent-minded staff was accustomed to working in an informal, nonhierarchical fashion. One immediate problem was lack of mutual respect. The consumer-product representatives, experienced in market issues, were appalled at the scientists' business naivete, while the researchers were reluctant to be directed by scientific „neophytes." The problem was compounded by the need of each group's representatives in the venture to prove their contribution to the parent company, which made them aggressive in competing for leadership positions.

Consider the additional challenge of combining companies that have a prior working relationship. In this case preconceptions invariably exist. And as the two companies rarely have a common mechanism for airing and untangling grievances, these preconceptions may well be negative. Unfortunately, the significance of this issue rarely becomes apparent until the alliance is well under way, because the senior managers who have met with their equivalents for semi-annual discussions don't have the same awareness of intercompany problems as do the operating managers who have daily interaction.

The significance of historical baggage is most evident when the alliance partners have had a prior customer-supplier relationship. Such relationships, unfortunately, provide ample opportunities for each organization to confuse and disappoint the other. It is much less problematic when two companies with similar roles join together. Even prior competitors, such as BP and Mobil in their European joint venture, are likely to have less initial ill will than did alliance partners such as Procter & Gamble and Walmart. The latter example is particularly instructive.

With more than $30 billion in annual sales, Procter & Gamble is a global leader in consumer products. One of P&G's largest customers is the North American retailing giant, Walmart. In the mid-eighties, relationships between the two companies were at an all-time low. The two companies were unintentionally locked in an adversarial cycle of deteriorating relations, as was typical of the relationships between consumer-products manufacturers and distributors at that time. P&G came to market with an array of promotions. Power-buying Walmart, with its policy of everyday low prices, used the advantageous pricing of P&G's promotions to stock up at discount. Walmart's buying skewed P&G's production schedules, cash now, and, ultimately, bottom line. P&G responded with more promotions. Walmart and its distributors countered with more forward buying, with the associated warehousing costs. Each entity chose the response that foreclosed the other's possibility of succeeding. Faced with an intolerable level of rising costs, P&G decided to meet the challenge head-on – and turn an „enemy" into an ally – by forging a strategic alliance with Walmart.

Innovation Associates was invited to help reforge the relationship to one of trust and mutual benefit. The initial challenge was to align the operating team, composed of managers from both organizations, who openly expressed doubt about the integrity and competence of their opposites. In a workshop lasting several days, the

team used systems thinking tools to build a shared understanding of the mutual consequences of their combined business activities. Managers from both P&G and Walmart saw how each other's actions could be understood as reasonable, rather than as self-interested maneuvers. Aligned around a new definition of „win/win" strategy for both companies, the team made the commitment to implement a powerful strategic alliance. The alliance they forged has since become a much-imitated model for the industry.

This partnership was an excellent example of piloting strategy through an alliance and „organically" creating company-wide commitment. During the year after the initial workshop, the strategic alliance team worked with each brand group to arrange an unprecedented nonpromotion arrangement for P&G products to Walmart. The results were so favorable that the policy spread – until P&G broke with the industry by dis continuing almost all its promotions. As a result, P&G reported significant increases in profitability.

Putting It All Together: A Roadmap For Action

You can dramatically improve your company's success with strategic alliances by paying attention to seven principles we find particularly critical.

Clearly articulate goals. Begin by clarifying your own goals and motivations. Although it may sound absurd, we have seen companies enter into alliances with little or no articulation of their long-term intent and with only vaguely defined measures of success. Every alliance needs a thoughtful and explicit rationale to guide its ongoing effort. The fundamental question is, „What existing or new opportunities could we realize more effectively by combining our capabilities with those of an appropriate partner?" A compelling answer to this question requires a deep understanding of your own company's strategic orientation, markets, and products, as well as those of your partner.

It is critical to think through the potential gains thoroughly – i.e., to carefully examine the „business case" for the alliance. One alliance went exactly as envisioned – the supplier tested out new systems that significantly improved service to its customer – but at a cost that was prohibitive to the supplier. In the original conversations, the supplier had never stated that it needed a significant increase in business from its customer for the arrangement to be profitable.

Define both the long-term and short-term goals for each alliance. Successful alliances establish ambitious long-term goals with shorter-term milestones. They use the accomplishment of those goals to generate trust and confidence in creating longer-term opportunities that may require significant investments.

Select appropriate partners. One key criterion for partner selection is often taken for granted: your partner must also be able to derive long-term advantage through the relationship. A critical early step in the selection process is to define an alliance that will be a „win" for both parties. Ideally, the win will become more significant over time. Alliances that aren't mutually beneficial may fall apart or focus solely on incremental, transactional opportunities, missing possible strategic gain. In contrast, when two potential partners work together to ensure that each understands precisely how the alliance can help the other partner be more successful, it builds trust and establishes a longer-term relationship to sustain the alliance through its inevitable ups and downs.

Other criteria may also be important in selecting a partner. Having an existing working relationship may be a good starting point, but it is not sufficient. Will your partner understand the far-reaching impacts of an alliance and be willing to work through systemic issues? Is your partner likely to be effective at cross-organizational issues (as evidenced by its cross-functional effectiveness)? Is the company able to learn from its own unsuccessful projects? Would you be comfortable revealing your business activities to this company and vice versa? Knowing the characteristics of a potential partner will steer you away from false starts.

Work at both strategic and operational levels.

The ability to work simultaneously at the strategic and operational levels is critical to an alliance's success. An alliance must move quickly from defining high-level strategic intent to successfully implementing new services and activities and from performing operational tests to reformulating strategy and tactics.

While an alliance may be championed by an individual, the management of an alliance cannot be delegated to one person in the organization. As pointed out earlier, successful alliances often require the active knowledge, expertise, and involvement of people from multiple functions, geographies, and levels in both organizations. Each alliance needs a representational team composed of players from both organizations to guide the effort and navigate the challenges of working in new and unfamiliar territory. The team should include people who are senior enough to have decision-making authority, as well as others tactical enough to be „hands-on."

Membership in the team may change over time as opportunities or projects progress. Great care should be taken to integrate new members of the team so that they understand how the goals and operating norms of this activity are different from those of their „home" organization. This does not happen in a 15-minute briefing; new

members need to be given extensive opportunities to understand the alliance's purpose, let go of old mental models, and assume personal ownership of success. Shortchanging these activities has sidetracked a number of efforts we've studied, as new team members took on significant roles without understanding the context, direction, and norms of the alliance activities.

Create organizational alignment. Clearly it is important to create conditions so that the direct alliance participants can operate as an integrated team. Less obvious, but equally critical, is for other groups to support the activities and the needs of the alliance team. For example, a sales-driven alliance will not succeed if the operations function considers it a low priority to modify systems to support the new activities.

How can one work toward organizational alignment? There are two critical tasks: generating widespread commitment to the alliance objectives and removing barriers to supporting the alliance.

Employees not on the team often have little or no exposure to what the alliance is trying to do. Therefore they are unlikely to keep the alliance in mind when they plan and execute their jobs – and can inadvertently take actions that will impede the efforts of the alliance team. Recognize that creating organization-wide commitment to a new direction requires skill and sensitivity. In the office products example, the CEO used the „tell them and tell them again" approach, responding to all his employees' concerns with yet another explanation of why „his" strategy made sense and implying that they were lacking if they didn't see the obvious rationale. Not only did he fail to generate commitment throughout the organization, some groups secretly hoped the alliance would fail. For example, the product development and marketing groups seemed indifferent to the impact on the allied dealers when they introduced a line of inexpensive recycled products that could erode the market for the high-end line carried by the dealers.

A misalignment between existing organizational goals and alliance activities will create barriers even for staff who support the alliance objectives. For alliance team members who also have „day jobs," the tension is generally between current objectives, such as quarterly sales, and time spent on the longer-term alliance activities. Employees outside the alliance team may also be requested to support the alliance in ways that conflict with their normal objectives. Should a customer-service representative who is requested to minimize his or her time per call take extra time for the nonstandard problems of an alliance customer? Should a researcher divulge highly confidential drug protocols to a joint developer?

In outlining the goals for an alliance, it's important to think about how those goals mesh or conflict with existing operational goals. One approach: gather a team and have them „walk through" likely scenarios to identify potential conflicts. Once goal conflicts have been identified, adjustments can be made. The more the alliance team strives to create results that are outside the status quo, the more they may need special dispensation, revised goals, and self-sufficient capabilities. A classic approach is to make the alliance team a virtual organization with its own goals and rewards. Unfortunately, this can exacerbate the sense of difference from the rest of the organization and create pushback.

Often one company takes a more active role in initiating an alliance and is therefore more prepared to grapple with the internal issues. However, it is important for all partner companies to be willing to address organizational misalignment.

Deal explicitly with conflicts and culture clashes.

All great partnerships enjoy high levels of mutual trust. However, partnerships rarely begin with such high levels, and what trust they do have may even erode during their involvement.

Companies with different cultures (i.e., most partners) have different norms and expectations of how people should respond to each other. Behaviors that make perfect sense for people coming from a highly structured, hierarchical organization may seem ineffective or even irrational to people coming from an organization with an entrepreneurial, open culture, and vice versa. For example, a member of a company that expected its employees to return phone calls every two hours was taken aback at how infrequently his opposite in the alliance responded to his messages. From his perspective, this indicated a lack of genuine commitment from the other company. His opposite, being part of a company that didn't depend much on voicemail, was astonished to find out that his trustworthiness had been questioned over such a „trivial" issue.

A common trap is to try to get off to a good start by avoiding or minimizing conflict and differences. Many people have an intuitive belief that the best way to solidify a partnership is to be very „nice" and keep the difficult issues buried, hoping the latter either won't emerge or can be dealt with more easily at a later date. *In fact, the opposite approach* is *critical to building trust.* As early as possible, hold frank discussions of past breakdowns and problems that may have created baggage or mistrust. A systems thinking approach can often help people see how they have unintentionally created difficulties for their partners in the pursuit of their own success. In addition to clearing the air, we have seen alliance teams use this technique to generate key insights into potential conflicts and breakdowns, which they were then able to address in advance.

Often the team will need to establish its own norms and practices as it begins to work together. This process can be frustrating and challenging, since these cultural mismatches may not be evident until they become visible through some clash or conflict in dealing with specific issues. This „culture gap“ can be compounded by „business gaps“ – different goals and perspectives among team members.

Invest time in building the team. Holding educational events early on in an alliance can bring people to develop a common understanding of the strategic and operational issues that drive success in each company, as well as some understanding of the unwritten rules that govern behavior. Establish ground rules for interacting with each other to create an environment in which conflicts and misunderstandings can lead to learning and problem solving, rather than blame and further breakdowns. Training in systems thinking, productive communication, and conflict management has been shown to be a good investment.

Maintain strong executive sponsorship.

Alliances often take on lives of their own as success breeds new opportunities. Acting on these opportunities may require capital investments, modifications to company strategies, or actions that are outside the bounds of current corporate policy. These factors all call for strong executive sponsorship of the alliance. Maintain continuous communication with your executive sponsors, with a particular focus on sharing insights about new opportunities and company practices that may be impeding your ability to proceed. Executives should also ensure that the organization has effective knowledge-sharing mechanisms to gain the maximum benefit from the insights about products, customers, and market opportunities generated by the alliance.

To the extent that the alliance team is required to pursue strategies and tactics that are outside what is considered „normal“ or „acceptable,“ executives will play a critical role in establishing different feedback, measurement, and reward structures for team members. This has been particularly important at the beginning of efforts, when team members may feel exposed or vulnerable, being part of a new activity that is unproved and may be regarded with skepticism by other parts of the organization.

Be willing to experiment and committed to learning. Alliances create the opportunity for learning that can fuel future success. The first and most obvious area for insights is the viability of the business strategy that the alliance represents. Alliances are a golden opportunity to run controlled pilots of new products, services, and activities. However, a learning approach is essential. The only guaranteed result of a cross-organizational alliance is that it will not roll out as planned! The capacity to continually document, reflect on, and modify activities is a critical element in a successful alliance.

A second area for learning is the process of building and maintaining successful alliances. Design into your alliance-building activities a method for documenting and sharing key insights into process, structure, roles, and resources that can be applied to future efforts. In this way, successes can be reliably replicated, and setbacks and disappointments in a single effort can still create great value for your company.

A third, less obvious, benefit comes from the opportunity an alliance gives you to see your company as others see you. Practices and assumptions that you have taken for granted may get challenged. This can yield learnings applicable to the whole organization, not just its alliance efforts. In one recent alliance effort, a supplier’s tendency to overcommit without follow-through – a tendency that was well understood and compensated for in the supplier organization – was seen in a much more critical light because of its negative impact on the alliance partner. Members of the supplier organization were motivated to understand and begin to address the underlying causes of this behavior throughout their organization.

As cross-organizational alliances become increasingly important elements of corporate strategy, mastering the ability to create and sustain these alliances may become a critical success factor for your organization.

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