

MANAGEMENT FOCUS

Managing Partnerships and Strategic Alliances: Raising the Odds of Success

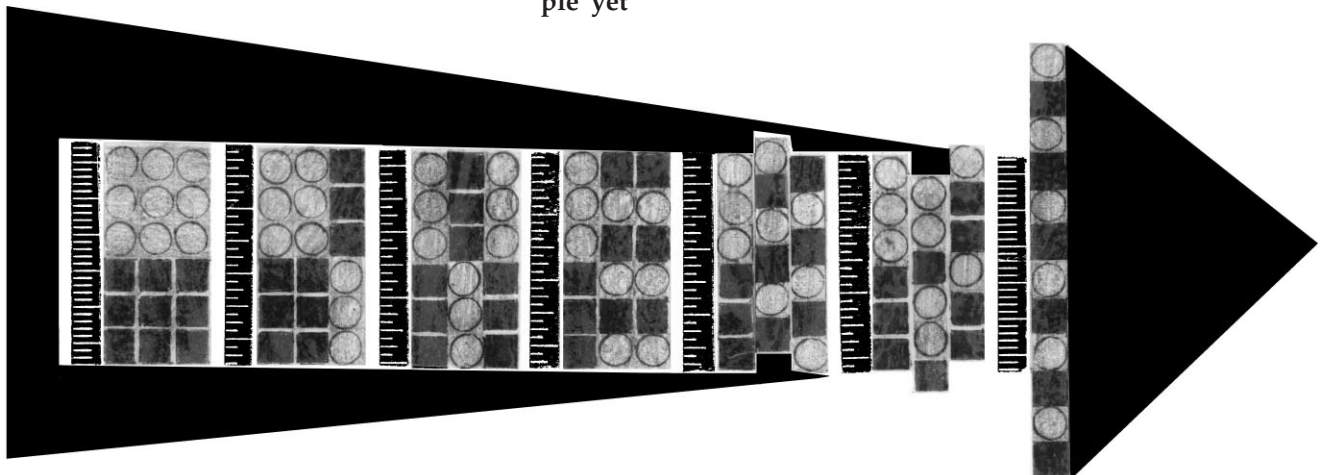
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Raising the odds of success of strategic alliances can have important performance consequences. It requires recognition that alliances are embedded in the strategies of each of the partners. The odds of success increase when the symmetry in the strategic exploitation/exploration intent of the partners is present at the start and is re-calibrated and maintained over time. However, the surfacing of asymmetry is not necessarily a sign of failure but should be expected as both the strategies of the parents and of the alliance evolve over time. In this paper we outline a framework for considering the strategic decisions for entering into an alliance and some of the key issues involving the management process of alliances. Our research and experience documents that this simple yet

powerful framework will work to raise the odds of a successful strategic alliance. © 2000 Elsevier Science Ltd. All rights reserved

The sunset of the 20th century has witnessed the emergence of a business rivalry paradox — cooperative competition (Balakrishnan and Koza, 1990). Its hallmark has been the rapid rise in popularity of all types of alliances — from informal coalition to minority equity interest to joint venture to merger to multiparty networks — to the point that some popular business writers have referred to it as the era of alliance capitalism (Gomes-Casseres, 1996). A surprising and by now a well recognized feature of alliances is their high instability and failure rates (Das and Teng, 2000).



When asked, managers offer plausible but a diverse list of reasons for entering into an alliance. Reasons often given include, gaining access to a restricted market or overcoming barriers to entry; gaining market power; maintaining market stability; acquiring technologies products or new skills; pooling resources; reducing uncertainty; sharing risky research and development projects; speeding up entry into new markets; deriving new incremental sources of revenue from combining complementary assets; and the list goes on. In an influential strategic management textbook Hitt *et al.* (1997) list no less than 15 different reasons why companies might enter a strategic alliance (see Table 1).

When asked why the alliance was dissolved or why it failed, managers often cite lack of cooperation and trust, inadequate advance planning, too much detailed negotiations and too little managing of the actual alliance, lack of organizational capabilities and resources to manage cooperative relationships, strategic mismatch, size mismatch, cultural mismatch, change in strategy of one partner, wrong choice of partner or wrong initial strategy and the list goes on.

The statistics bear out the inescapable conclusion, *alliances are tough to manage*. Studies have reported that two thirds of all alliances experience severe problems in the first two years and reported failure rates range as high as seventy percent (Das and Teng, 2000). At first blush alliances offer a very seductive concept, they represent an obvious simple solution to a range of strategic dilemmas, but in reality very often end up as disappointments. The adage that *even marriages made in heaven run a high risk of failure* appears to be especially apt in the case of alliances.

Table 1 Reasons for Strategic Alliances by Market Type^a

Market	Reason
Slow Cycle	Gain access to a restricted market
	Establish franchise in a new market
	Maintain market stability (e.g. establishing standards)
Standard Cycle	Gain market power (reduce industry overcapacity)
	Gain access to complementary resources
	Overcome trade barriers
	Meet competitive challenge by other competitors
	Pool resources for very large capital projects
Fast Cycle	Learn new business techniques
	Speed up new goods or service entry
	Speed up new market entry
	Maintain market leadership
	Form an industry technology standard
	Share risky R&D expenses
	Overcome uncertainty

^aHitt *et al.* (1997)

Our experiences and research with countless alliances of every type, has led us to conclude that the root cause of alliances failing to realize the hoped for potential can be traced to failure to grasp and articulate the strategic intent for the alliance, including the failure to consider and recognize alternatives to entering into an alliance to begin with. The second most common reason involves lack of recognition of the close interplay between the overall strategy of the company and the role of an alliance in that strategy. Just as the strategy of the company evolves over time so will the strategic intent for an alliance evolve. It evolves as the alliance progresses and it changes as the company strategy changes. In short the first lesson: *put the strategic back into alliances*.

Why enter an alliance? Our research suggests that the most important reason for entering an alliance is to augment and support the adaptation strategies of the parent. Successful companies understand that strategic alliances can be one powerful means for adaptation in turbulent or uncertain environments. Mergers, acquisitions, and internal development are also important vehicles for adaptation. However, in this article we restrict our discussion to strategic alliances.

Exploitation and Exploration in Organizational Adaptation

In a classic paper on organizational learning, James March (1991) distinguishes between exploration and exploitation as motives for organizational adaptation. *Exploitation* refers to the elaboration and deepening of existing capabilities and to incremental improvements in efficiencies. *Exploration* refers to experimenting with or establishing new assets and new capabilities. The strategic intent of exploitation is to obtain residual revenue and incremental enhancement of other competencies from the extension and elaboration of existing assets and capabilities. The strategic intent of exploration is the discovery of new opportunities, which have the potential to dramatically affect a company's performance. The survival and prosperity of companies is a direct reflection of their ability to pursue enough exploitation to ensure the company's viability today, and engage in sufficient exploration to ensure its viability tomorrow (Levinthal and March, 1993; Lewin *et al.*, 1999).

Koza and Lewin (1998), building on March (1991) advanced a coevolution theory of strategic alliances. The theory distinguishes between two basic logics for entering alliances. First, alliances can offer a source of incremental revenue from pooling complementary resources that neither partner is interested in developing on its own. These *exploitation alliances* generally will be implemented as joint equity ventures. Prior to the early 1980s exploitation alliances were by far the most prevalent. The Corning com-

pany, for example, entered its first joint venture *exploitation alliance* in 1937 and by 1988 had been involved in over 20 such alliances. In 1983 Corning derived 2.4 per cent of net income (after taxes) from such alliances. A second distinguishing feature of *exploitation alliances* involves the monitoring and measurement of performance. The performance goals for *exploitation alliances* will generally be stated as measurable operational objectives, which greatly simplifies monitoring progress through outcome controls.

Alliances, however, can also be useful as the strategic and organizational vehicle for probing or co-developing new markets, products or technological opportunities. These *exploration alliances* are generally implemented as open-ended co-development joint venture projects. They are intended to accomplish learning of unknown technologies, new geographic markets or new product domains. In short *exploration alliances* can serve as prospecting strategies. However, establishing goals and objectives and monitoring progress is not as simple as identifying and agreeing to measurable operational goals. The performance goals of *exploration alliances* are generally stated in much less specific, causally ambiguous, open-ended terms such as acquiring new capabilities and learning new technologies. This greatly complicates monitoring of progress and performance outcomes, which requires the design and execution of process controls. Often the failure of an *exploration alliance* can be traced to the reliance on substitute outcome controls and the failure to develop appropriate process controls.

The seeds of alliance tension and instabilities have been sown from the start when the alliance partners fail to recognize a mismatch in their strategic intents. An *exploitation/exploration* asymmetry raises the odds for ultimate dissolution or failure, with the notable exception of licenses and franchises. The two partners may have symmetric strategic intents when they enter into the alliance but may fail to observe the emergence of asymmetry. The emergence of asymmetry is also a major cause of alliance failures and dissolution and arises for several reasons. The overall strategic direction of one partner changes as the firm evolves over time and the initial strategic intent for entering the alliance becomes non-operative. Another example relates to the evolution of the alliance itself. It may very likely develop in directions that are at variance with the strategic intent of either parent and once again can lead to dissolution or buyout. It is only natural that alliances evolve over time and that they develop their own direction and identity. Similarly it is to be expected that the strategy of the parents could over time diverge from the direction of the alliance. Therefore, high dissolution rates or instabilities are always present and should be anticipated. Long-term success will be more likely when symmetry of strategic intents is present during formation and is maintained as an outcome of continuous mut-

ual adaptation, recalibration and reaffirmation of strategic intents of the alliance partners.

Three Types of Strategic Alliances

Not surprisingly, this *exploration/exploitation* logic produces three basic kinds of strategic alliances (see Table 2). Each of these alliance types embodies a unique strategic intent and each demands a unique alliance management process.

Learning alliances join companies sharing strong exploration intents, and with limited or no explicit or hidden exploitation intents. These alliances have as their primary strategic intent the reduction in ignorance of the partners (c.f. Balakrishnan and Koza, 1993; Dierickx and Koza, 1991). Learning alliances can reveal new information and insights about (1) markets, including local competition, regulations, customer tastes and habits, marketing infrastructure, and the like; (2) new core competencies such as just in time processes, negative working capital, one on one marketing, and mass customization; and (3) new technologies, such as competency destroying innovations, new complementary technologies, as well as franchising capabilities such as the Pizza Hut brand. Regardless of the specific learning outcomes, *learning alliances* seek to reduce information asymmetry among the parents and may also involve the joint creation of new knowledge. Thus, many market access alliances actually begin as learning alliances in which companies unlock information about local context prior to fully committing to an entry approach, such as Greenfield investment, equity joint venture, or outright acquisition (c.f. Reuer and Koza, 2000).

The critical success factor in learning alliances is the ability of the partners to design, manage and continuously adapt organizational processes and informal linkages which keep the alliance on track. For example, failure to recognize and adjust for imbalances in differential learning rates give rise to learning races in which one party disproportionately cap-

Table 2 Three Types of Strategic Alliances

		Low	Hi
	Hi	Learning Alliance	Hybrid Alliance
Exploration			Business Alliance
	Low	Exploitation	

tures value, and then moves to dissolve the alliance (Hamel, 1991).

Business alliances link companies with strong exploitation intents, but with limited or no exploration intent. Typically, these alliances seek to establish a position in a geographic or product market or market segment. Typically the overriding objective of a business alliance is to secure new incremental revenues from the combination of specific assets unique to each parent.

Many successful business alliances are structured as equity joint ventures (EJVs) and produce a child, that is a distinct legal or administrative unit designed to pursue the goals of the alliance. CFM International in the ten ton jet engine business and EVC in the polyvinyl chloride business are examples of business alliances structured, at least initially, as equity joint ventures.

A critical success factor in EJV business alliances is the achievement of an independent strong corporate identity which facilitates both recognition in the market place among customers, suppliers, and the like, as well as loyalty among the alliance managers and identification of the alliance by its managers and employees. Moreover, identification with and loyalty to the alliance can have the added benefit of forestalling the ever-present danger of tribal warfare within the alliance.

A new trend involves business alliances structured as networks. A network is a form of collaboration among multiple companies in which, typically, the network members are each specialized, bringing a unique value-adding resource to the network such as market access or skills. Usually, the network members include a subset of these activities within the network but maintain their autonomy in other matters. The Star Alliances in the airlines business consists of several carriers who list one another's flights in a 'code sharing' arrangement. Nexia International is a non-equity alliance of over 122 national accounting companies in 66 countries, which have joined together to facilitate referrals for international business (Koza and Lewin, 1999).

Critical success factors for a network business alliance involves a conscious balancing of loyalty to

the network and to the member companies. In addition, the collective benefits from the network must overwhelm or outweigh any benefits potentially available through member defection. As the collective benefits or benefits captured by an individual member decline the tendency to defect will increase.

A third type involves *hybrid alliances*, which joins companies with strategic intents that include strong exploration *and* exploitation objectives. In these alliances the companies seek to simultaneously maximize opportunities for capturing value from leveraging existing capabilities, assets, and the like, as well as from the opportunity to create new value through their joint learning activities. For example, the pre-Novartis Ciba Geigy alliance with Alza was designed to ensure that the companies would go to market with lower risk products, but also facilitate Ciba Geigy's learning of the ADDS (advanced drug delivery system) technology. Thus, hybrid alliances begin as a combination of business and learning alliances. Early success of the exploitation alliance in the marketplace facilitates the longer learning process of the exploration venture. On rare occasions hybrid alliances will result in a major transformational outcome. Historically such outcomes seem to have been serendipitous but *a priori*: there is no reason why a transformation outcome could not be anticipated and actively managed, to increase the odds of dramatic gains.

Managing the Alliance Process

These three types of strategic alliances differ on five dimensions (see Table 3).

1. *Loyalty* of managers in a strategic alliance may reside with one or another partner, or with the child, if one has been created. In a learning alliance the loyalty of the managers must remain with the parent company. Should a manager in an exploration alliance transfer loyalty to a partner or to the alliance, repatriating learning becomes extremely problematic. In a business alliance loyalty should transfer to the child. This will reduce the tendency for tribal warfare between the partners, between the alliance managers, or between partners and alliance managers when major conflicts arise. In hybrid alliances loyalty must also

Table 3 Managerial Characteristics of Strategic Alliances

	Learning alliance	Business alliance	Hybrid alliance
Loyalty	Parent	Child	Parent (transformed)
Control mechanism	Behaviour and process	Output	Behaviour and process <i>and</i> output
Ability to absorb knowledge	High	Lowest	Highest
Time horizon	Limited term (learning cycle)	Open-ended (industry cycle)	Multiple time horizons
Success criteria	Pacing the partner	Performance	Transformation

remain with the parent; however, it is loyalty to a new and improved version of the parent. In the Ciba Geigy – Alza alliance, Ciba Geigy managers remained loyal to Ciba Geigy but also internalized a new vision of Ciba Geigy which included the ADDS technology as a new critical competence.

2. *Control* in business alliances should be based on the application of clear and unambiguous output controls. The strong exploitation intent of a business alliance can be best measured and rewarded on the basis of financial and market performance. Learning and hybrid alliances require process and behavior control as change in behavior and assimilation of new knowledge becomes the crucial outcome. This might require, for example, careful specification of the project organization, articulation of boundary conditions enabling self organization and periodic reviews to establish progress and achieve consensus for future direction. The intensity and organizational complexity of process controls mandates ongoing involvement by both partners which becomes crucial for obtaining transformational outcomes.
3. *Ability to Absorb Knowledge (AAK)* is especially important in learning and hybrid alliances, because their success depends on the reduction of information asymmetry. The capacity to assimilate the new knowledge created by a learning alliance is unique to each partner. To avoid the destructive learning race asymmetry, each partner must have structures and processes in place which keep pace with rate of knowledge creation from the alliance. However, in hybrid alliances the further challenge is to anticipate and mediate the mixed performance signals which managers will receive from the interaction of outcome measures and process controls. In business alliances AAK issues can also become relevant when the alliance partners must facilitate the transfer of a strategic capability between the partners and the child.
4. *Time Horizon*. Strategic alliances vary in the stability of the alliance over time. Learning alliances tend to have limited time horizons extending only to the length of the learning cycle. For learning alliances the major challenge is to recognize when to end the relationship. Business alliances tend to extend to the industry cycle, as long as a business opportunity exists. The challenge of these alliances is knowing how to maintain continuity and oversight in the face of success over time. Hybrid alliances involve the simultaneous balancing of multiple time horizons. The business alliance is essentially an open-ended relationship which will terminate when the underlying business model ceases to be economically viable or when one of the partners or both opt to cash out. In addition the partners are simultaneously also managing the limited term relationship involving their learning joint venture. The challenge is to maintain focus on the potential for realizing transformational outcomes and not confuse the two distinct types of

managerial attention processes necessary for managing hybrid alliances.

5. *Success Criteria* in learning alliances require that partners keep pace with the rate of knowledge creation by the alliance. This requires a process of benchmarking the other partner's learning. The fatal flaw with benchmarking oneself is the self-fulfilling nature of such evaluations, which explains why *virtually all* learning alliances are described by each partner to be successful up to the moment of dissolution. In a business alliance periodic reviewing of the business plan and the appropriateness of the business model is key. Managers must guard against the complacency which accompanies market success such as the experience of the Dow Chemical and Corning with the Dow Corning company involving the silicone breast implants. In a hybrid alliance the challenge is to keep pace within the learning alliance by benchmarking the partner and simultaneously measuring and evaluating the performance of the business alliance. The ultimate challenge of the hybrid alliance is to anticipate and realize the potential of a true transformational outcome. It requires, for example, that one partner, at least, recognize and anticipate the potential for a transformational outcome which could emerge as a result of the success of the business alliance.

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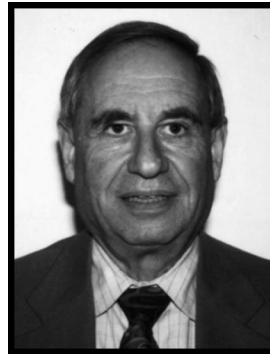
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