

Equity alliances take centre stage

Peter Pekár Jr and Marc S Margulis

Management is asked to act faster, invigorate growth and capture even greater profits, while using fewer resources and less capital. Under these circumstances, it is no surprise that alliances, predicated on shared risk and on the prudent use of capital and resources, are becoming an increasingly important approach for increasing shareholder wealth and competitive strength.

In May 2001, Matt Schiffrin, editor of Forbes.com, wrote in a *Forbes* special issue on alliances: “Alliances may be the most powerful trend that has swept (global) business in the past 100 years. Strategic alliances are hot....” Schiffrin is not alone. Fred Weston, former president of the American Finance Association and UCLA professor, noticed a dramatic rise in new joint venture announcements to rival merger completions – a correlation of nearly 100 per cent. Peter Drucker, the father of modern management, has observed “not only a surge in alliances, but a worldwide restructuring for major corporations is occurring in the shape of alliances and partnerships.”

Just five years ago such statements about alliances would be hard to find. Most professional service firms and academics dismissed alliances as a fad. So what has happened in the last five years for alliances in general, and equity alliances in particular?

In 2000, we wrote an article titled “The next wave of alliance formations: forging successful partnerships with emerging and middle market companies”. That article was a primer on alliance formations, written from the perspective of inexperienced, small to middle market firms seeking to partner with large firms experienced and skilled in alliance formations and management.

In this article we will discuss why equity alliances are taking centre stage and why major corporations are choosing the “bond” option over the “buy” or “build” options to stimulate growth and increase corporate wealth.

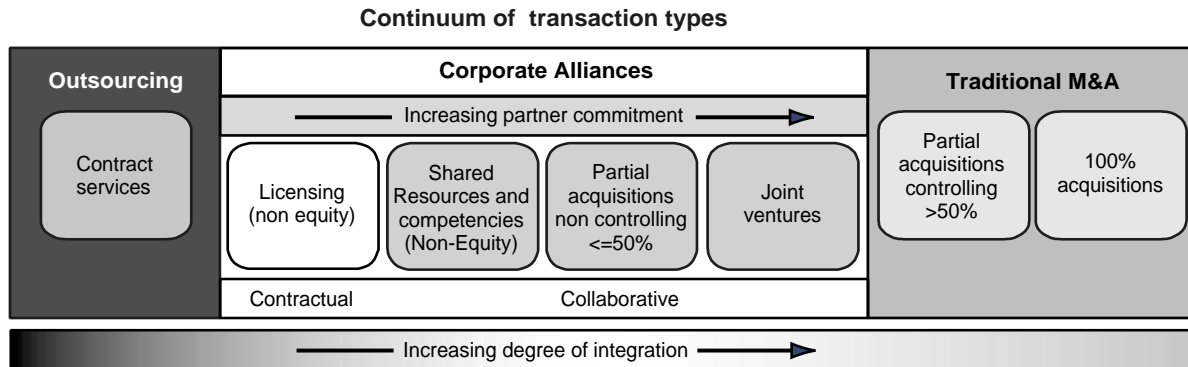
We argue that this drive to equity-based alliances amounts to a new chapter in the evolution of free enterprise.

In addition, we discuss the different equity alliance types and highlight characteristics, benefits and limitations of each. We compare alliances with acquisitions in terms of wealth creation, revenue growth and probabilities of success and present some real-world examples and insights from executives. Finally, we look at best practices in successful alliance formations in the section The art of the deal.

What are equity alliances?

A corporate (strategic) alliance is an organisational and legal construct wherein “partners” are motivated to act in concert and share core competencies. To a greater or lesser degree, most alliances result in the virtual integration of the parties through contracts that define rights, roles

Figure 1

Alliances come in a variety of forms

and responsibilities over a span of time or through purchase of debt or equities securities. Many result in actual integration through acquisition.

The fundamental purpose of an alliance is to facilitate collaboration and varying degrees of integration between companies without necessitating merger or acquisition but often leading to merger or acquisition.

Figure 1 reflects the full spectrum of inter-corporate transaction types, with the exception of purchase orders, arrayed by level of commitment and degree of integration between the parties.

At the far left is outsourcing; at the opposite extreme is M&A. Corporate alliances lie in between. While many refer to their suppliers or customers as their “partners”, not every party that one does business

with is a true partner; and not every relationship is a true alliance.

As the chart highlights, licensing is a *contractual* alliance, requiring only moderate collaboration. *Collaborative* alliances include shared resource arrangements, partial acquisitions and joint ventures. Pilot projects and R&D funding agreements are typical examples of shared resource arrangements and competencies agreements. Many such collaborations start out as contractual arrangements but evolve into more permanent equity-based structures once the relationship proves beneficial to both parties.

Equity alliances can be classified into two general types. The first includes partial acquisitions and cross-equity arrangements. In a partial equity acquisition, a company purchases a minority equity stake in another

Figure 2

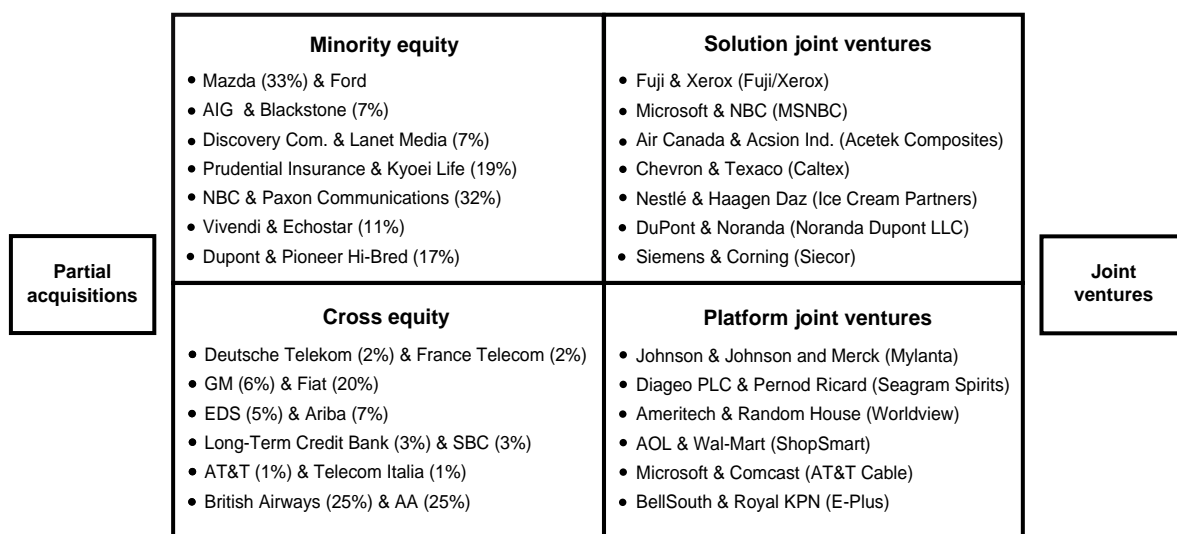
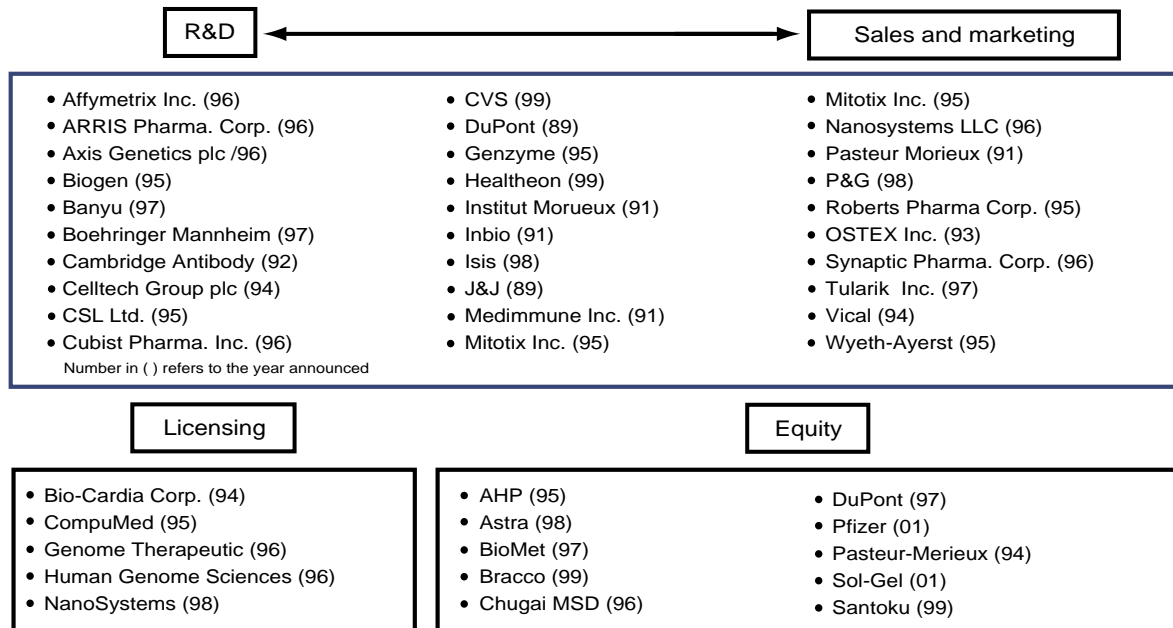
Equity alliances come in a variety of types

Figure 3

Alliances are particularly prevalent within Merck

such as Viacom purchasing a 35 per cent stake in Infinity Broadcasting. In a cross-equity transaction, each partner becomes an equity stakeholder in the other. The exchange of shares between EDS and Ariba is an example of such an exchange.

Next are joint ventures, which are separated into two forms: solution joint ventures and platform joint ventures. A solution JV occurs when two or more companies, usually of similar size or value, form a new entity to exploit a business opportunity that neither could do alone. The teaming up between GE Capital and BankOne to create Monogram Credit Services illustrates a solution joint venture.

A platform JV is where two or more partners realise that even together they are missing a critical core competency or competencies to meet their strategic co-operative objectives. To proceed quickly, they capitalise a JV to purchase a company or a stake in a company that has the missing piece. Platform alliances are best when the opportunity is very large and the window of time for exploitation is narrow. In other words, speed is of the essence. An example of a platform JV is the joint purchase of Midlands Electricity (UK) by General Public Utilities and Cinergy.

It is important to note that just 750 equity alliances and joint ventures were formed in the US throughout

the 1970s, but now thousands are formed annually in the US alone. Figure 2 shows a number of examples of the various types of equity alliances

Merck is an example of one company that has employed nearly all types of non-equity and equity alliances. Figure 3 lists some of the different types of alliances that Merck has formed.

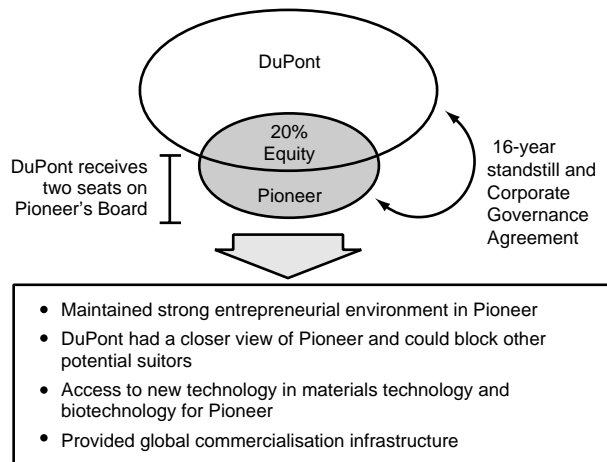
Examples of equity alliances: Minority stake*Minority stake: DuPont and Pioneer Hi-Bred*

On August 8, 1997, DuPont, the largest US chemical company, announced that it was acquiring a 20 per cent stake in Pioneer Hi-Bred International, an Iowa-based seed company, creating a powerful rival to Monsanto in the fast-growing business of genetically engineered crops (see Figure 4).

The two companies also set up an equally owned joint venture, Optimum Quality Grains, which integrated DuPont's agricultural research expertise and Pioneer's nutrition technology group. The alliance created one of the world's largest agricultural research collaborations. Both companies recognised that rapid advances in biotechnology were transforming life sciences.

John Krol, then Dupont's chief executive, noted that the alliance was aimed at integrating DuPont's core strengths in material sciences and biotechnology with

Figure 4

**DuPont & Pioneer Hi-bred equity investment:
a win for both sides**

Pioneer's core competencies in corn and oilseed genetics. The alliance linked the nation's biggest seed company with DuPont, a company known for countless patents for bolstering the nutritional qualities of crops.

DuPont also perceived that one of its most exciting growth prospects was in its life sciences businesses. DuPont, which considered itself to be one of the world's industrial leaders in biotechnology, expected life sciences to account for a significant share of future revenues and earnings.

The alliance with Pioneer Hi-Bred was aimed at strengthening DuPont's position as one of the top suppliers of crop protection and enhanced food and feed products. DuPont also saw the stake in Pioneer as a defensive manoeuvre to outflank Monsanto. Monsanto had made an earlier overture to Pioneer and been rebuffed.

Pioneer sought the alliance to gain access to technology that its rivals had yet to develop. Charles Johnson, Pioneer's CEO, noted: "A revolution is underway in improving crop genetics, which has the potential to benefit everyone. It is clear Pioneer and DuPont have the people, technology and access to world crop production systems to anticipate and meet the dynamic marketplace."

In return for its investment, DuPont received two seats on Pioneer's 15-seat board and agreed to a 16-year standstill and corporate governance agreement,

pegging the DuPont stake at 20 per cent unless both companies agreed to waive this ceiling. Two years later, Pioneer and DuPont announced that DuPont would be acquiring the remaining 80 per cent of Pioneer's stock that it did not then own for \$7.8bn.

The merger that resulted in DuPont's complete ownership of Pioneer Hi-Bred was announced as a major step in DuPont's overall strategy to more fully integrate biology into DuPont's science and technology base. The strategic driver was to be able to develop new generations of products for food and feed crops, food ingredients, industrial applications and nutrition science.

Solution joint venture: Nestlé and Haagen Dazs

In 1999, Nestle and Haagen Dazs (a subsidiary of Pillsbury) announced the creation of Ice Cream Partners (ICP), a 50:50, US- only joint venture. ICP was seen as a powerhouse for both companies.

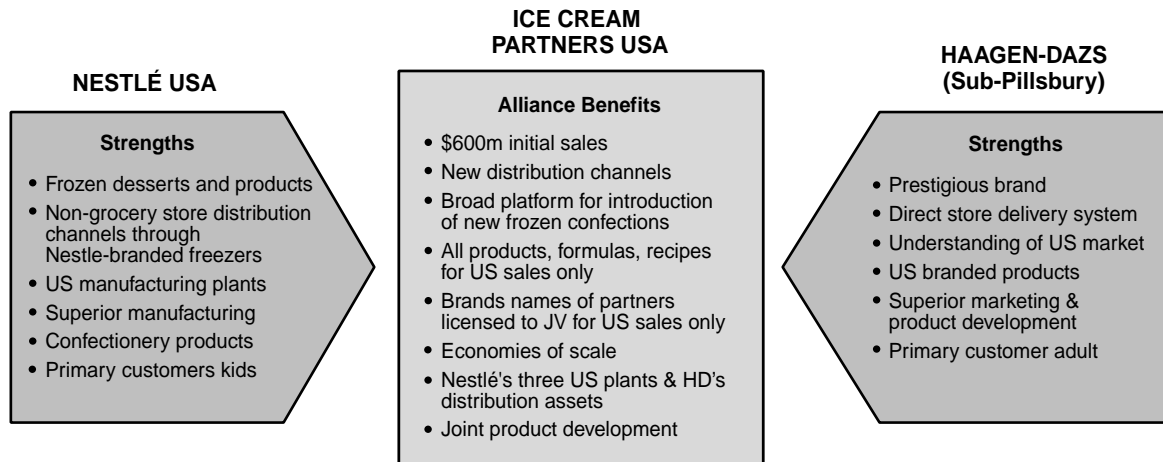
Nestlé had manufacturing and was the market leader in novelty ice cream products for children. Haagen-Dazs had a superior brand name, direct store delivery and was focused on adults. For Nestle, ICP was seen as the vehicle to rejuvenate its US ice cream and confectionery business, which was on a negative growth trajectory, and leapfrog Unilever, which was the number-one ice cream maker in the US and parent of Ben & Jerry's, another popular luxury brand.

All brands of both parties were licensed to the JV for US sales only. There was joint development on future products. The partners also contributed manufacturing facilities to the JV, which was focused on non-scoop store channels – grocery and non-grocery. The resulting company projected \$600m in sales in the first year. ICP was seen as a vehicle to accelerate growth of the ice cream business and a win-win for both partners (see Figure 5).

For its participation, Nestlé secured an option to purchase Ice Cream Partners should Haagen-Dazs' parent, Pillsbury, ever be acquired. When General Mills announced its purchase of Pillsbury in 2001, Nestle exercised its option to acquire Haagen-Dazs' 50 per cent share in ICP for an estimated \$650m.

Through the creation of ICP and later purchase of Haagen Dazs' interest, Nestle accomplished all of its goals and outflanked Unilever.

Figure 5

Ice Cream Partners: complementary marriage of two ice cream powerhouses: Nestlé and Haagen Dazs

Source: Public Documents

Platform joint venture: BellSouth and KPN

BellSouth and Royal KPN wanted to enter the German wireless market without the risk associated with an acquisition. In 1999, KPN and BellSouth agreed to jointly purchase E-Plus, a German wireless company. E-plus was the third-largest mobile operator in Germany with nearly four million customers.

Wim Dik, chairman and CEO of KPN, commented: "We already made clear that we would be able to reach a major position in mobile through teaming with the right partner. We are convinced that we have found in BellSouth an experienced partner in modern telecom services with a progressive attitude to new developments. With them, we will be able to speed up our growth in the European mobile markets".

Both companies saw Germany as the most promising growth market in Europe and the joint purchase of E-Plus as a way to spread risk and learn about the market. "This is a true win-win for BellSouth and KPN and their respective shareholders", said F Duane Ackerman, chairman and CEO of Bell South.

For BellSouth's participation (\$150m for a 22.5 per cent stake in E-Plus), KPN gave an option to Bell South to be able to convert its stake in E-Plus into KPN shares within a three-year period (see Figure 6).

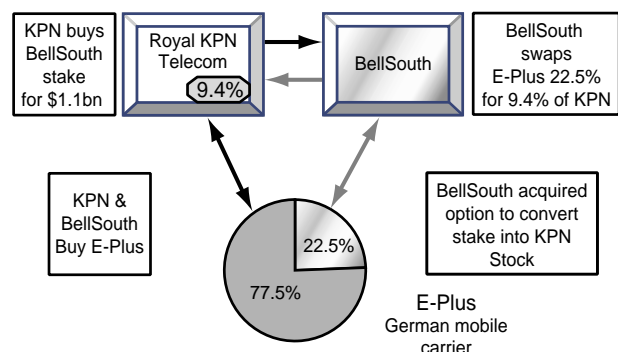
In 2002, BellSouth decided that its strategy for the German market had changed. The company exercised its option and received 9.4 per cent of KPN. However,

KPN preferred not to have BellSouth as a minority stakeholder and purchased BellSouth's holdings for over \$1.1bn, resulting in a gain for BellSouth of nearly \$850m in the worst telecom market in over two decades. Everyone was happy – KPN owned E-Plus and BellSouth recorded a record gain.

The emergence of equity alliances

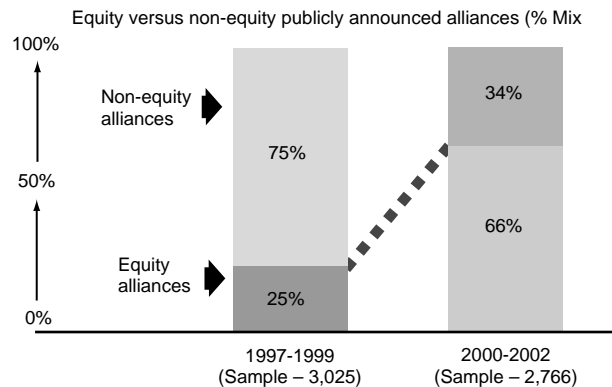
There has been a dramatic increase in equity-based alliances. Since 2000, the number of acquisitions has declined by 65 per cent while equity alliances have continued to grow. For example, in a review of 3,000 announced alliances from 1997 through 1999, we found that only 25 per cent were equity-based. This percentage, however, rose to 66 per cent when we looked at over 2,500 alliances formed between 2000 and 2002. A number of forces are driving the formation of equity-based alliances (see Figure 7).

Figure 6

BellSouth uses a platform JV to enter German wireless market and generate a record gain

Source: Public Documents

Figure 7

Equity alliances are taking centre stage

Businesses have long blurred the boundaries between competition and co-operation. In the US and Europe, cartels carved up important markets for much of the last century; in Asia, companies have long been bound together by cross-shareholdings. But in recent years, companies are collaborating on an unprecedented scale.

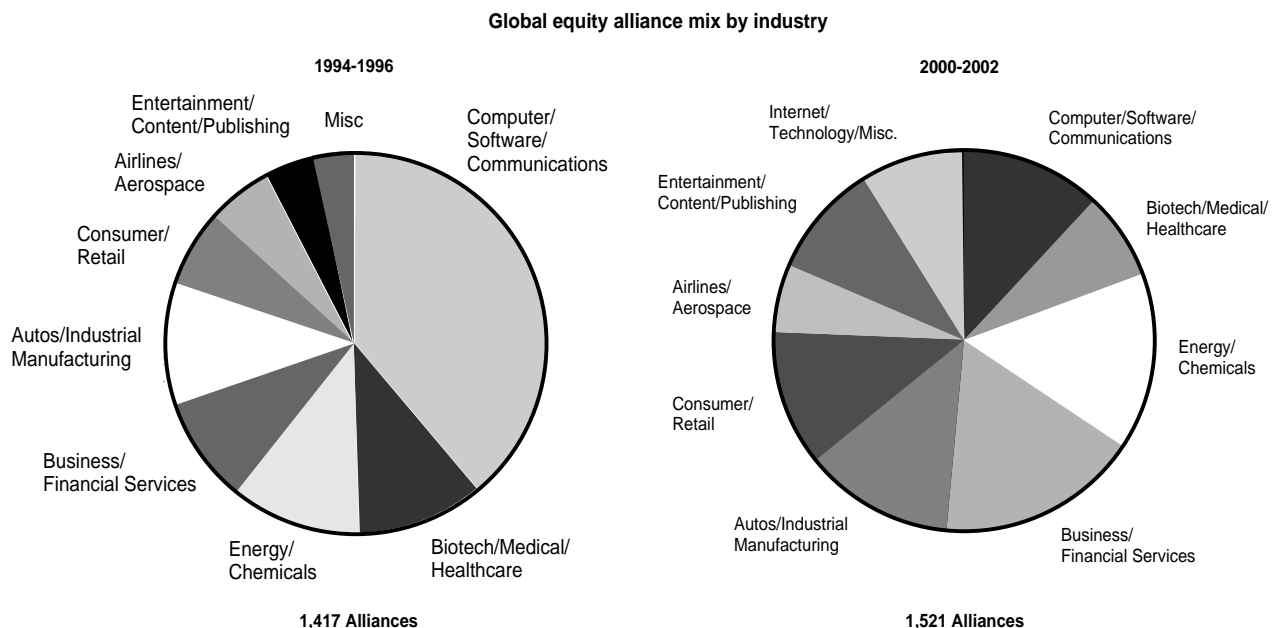
In the recent past, alliances tended to be merely tactical – for example, enabling a company to achieve its sales objective for individual export markets. But today's strategic partnerships are often more far-reaching in their scope. For some industries the urge to collaborate is particularly intense. For example, Europe's heavy engineering and defence industries are banding

together to cope with shrinking markets and to overcome national barriers to take-overs. The global auto industry – which wants to build a global web of distribution and product offerings and get around national restrictions – has entered into more than 400 deals in the past few years.

The same urge to collaborate is true for durable goods, business and financial services, entertainment and media, and pharmaceutical companies. Indeed, strategic partnerships are being formed in virtually every industry as shown in Figure 8. The global equity alliance mix has also significantly changed. From 1994 to 1996, technology companies dominated the mix, representing nearly 50 per cent of all equity alliance formations. Today a more even distribution prevails across all industries.

In 2000, *Forbes* and Thomson Financial noted that the number of publicly announced alliances and acquisitions were nearly equal. The number of alliances being formed worldwide continues to grow by 25 per cent to 35 per cent annually. The current rate of formation is roughly 10,000 per year. Moreover, we found that the top 50 global alliance-forming firms are averaging 150 publicly announced alliances of which 59 per cent are equity-based. We believe, as do many others, that alliances will soon surpass M&A as the predominant form of corporate integration.

Figure 8

Global equity alliance mix has changed from a high-tech orientation to one impacting all industries

Source: Sample of publicly announced equity alliances 1994-2002

Globalisation, retrenchment into core and pace of technology

Companies today face a staggering array of both opportunities and threats. They are simultaneously constrained in their abilities to respond effectively by obvious limitations on their capital and managerial resources, especially given the loss of stockholder confidence and contraction of capital markets.

There is simply not enough money, time or personnel to be successful in all sectors and in all markets that may bear on the future of any business. Under these circumstances, it really should be no surprise those alliances, which are predicated on shared risk and shared resources, are regarded as a prudent tool for the use of scarce corporate resources and are proving to be successful at increasing shareholder value and gaining competitive advantages.

While the contraction of the capital markets is providing added stimulus toward alliances, there are three primary reasons for the alliance phenomenon: the global meltdown of barriers to geographic expansion; the retrenchment of major companies into their core competencies; and the rapid pace of technology innovation, development and adoption. Let's examine some of key factors that are driving major companies to form equity alliances in unprecedented numbers.

Globalisation

Revenues from offshore markets of the top 1000 US firms have increased from 14 per cent in 1980 to 33 per cent in 2000. Over the same period, Asian/European companies saw revenues from offshore markets increase from 23 per cent to 50 per cent. It is not surprising that well over 50 per cent of equity alliances over the past decade contain multi-international partners.

Core retrenchment

While companies were globalising, they also were retrenching into their core competencies at a rapid pace. Our surveys revealed that only 21 per cent of the revenues of the top 1,000 Asian, US and European firms were generated from their core businesses in 1980. In 2000, these same companies saw over 70 per cent of their revenues coming from core business lines. Companies today that wish to explore opportunities outside their cores are increasingly utilising equity alliances for that purpose.

Pace of technology

As management was refocusing on the core, there was an unprecedented explosion of technology innovation. Our research shows that the revenues of major global firms generated by the introduction of new products each year are up from 15 per cent in the 1980s to 22 per cent in 2000. It is no wonder that over 30 per cent of all equity alliances contain some element of technology. Alliances enable companies to access innovative technology without an outright acquisition, avoid questionable expenditures before the technology is proven, and leapfrog the research and development cycle.

Diminishing role of acquisitions in invigorating growth

Many US executives historically favour mergers and acquisitions for gaining rapid increases in market share, profit improvements, EPS growth and, in turn, accretion of shareholder value. However, when comparing success rates between the "bond" and "buy" options, alliances hold the higher ground.

Let's examine some findings from a few recent studies:

- In a 1998 *Barron's* article "Merger mayhem," author Leslie Norton states that "research studies indicate that between 60 per cent and 80 per cent of mergers (and acquisitions) are financial failures".
- In a 2001 study of 118 mergers and acquisitions, KPMG found that 70 per cent of the transactions did not create shareholder value for the combined companies. KPMG also found no correlation between the M&A experience of the acquirer and success.
- In a recent study of 160 acquisitions by 157 public companies across 11 industry sectors, McKinsey & Co found that 42 per cent of acquirers suffered lower growth rates than their industry peers after the acquisition. Even more notable are the findings that 88 per cent did not manage to accelerate their growth appreciably and that 60 per cent of the companies failed to earn returns greater than the annual cost of capital required for the acquisition.
- A *BusinessWeek* analysis of 302 major M&A transactions revealed that 61 per cent of the merged companies destroyed shareholder wealth.

There are as many reasons given for the failure of mergers and acquisitions as there are mergers and acquisitions. This dismal success rate should not be surprising: While achieving full control, M&A

transactions bring to the acquirer all of the acquired entity – both strengths and weaknesses – as well as redundancies and losing, marginal or superfluous business units requiring disposition in some form, usually divestiture or closure. Moreover, many acquisitions are processed in an auction-like environment yielding “the winner’s curse” – in other words, winning requires bidding more for the target company than all other bids.

These failures no longer can go unnoticed and unreported. New accounting rules have eliminated pooling of interest and require the write-down of goodwill when impaired. A few examples include Sony’s purchase of Columbia Pictures (resulting in a \$2.7bn write-down); Quaker Oats’ acquisition of Snapple (\$1.4bn write-down); Dow Jones buying Telerate (\$900m); Eli Lilly purchasing PCS Health Systems (\$2.4bn), and the AOL Time Warner merger (\$100bn).

Many M&A failures – a failure being defined as an actual and persistent post-transaction loss in market capitalisation for the acquiring company, persistent market underperformance or both – are attributed by management or journalistic pundits to failure to deliver on expected and promised synergies.

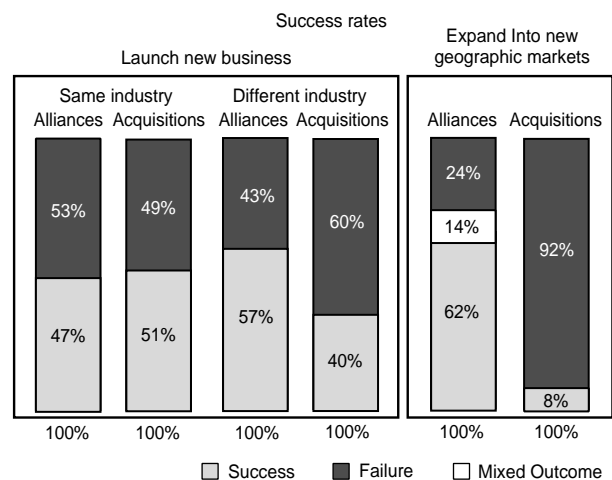
So what are the factors driving senior executives to carry out M&A transactions? KPMG found in a survey of senior executives that the top four objectives motivating M&A transactions are to: increase market share; maximise shareholder value; access new markets; and access new products. The real question is not the objectives but whether acquisitions are the best approach to achieve them.

A recent McKinsey study takes issue with the acquisition tactic for two of the objectives. McKinsey found that alliances are more attractive than acquisitions when trying to launch a new business or enter or expand into new geographical market (see Figure 9). In terms of increasing shareholder wealth *vis-à-vis* a robust acquisition program, all the acquisition studies discussed in this article clearly show that the vast majority of acquisitions have not increased shareholder wealth.

Through co-operation, not acquisition, a company can break into new markets, obtain access to new technologies and gain economies of scale with,

Figure 9

Use alliances (not acquisitions) to launch new businesses and enter new geographic markets



arguably, higher success and at lower cost than through acquisitions.

Alliances: engine to growth and shareholder wealth

The facts favouring alliances over acquisitions are multiplying and executives are taking notice. Consider the following:

- Harvard and Yale published results from a study of 1,300 alliances that showed positive share price movement on the day of the announcement for both partners.
- A 2000 study by Ernst & Young and Wharton Business School revealed that alliances are one of the top five factors driving market value in all industries.
- Accenture has looked at the linkage between market capitalisation and alliances. In 1999, alliances contributed over 12 per cent of total market capitalisation for 40 per cent of all companies. Accenture is forecasting that this will grow to 25 per cent by 2004.
- A recent study by the universities of Michigan, Wharton and Bingham Young of the top 500 global companies found that each partner’s stock price increased upon the announcement of each new significant alliance.
- Alliances are yielding, on average, 50 per cent higher return on investment for the top 1,000 US and non-US global companies as compared to returns on their core businesses.

In terms of alliance investment, we examined nearly 1,300 publicly announced equity alliances that were formed since 1995. We found that the median investment by a partner has increased from \$28m during the 1988 to 1992 period to \$90m currently. The median investment for the top 25 per cent of equity alliances was \$1bn for each partner.

Next, we looked at the level of buyouts of a partner's interests for nearly 180 equity alliances formed since 1995. We found that the median buyout was \$350m. More importantly, buyout amounts are dramatically increasing. For example, the top 25 per cent of equity buyouts of a partner's interests have a median of \$2 billion dollars (see Figure 10).

When comparing acquisitions to alliances, acquisitions are unsuccessful in terms of increasing shareholder value in 67 per cent of the transactions. In contrast, the alliance success rate hits 80 per cent for those firms that have developed alliance skills as a core competency (Figure 11).

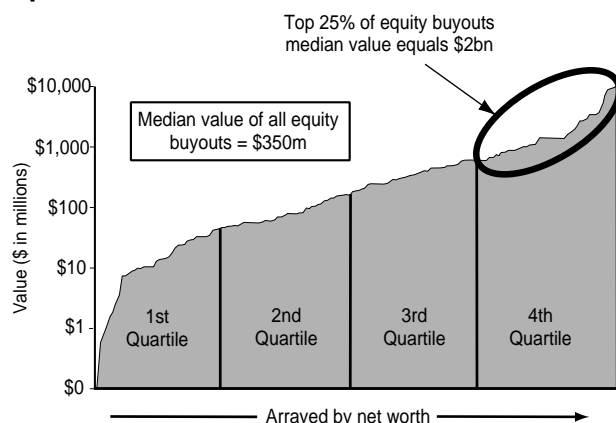
While we are advocates of alliances, we are not opposed to acquisitions. Quite the contrary, alliances often lead to a merger or acquisition – only delayed and in stages. The premise being that it is sometimes better to live together a while before tying the knot.

Choosing the appropriate equity alliance type

Broadly speaking, where the business objective necessitates a high degree of integration and commitment, a strategic investment or cross-equity

Figure 10

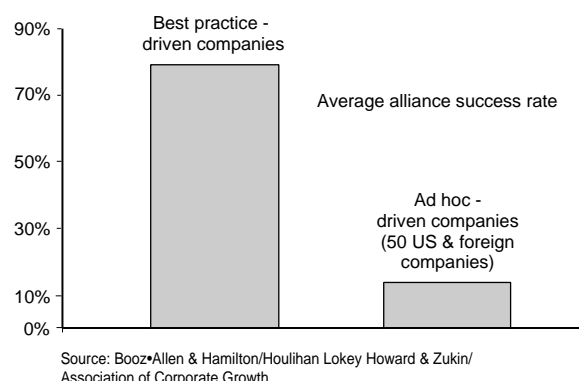
Median partner buyout in equity alliance equals \$350m



* Source: P. Pekár: Study of nearly 180 equity alliances (1995-2002)

Figure 11

Best practice-driven companies are 8 times more likely to succeed in an alliance



transaction is the proper vehicle. Equity securitises the parties' interests; it is the glue that binds the partners to each other and to the enterprise. Where, in addition to integration and commitment, autonomy of the enterprise from its founding partners is desirable, the alliance should be organised as a joint venture.

We were asked to assist two major companies in negotiating and constructing deal terms, a governance structure, and an operating decision-making process for an alliance they were forming.

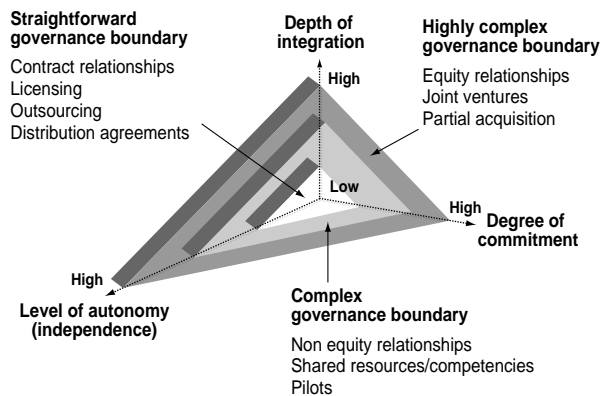
After listening to the executives discussing the value proposition and elements of their strategy, we were asked what type of arrangement we thought would best work in this situation. Our response was that the alliance would require equity to bind the partners. Figure 12 highlights our reasoning.

First the alliance strategy needed real commitment from the partners; second, the alliance also required a high degree of integration of the partners and their core competencies; third, the decision-making process to make the alliance work in this high-tech area would be at a pace unfamiliar to the partners. This led us to believe that for the alliance to be successful, it would require equity stakes by partners and separate governance and management to drive operations.

To reinforce our thinking, we outlined the key characteristics and objectives of the purposed alliance. We compared these with templates that we have developed from examining hundreds of alliance types. The key characteristics of this particular alliance did not match those elements in licensing, shared resources/competencies, minority investment, cross-

Figure 12

Each alliance type has a unique structural complexity boundary



Source: G. Hamel/Houlihan Lokey Howard & Zukin

equity or platform arrangements. This alliance was targeted at specific markets in the US and Europe with new products and integrated services beyond the scope of each partner.

Value creation was also dependent upon the ability of the partners to integrate their core competencies. The focus was on rapid development, integration and market penetration. It soon became obvious that an independent organisational structure was necessary to achieve the strategic objectives (Figure 13). We suggested that a Solution Joint Venture was the appropriate vehicle to get the alliance off on the right start.

Figure 13

Each equity alliance has a unique set of characteristics: solution JV example

Solution joint venture	
Forming a new entity by market-leading organisations for: <ul style="list-style-type: none"> entering specific geographical markets and/or creating new products/services beyond the scope of each independently 	
Key characteristics: <ul style="list-style-type: none"> Specific defined scope: strategic in nature - formed to create a new seamless integrated product/service offering or facilitate entry into foreign market Varying dependence on parents Independent structure to achieve strategic goals Overcomes the "not invented here" syndrome Value creation based on ability to integrate partners' core competencies into new entity Relationship is co-dependent, many interfaces in real-time – highest degree of shared risk Focused on performance, customer acceptance and rapid market penetration Bilateral control – complex governance model 	
Examples <ul style="list-style-type: none"> Ice Cream Partners - Nestlé & Haagen Dazs Wal-Mart & Cifra 	

Source: Houlihan Lokey Howard & Zukin

The art of the deal: best practices

Compared to acquisitions, corporate alliances are much more complex and time consuming to negotiate and close. In mergers and acquisitions, the principal concerns are price, structure, representations and warranties, and indemnification. In equity alliances, you have the same issues as in M&A, *plus* a host of additional ones that fall into seven general categories. They are (see Figure 14):

- Scope and limitations on scope of the alliance
- Capitalisation and relative ownership resulting from that initial capitalisation
- Governance, which is actually two issues: policy control and operational control, and the sub-category of disputes and dispute resolution mechanisms
- Allocation of risks and returns, including allocation of liabilities in the event that the alliance fails
- Technology issues (the form of initial intellectual property transfers, rights to new technologies and policies such as the rights or restrictions on the new entity or partner to sublicense technology)
- Restrictions on transfers of ownership
- Exit strategies and their triggering events

If agreement on these issues is to be reached, the parties must convey their willingness to find mutually agreeable solutions through a win-win approach to the negotiations. It is important for all involved to bear in mind that the objective is to form a partnership, not to take control. Winning every point will only leave the weaker partner without incentive to be a good partner.

Surveys of 500 CEOs whose companies had engaged in alliances successfully highlight what they viewed as key reasons why some of their alliances have failed:

- Selecting the first partner identified; in other words, not identifying the market of *possible* partners up front.
- Parties had not engaged early

Figure 14

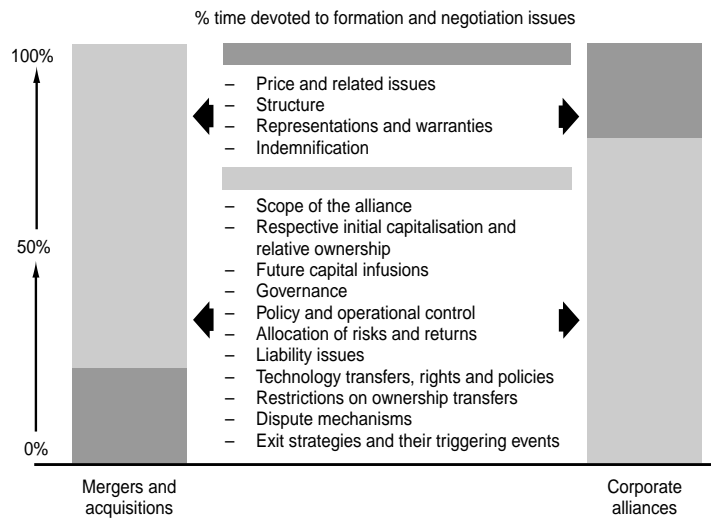
Corporate alliances: complex to form and negotiate

Exhibit 15 illustrates appropriate steps in the alliance formation process. Many executives underestimate the magnitude of time and effort required to forge a sustainable alliance. Unless alliance skills are a core competency, the typical company will find it a daunting challenge to bridge the gap between strategy and implementation.

The second step in the process is to identify potential partners, surfacing as many suitable partners as possible. In typical situations, a partner-candidate comes forward and negotiations ensue without consideration of alternatives. Soliciting a number of partner-candidates fosters a competitive environment, allowing the most motivated partner to surface.

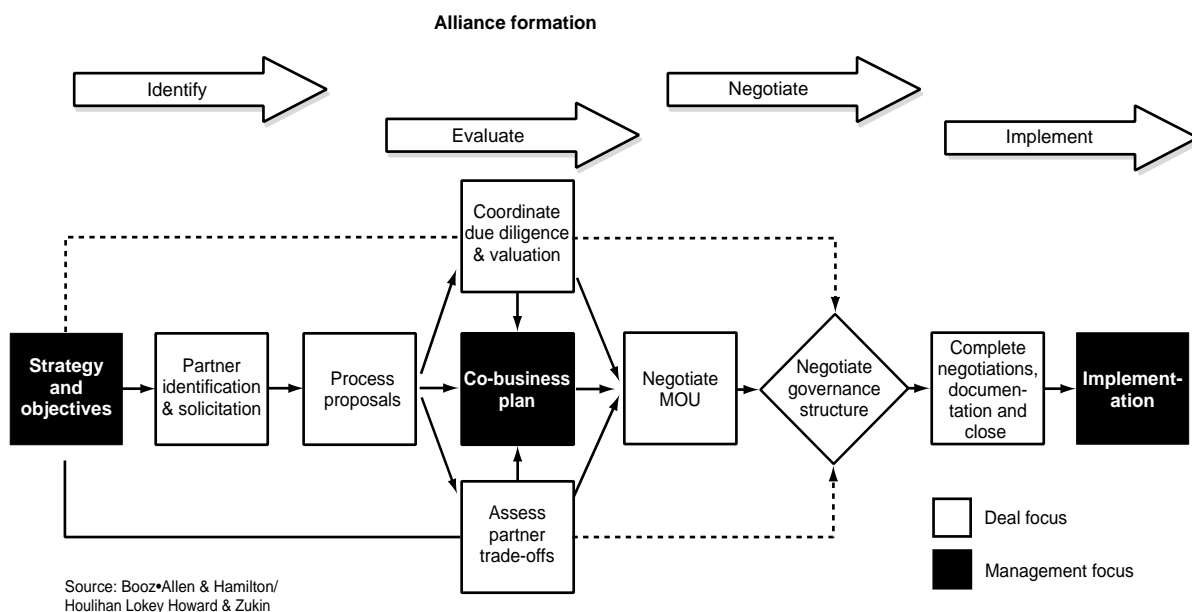
enough in frank dialogue on objectives, tactics and constraints.

- Parties had not included the ultimate managers of alliance in the due diligence process or in the decision to proceed.
- Parties had generally failed to establish effective and collaborative communications among the rank and file.
- Parties had created “too loose” an agreement.

A key element of the successful process is bilateral due diligence, which we identify as the co-planning box depicted in Figure 15. This is not legal and accounting due diligence; it is due diligence performed by marketing, planning, manufacturing, systems, engineering and other line personnel, including the alliance managers from both sides. Their deliverable is a joint tactical and strategic plan - the business plan for the alliance.

It justifies the alliance, or correctly terminates it before it starts. The plan sets the performance measures

Figure 15

The deal continuum: bridging the gap between strategy and implementation

and milestones, and it estimates the time and resources required.

Governance

As we note in Figure 16, each alliance is comprised of numerous building blocks. Each is unique in terms of the content of the blocks and their relative importance, with one exception. It is indisputable that governance is the capstone, if not the foundation, of any alliance structure.

However, governance is the most frequently mishandled and inadequately addressed element in alliance building. Alliance governance presents the greatest challenge because of the many rights, privileges and obligations that must be addressed to form a functional and sustainable structure.

Under the traditional corporate model, the duties and responsibilities of directors are straightforward and well defined by statute and case law. Directors have strict fiduciary duties to shareholders and the corporation; they perform executive oversight; and they monitor performance.

In the context of alliances, the duties of directors are quite a bit muddier and broader.

Second, corporations are supposedly infinite in life; alliances generally have finite objectives and lives. So

exit strategies are in partners' thoughts from the earliest stage of negotiation.

Many executives instinctively equate equal contribution with equal governance. Fuji Xerox, which is based in Tokyo, for example, is a nearly \$9bn 50:50 solution joint venture between Xerox and Fuji Photo Film Co. The board of directors has 15 members, of which four are American and the rest Japanese. The breakdown by company is: Fuji Xerox (five), Fuji Photo (two) and independent directors (four). Yotaro Kobayashi is also a member of the board of directors of Xerox Corporation, as is the vice chairman of Fuji Xerox (Figure 17).

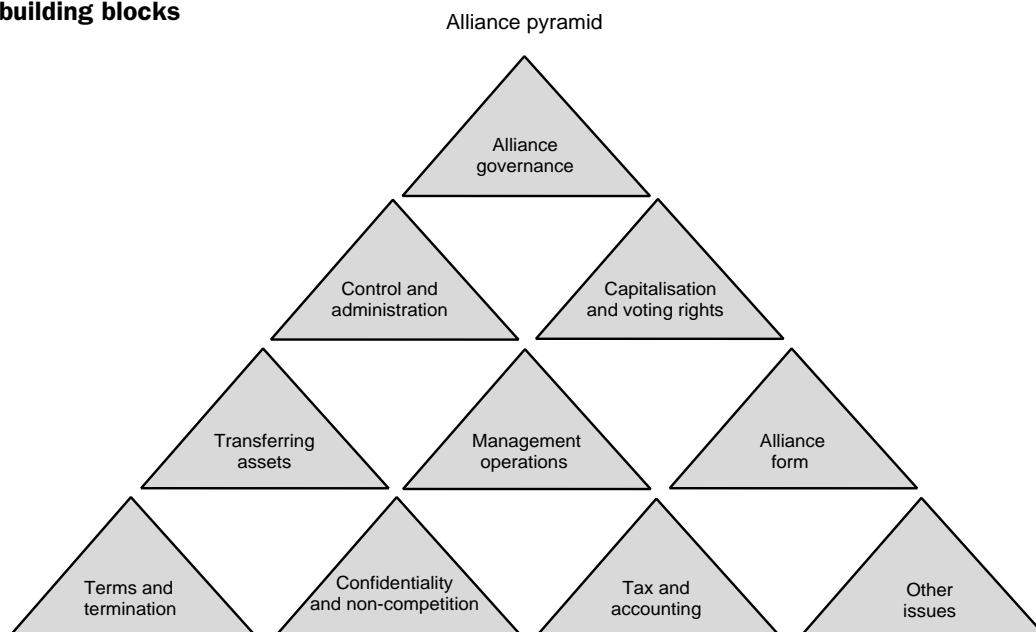
This alliance has been very successful for both companies. In fact, in 2001 the Fuji Xerox alliance became a critical source of funds for Xerox as equity and capital markets contracted for the company. Xerox sold half of its interest in Fuji Xerox for \$1.3bn to Fuji Photo.

The question for major companies is no longer whether forging equity alliances is a responsible corporate tactic. Instead, corporate executives must address other questions such as:

- What type of equity alliance is most appropriate to invigorate growth and gain competitive advantages?

Figure 16

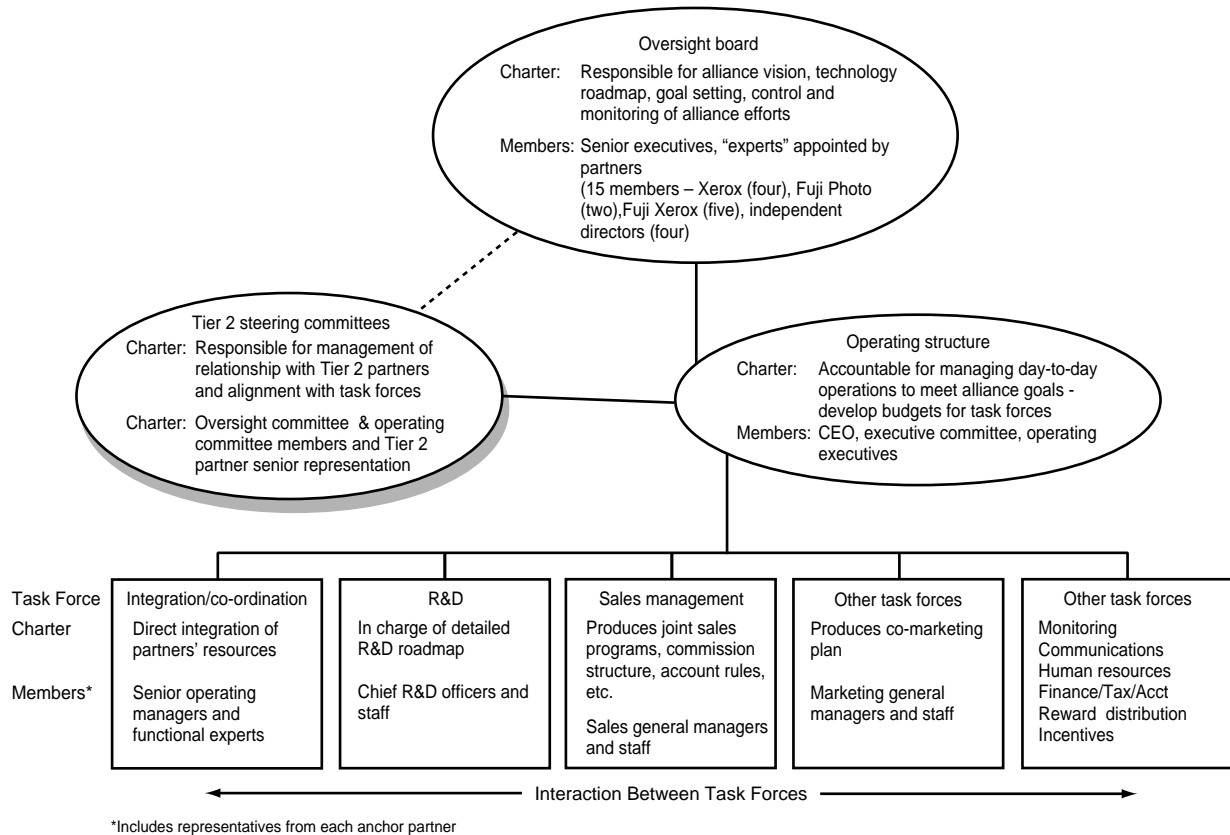
Alliance building blocks



Source: Booz•Allen & Hamilton/Houlihan Lokey Howard & Zukin

Figure 17

Fuji Photo and Xerox create Fuji Xerox



- How do we, under a particular set of facts and circumstances, find the "best" partner?
- How do we manage the alliance process and negotiate a "win-win" arrangement?
- Have we engaged the best advisors – strategic, legal and transactional?

Resources

J Fred Weston, Kwang S. Chung, and Juan A. Siu. *Takeovers, Restructuring, and Corporate Governance*. 2d ed. Upper Saddle River, NJ: Prentice Hall, 1998.

MS Margulis and Peter Pekár Jr. "The next wave in alliance formations." Houlihan Lokey Howard & Zukin, 2000.

Matthew Schiffrin. "Partner or perish". May 21, 2001 *Forbes* Special Issue on Alliances.

Colin Cook and Don Spitzer. "World class transactions". KPMG. 2001

Matthias M Bekier, Anna J. Bogardus, Tim Oldham. "Why mergers fail." *The McKinsey Quarterly*. 2001, Number 4

B Ananad and T Khanna. "Do firms learn to create value? Case for alliances." *Strategic Management Journal*. 21, No.3, 2000

Jeffrey H. Dryer, Prashant Kale and Harbir Singh. "How to make strategic alliances work." *MIT Sloan Management Review*. Summer 2001.

Dr Peter Pekár is senior alliance advisor for Houlihan Lokey Howard & Zukin, an international investment bank. In addition, he is President of Pekár Advisors: Center for Corporate Strategic Alliances. He previously was a senior advisor to Booz·Allen & Hamilton on strategic alliances and a visiting professor at London Business School.

Marc S Margulis is the Managing Director of the Corporate Alliances Group of Houlihan Lokey Howard & Zukin. He has over 20 years of experience serving as the principal advisor and lead negotiator in numerous mergers, acquisitions, divestitures and alliances.