MANAGING STRATEGIC ALLIANCES*

by

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MANAGING STRATEGIC ALLIANCES

The vast numbers of domestic joint ventures (and other forms of strategic alliances in firms' home markets) that are sweeping the United States and Western Europe (as well as the Pacific Basin) suggest some inescapable conclusions about firms' future competitive strategies: (1) One-on-one competition will be replaced by competition among constellations of firms that routinely venture together. (2) Teams of cooperating firms seeking each other out like favorite dancing partners will soon replace many current industry structures where firms stand alone. (3) To cope with these changes, managers must learn how to cooperate as well as compete effectively in the future.

An Explosion in Joint Venture Activity

Since 1978 the use of joint ventures within mature economies has blossomed due to the many technological and economic changes that precipitated deregulation, globalization, and increasing emphasis on the need for product innovation. In 1983 alone the number of cooperative strategies announced in some industries, such as communications systems and services, exceeded the sum of all previously announced U.S. ventures in that sector. By the mid-1980s domestic joint ventures had become an important means of supplementing strengths and covering weaknesses of firms in mature economies. The willingness of managers to contemplate cooperative strategies where previously they did not do so represented a watershed in their way of thinking about competitive strategy. It also raised a warning flag for firms whose managers had not yet considered the implications of this strategy option.

More joint ventures and other forms of cooperative strategy undoubtedly will be launched in mature economies like the United States in the wake of increasingly rapid rates of technological change, deregulation, and globalization. As boundaries blur between industries -- especially where the enhanced capabilities of information processing and data transmission technologies link together formerly disparate products and competitors -- managers need to understand how changes like these will affect their need for strategic alliances.

Uses of Joint Ventures

Joint ventures are separate entities with two or more actively-involved firms as sponsors. Because joint ventures can draw upon the strengths of their two or more owners, they should possess superior competitive abilities that allow their sponsors to enjoy synergies. But if a venture's owners cannot cope with the demands of managing joint ventures effectively, they would do better to use <u>non-equity</u> forms of cooperation, such as research and development consortia, cross-marketing and/or cross-production agreements, licensing arrangements, and joint bidding activities, among others, to meet the coming challenges.

Research studies and observation of current management practices suggest many uses for joint ventures, but they also suggest ambivalence concerning the need to use this new capital- and risk-sharing strategy. My experiences suggest that if managers can overcome their inhibitions about joint ventures and develop systems to use them effectively, their firms can build strengths and gain knowledge by cooperating. Joint

ventures offer a variety of internal, competitive, strategic and diversification uses that could be of benefit to sponsoring firms.

Internal Uses

As table 1 suggests, joint ventures should not be seen as a way to hide weaknesses. Rather, if used prudently, such ventures can create internal strengths. Joint ventures can be resource-aggregating and resource-sharing mechanisms, allowing sponsoring firms to concentrate resources in those areas where they possess the greatest respective strengths. Companies like Rolls-Royce, Pratt & Whitney, and General Electric have cooperated in building airline engines because they wanted a piece of the pie but did not care to risk financial indigestion by investing in new approaches alone. Some projects such as the Great Plains coal-gasification venture of American Natural Resources, Peoples Energy, Tenneco, and Transco, would never have been undertaken without this means of spreading risks and costs. Joint ventures are particularly appropriate when projects involve great uncertainties, costly technological innovations, or high information costs as in the synthetic fuel and offshore oil exploration industries. Through joint ventures, small firms gain access to larger quantities of capital than would otherwise be available through the ordinary licensing of their technology, as is the case with revolutionary medical products, biotechnology processes, or other products with very long payback periods.

Access to scarce resources. Because technology, distribution networks, and other assets that provide internal strengths are not always for sale, firms sometimes form joint ventures to acquire the resources and competence they cannot obtain elsewhere. Frequently,

the knowledge and assets that firms seek cannot be purchased, or firms cooperate because they cannot penetrate markets easily alone. In those situations, joint ventures can be a means of coping with demand uncertainties and building competitive strengths by providing firms with resources for which there are no equally efficient substitutes.

Using existing assets better. Joint ventures can be a means of using a new manufacturing process, a by-product, or a new capability. Co-production, common procurement, or other joint activities are often a means of attaining increased efficiency, productivity, scale economies, and other benefits, such as are exemplified by joint ventures like PD Glycol (DuPont and PPG Industries) in the petrochemical industry. Access to improved brands or distribution networks can increase sales force productivity, as in the example of the many cross-marketing arrangements found in the ethical pharmaceuticals industry. Access to an economical source of low-cost, better-quality raw materials, as in the coal mining joint ventures, can produce both partners with better profit margins.

Enhancing innovation. As table 1 suggests, cooperative ventures can build internal strengths by offering firms a window on promising technologies such as robotics, genetic engineering, and solar energy. In addition to providing access to modern technological information, joint ventures can offer opportunities for engineering units to exchange technical staff, thereby saving sponsoring firms costly and unnecessary duplicate R&D efforts. In summary, joint ventures can offer partners many technological, financial, marketing, and managerial strengths, if managed effectively. The trick is to realize those benefits.

If managers are open to change, joint activities can be a way of building strengths by exposing them to innovative managerial practices

and better methods of diffusing technology. Managerial practices can be modernized through contact with innovative information systems and administrative techniques used by other firms, as with cooperative ventures that bring together international partners. Firms can become more flexible strategically since joint ventures can facilitate better information exchange and enhance communications, if they are managed effectively.

Venturing internally. Finally, table 1 suggests that joint ventures build internal strengths by reducing personnel turnover, thereby conserving a firm's most valuable resource -- its entrepreneurial talent. Joint ventures offer an excellent method for retaining managers who lack the capital backing required to launch their own business ideas. Through them, sponsors can work with their ventures' management teams, providing more than just cash and gaining more than just dividends.

Competitive Uses

Table 1 suggests that cooperative ventures can create competitive strengths or consolidate firms' existing market positions. Joint ventures can tame potentially tough customers (such as the defense department when purchasing armaments) or provide technological assistance through access to innovations pioneered in other industries (such as applying the knowledge of customer needs in office equipment to the development of vertical software for such customers). Erratic competitors who threaten industry stability can be mollified by drawing them into cooperative arrangements that focus their efforts on longer-term objectives rather than the short-term gains obtained from price-cutting. Joint ventures also can rationalize mature industries,

like mining, metals processing, and steel. They can combine the assets of foundering partners (to consolidate the industry's structure) and eliminate excess capacity.

Controlling evolutionary forces. Joint ventures have the potential to become an effective competitive weapon. They can be used in pioneering new industries like videotex services where they minimize the capital investments that firms must commit to embryonic and potentially volatile settings. They can be used in overcrowded mature industries like farm and industrial equipment, automobiles, basic petrochemicals, and electronics to create the strongest surviving competitor. Table 1, which suggests some of these competitive uses of cooperative ventures, indicates that a prospective strategic posture requires firms to use strategic alliances to seize initiatives and force their industries' structures to evolve in a favorable manner. Astute managers can draw on the cooperative strategy experiences of business units operating in mature industries and apply that venturing knowledge to business units in emerging industries to accelerate the pace of infrastructure development and control the direction of structural evolution, as petrochemical firms have done in genetic-engineering ventures to shape the use of biotechnology.

Moving pre-emptively. Table 1 also notes that joint ventures can be a means of preempting suppliers or customers from integrating in a manner unfavorable to the firm, as in the example of software programmers joining forces with hardware firms to offer database services, and joint ventures can blunt the abilities of ongoing firms to retaliate by binding potential enemies to the firm as allies. Thus firms can more quickly gain new competitive capabilities (or enter new markets), create market

power, or stake out leadership positions in emerging industries such as robotics, data communications services, and electronics retailing through joint ventures.

Opening closed markets. The competitive benefits enjoyed by firms that enter cooperative ventures will differ by their positions. Newcomers seeking to enter a new geographic market may see joint ventures as insurance against domestic trade barriers. Sometimes firms with technological complementarity may cooperate out of necessity to gain a local identity. For firms already engaged in the business that the proposed joint ventures will encompass, the critical competitive question is often whether established players should trade access to their sales networks for the capabilities outsiders can offer. The answer will depend on the competitive challenges they face.

Tapping talent pools. Because joint ventures can be used to defend current strategic positions against forces that are too strong for one firm to withstand, the combined resources of diverse firms often create more effective competitors than going it alone. Cooperative ventures can provide them with a buffer to marry dissimilar cultures, providing larger firms access to innovations made by the types of researchers who prefer to reside in smaller organizations (like the genetic-engineering firms, for example), because they want no part of the culture of larger firms and the "professional management" practices that characterize them. In brief, table 1 suggests that the unexplored structural and competitive potential of joint venture strategies can be immense if managed skillfully.

Strategic Uses

Joint ventures can be strategic weapons as well. They can be a way to implement changes in a firm's strategic position. They can increase (or decrease) a firm's domain, stabilize a firm's existing domain, or help a firm achieve diverse strategy objectives. The strategic objectives that can be attained by using joint ventures are numerous, provided they are managed effectively.

Creating synergies. Table 1 notes that if partner-to-partner relationships are managed correctly, joint ventures may create synergies among owners' activities. Strategic alliances also offer a means of leveraging synergies between the skills and resources of an owner and its venture. As an intermediate alternative between acquisition (or internal development) and dependence on outsiders, joint ventures represent a special, highly flexible means of enhancing innovation or achieving other strategic objectives that managers should not overlook.

Entering quickly. As product lives become increasingly short and the rate of technological innovation accelerates, strategic alliances could become increasingly important as a means of attaining "toehold" entries into new businesses that may be of long-term strategic importance to venture sponsors, such as cable communications for newspaper publishers or cable television services for motion picture distributors. Joint ventures can allow firms to diversify into attractive but unfamiliar business areas, and they can help firms diversify from unfavorable businesses into more promising ones.

Restructuring. Table 1 also points out that joint ventures can be a means of entering (or divesting) businesses or of expanding internationally. In addition to providing a less risky means of entering

new markets, strategic alliances (such as "fade-out joint ventures") can provide a nondisruptive means of divesting substantial businesses that no longer fit corporate objectives.

Diversification Uses

When a venture is used as a means of diversifying from or enlarging the scope of a firm's ongoing activities, the way in which the venture is related to its owners determines its pattern of diversification. If the joint venture is horizontally related to its owners, it performs the same product, market, or technology tasks that its owners perform, albeit in a different geographic arena. Vertical ventures are entities whose activities and outputs supply to or distribute for their owners. Diversifying ventures, on the other hand, are entities that do not duplicate the activities of the venture owners nor can the venture owners consume or distribute the products or services of the venture; there are no natural horizontal or vertical linkages from sponsors to diversifying ventures.

Since there will be at least two owners in a strategic alliance, two or more types of relationships can exist between a joint venture and its sponsors. If owners are not competitors, then different patterns of diversification will relate each owner to the joint venture.

Horizontal cooperation. A firm may form a venture that creates a horizontally related competitor to expand its market scope, expand or flesh out its product lines, or rationalize excess capacity. Innovation may be a firm's primary motive to cooperate in forming a horizontally related venture.

The issues associated with horizontal cooperation are those of creating new competition (the horizontally related venture) versus

deterring potential entrants that might enter the market on their own if not embraced as partners. These are tradeoffs that U.S. firms have faced several times in the past. In the 1980s the major difference is that the partners they might embrace are often foreign horizontal competitors, who possess absolute cost advantages over ongoing domestic firms. These intruders need not create a joint venture to enter the domestic firm's markets successfully, but they may prefer to use a cooperative venture to ease their way in. The issue for domestic firms, then, is whether the cooperative advances of such potential entrants should be welcomed or rebuffed.

Vertical cooperation. Vertical ventures (those ventures linked with sponsors that are at different stages of the transformation chain -- like Twentieth-Century-Fox's videocassette distribution venture, or Control Data's magnetic peripheral devices ventures) often are formed to decrease dependency on outsiders and circumvent market imperfections. They can also be used to develop young industries (like plastics during the 1950s). Sometimes competitors join forces to build supplying (or distribution) facilities with capacities that are larger than either firm could use alone. Sponsors form vertical ventures to exploit scale economies, as in the example of steel firms sharing iron ore mines, or to pioneer new distribution channels together. If closer control over product quality and/or differentiation is likely to give their firms sustainable competitive advantages (and if economics necessitate sharing a facility), managers are especially likely to forge ventures that are vertically related to their firms. Most likely, sponsoring firms form vertical ventures because quality control depends on good relationships between production stages. Thus, suppliers (or buyers) may form a

cooperative venture to improve raw material or component quality, design new products, or shore up domestic firms' positions against imports.

Vertical integration is necessary in embryonic industries if an appropriate infrastructure does not yet exist. In mature economies, vertical joint ventures are most prevalent in new industries such as synthetic fuels, genetic engineering, or other products that satisfy new customer demands or provide technologies to accomplish unheard-of tasks. In the young economies of newly industrializing countries, vertical joint ventures are commonly used to illustrate the efficacy of new raw materials by creating markets for them, create nonexistant distribution channels, fabricate components (or procure other supplies), or share the costs and risks of making other investments in local infrastructure.

Diversification and cooperation strategies. Diversifying ventures (involving owners who are neither horizontally nor vertically related to their venture's activities) are used to gain access to knowledge, technology, or other resources that firms seek, as well as to enter new and unfamiliar businesses where entry barriers are so high that firms could not enter alone. Related diversification ventures exploit some core skill or expertise of their owners -- whether it is marketing, R&D, production, or managerial skills. (Unrelated diversifications do not.)

As with the horizontal and vertical diversifications discussed above, the true strategic benefits of strategic alliances cannot be determined until all sides of the triangle of relationships shown in figure 1 can be assessed. In brief, the strategic benefits anticipated from diversification (and associated synergies) depend on the dynamics of relationships between owners and their venture, between owners as partners, and between the venture and its competitive environment.

Managers embrace ventures where they anticipate that synergies with their firms' wholly owned business units can be exploited or where they can attain scale or integration economies through them. However, synergies and economies cannot be realized unless the appropriate managerial systems are in place and unless sponsors allow their venture sufficient autonomy to cope with competition effectively.

Control Mechanisms

As figure 1 indicates, the joint venture is governed by terms of a bargaining agreement between partners that specifies: (1) the nature of information sharing; (2) personnel contacts; (3) representation by owners in the venture's performance; (4) reporting mechanisms; and (5) other details of the management system created to support owners' strategy objectives. If the purpose of the venture includes innovation and technology transfer, special attention must be devoted to control mechanisms that protect the venture's proprietary knowledge and property rights, as well as those of its owners.

The bargaining agreement provides for control mechanisms to ensure that owners' objectives in cooperating are attained. These control mechanisms usually include trial marriages, representation on boards of directors, provision and rotation of personnel from sponsoring firms, review points, and divorce clauses. Many sponsoring firms erroneously include the division of ownership shares in their control mechanisms, a misperception that I will try to correct.

Symmetrical Ownership Shares

Many firms believe that the division of ownership shares will solve most questions regarding control. This belief may originate from earlier studies of ventures that devoted a disproportionate emphasis to the need for a balance (or imbalance) in equity ownership. They have asserted, for example, that evenly-divided ownership of the venture (that is, 50%-50% ventures) often encourages deadlocks in decisions making, unless one partner is willing to trust the decisions of the other partner on minor issues. For this reason, asymmetric equity controls (such as 51%-49% ownership splits) have been touted as being more effective than ventures where ownership (and veto power) is evenly distributed to accommodate managers' desires for equal control.

Such arguments have erroneously assumed that ownership of shares is equivalent to management control. The correct balance of managerial controls and autonomy, not of ownership shares, is the key to effective management of the venture. Some firms will take a slight minority ownership position so long as they can obtain a clear majority position in managerial authority. Others are more likely to concede a larger share of profits to their partners if the venture's activities are of high strategic benefit to them in other ways. For example, in 1974, AMAX and Mitsui & Co. formed a 50%-50% joint venture in aluminum fabrication that was more successful than many wholly owned aluminum fabricating companies. ALUMAX gave AMAX an investment tax credit when it was fully owned, but this benefit could not be tax-consolidated when AMAX owned but 50 percent of the venture. Later in 1984 when AMAX wanted to apply its ALUMAX profits against losses in its core businesses, AMAX and Mitsui restructured their venture to provide AMAX with 80 percent ownership for

tax purposes. Mitsui received slightly more than 50 percent of ALUMAX's profits as compensation for this concession. The venture continued to operate as before even after AMAX later bought out Mitsui's interest in ALUMAX.

Ownership versus control. Most managers prefer that their firms hold majority equity control in their ventures, but, as I suggest above, some managers are able to distinguish equity ownership from issues concerning operating control. The distribution of equity shares is important for accounting, consolidation of interests, and qualification for tax benefits. Operating control is important for running a joint venture frictionlessly. Some managers are comfortable with asymmetric profit splits (distributions of profits that do not match distributions of equity ownership). They will also accept management control splits that do not mirror the distribution of ownership interests, as long as their firm's interests are fairly represented.

Although there is no rule in such matters, if a partner wants to take less than 25 percent ownership in a joint venture, it is considered a financial investor by many firms and often is not entitled to much of a voice in managing the venture's activities. Although majority owners may consult such partners if the size of their joint-venture investment is to be increased substantially or if another major change is contemplated, such minority partners usually are expected to be passive. There are exceptions to this pattern, however. In one situation a partner with a 24-percent interest in a joint venture was asked to supply the managers for and to operate the venture on behalf of the majority owner because it possessed the relevant experience and management skills. Sometimes a comparison of each partner's skills determines which firm will be the

joint venture's operator, and the minority partner's managers are often better qualified to run the venture than those of the majority partner.

Division of ownership shares -- owners' perspectives. Managers from sponsoring firms who favor an unequal distribution of ownership shares often believe that it is desirable to have one partner who is clearly in charge of the venture and that the split of ownership shares should reflect this power structure. Too many failed ventures, these managers argue, have 50%-50% ownership splits and partners that are deadlocked on the venture's direction. All that a 50%-50% pattern of ownership really guarantees to partners is the right to fight, such managers note.

Even managers who use 50%-50% ventures say that they distrust the idea of equal ownership splits in general because when the venture is established as a 50%-50% joint venture, it is presumed that partners will be able to work out every problem along the way. Managers often find that such presumptions are not realistic. They insist that one of the venture's owners should be identified as having primary responsibility for overseeing and running the venture. The other owners of the venture, they suggest, should hold the operating partner accountable for the venture's performance.

Managers from sponsoring firms are more likely to believe that three owners are desirable rather than two when a means of governing and resolving conflict within ventures is sought because it is less likely that three owners will fall into a deadlock. The experiences of ventures with three owners suggest, however, that running a three-party joint venture is extremely difficult, especially with respect to its direction and control.

Division of ownership shares -- venture's perspective. My research suggests that the long-publicized dislike by managers of equally-owned joint ventures originated in interviews with managers from sponsoring firms, not with the managers of jointly owned ventures. Most venture managers tend to be more interested in sustaining harmony among owners by ensuring that no owner shortchanges the others than their counterparts in owner organizations are. Managers in charge of running jointly-owned ventures often express dramatically different attitudes concerning ownership splits and the relative influence that should be exerted by the venture's owners. Many joint venture managers express a distinct preference for two (not more) owners and for 50%-50% joint ventures rather than uneven equity splits.

Venture managers who favor equal ownership shares believe that 50%-50% ventures ensure that each owner's interests and opinions will not be quashed. This opinion may arise because venture managers often are placed in the uncomfortable position of implementing the orders of their owners and they fear that a minority owner's interests will be quashed in asymmetric ownership structures (such as 51%-49% or 75%-25% arrangements). Venture managers tend to be more sensitive to the need for a consensus than managers in sponsoring firms because they recognize that a joint venture cannot be managed for long against any owner's wishes. Venture managers are most likely to believe that equal ownership shares are the outward symbol of the owners' equality in the joint venture.

Venture managers note that although 50%-50% ventures are widely acclaimed as being difficult to manage, such arrangements best capture the true spirit of a partnership. Venture managers are more likely to find 50%-50% ventures desirable to use in high technology ventures

(especially with entrepreneurial firms) because they ensure that owners will remain interested in and involved with the venture's technological development activities. Equally-distributed ownership is the only way, venture managers argue, that sponsors remain interested enough in a venture's activities to avert problems before it is too late.

Trust between sponsors. At the basis of a successful 50%-50% joint venture, most venture managers concede, is personal trust, usually between the managers from the sponsoring firms who originally formed the joint venture. Venture managers recognize that the spirit of the founding relationship must be kept healthy and vibrant in order for a joint venture to run successfully. Although examples from the oil industry suggest that ownership shares can be renegotiated when owners' interests change, venture managers tend to disagree with this practice, suggesting that if owners must renegotiate ownership shares, they probably made a poor deal in the first place and should back out. If a joint venture is not right on a 50%-50% basis, it is not likely to be right on a 90%-10% basis (or any other split either), they asserted. Instead, venture managers suggest that sponsors can fine-tune other terms that define partners' relationships with each other and with their venture.

It is important to recall that when decisions must be reviewed by all partners, they can become deadlocked whether one particular firm has majority ownership or not. If partners cannot agree, their cooperation simply cannot work. Mechanisms to encourage continued cooperation among partners should be included in negotiations concerning how to structure joint ventures. The distribution of equity control, profit splits, board representation, and other forms of managerial control that evolves from such discussions will not necessarily be symmetrical because some

partners will accept a lesser degree of control to obtain something else they seek.

Managerial control. Ownership share distribution matters less than how operating control (and participation in decision making), is actually apportioned. It is often necessary to spell out each owner's responsibilities carefully and to keep the lines of authority clear (between the owners' managers and the venture's managers) in order for a joint venture to succeed. Otherwise, squabbles ensue. Sponsoring firms should be pragmatic concerning the apportment of operating control over ventures where project leadership can be determined by owners' skills and experiences, as in the example of letting an owner with navy experience lead a navy contract team. Experienced sponsoring firms find it easier to work with partners that respect each other's knowledge and personnel well enough to send in their engineers, go through the facts, and reach agreements together concerning what should be done when problems arise. When firms cannot accept information provided by their venture or their partners, they become uneasy with their control over such partnerships.

Shared decision making in volatile settings. Confusion about who is operating a joint venture cannot be tolerated in highly competitive settings where conditions change so rapidly that ventures need great flexibility in order to respond fast enough. For example, clear leadership authority is needed in volatile businesses like the financial services industry where global communications and rapid coordination are important. It is very difficult to operate a successful financial services company using a bureaucratic decision-making process, for example, because it is necessary to be able to move fast when prices swing erratically. In such settings, there cannot be any management by

committee, unless the decision-making committee can be convened immediately and possesses the power to bind the venture in making difficult decisions quickly. Although partners can use their veto power and the joint venture's voting structure to protect their ownership interests when they review the venture's performance later, somebody must be able to obligate ventures that operate in volatile industries until owners' representatives on management boards can make their review.

Trial Marriage.

Joint ventures can result in disasters if partners have not created equitable mechanisms for resolving day-to-day deadlocks in decision making. Sponsoring firms can reduce the likelihood of deadlocks occurring by drafting a team of operating managers from both owners' ranks to serve on the negotiating team. This team works together during the courtship stage to maximize synergies (from shared resources) and economies (from centralized facilities) in a "trial marriage."

During this study period, managers in the trial marriage assess whether their firms can indeed maximize benefits by sharing assets, managers, and capabilities within their venture. The trial marriage management team considers both firms' respective positions within the industry that the joint venture will cover before the marriage is consummated and creates a proposal for the best use of all owners' facilities that would be contributed to the joint venture -- without preconceived notions of equitable schedules concerning which plants will be shut down, what political solutions are needed for layoffs, and so forth. The trial marriage managers develop the most economic use of all contributed facilities and how to combine these facilities, without

knowing who will be chosen to run the venture's operations after the trial marriage period or how each partner's contributions will be valued. During the trial marriage, the team of managers works together to create the best plans for adding capabilities and rationalizing the venture's redundant facilities. Finally, when the trial marriage organization evolves into a full-fledged joint venture entity, the venture's permanent management team is selected on the basis of which managers best solved problems together -- not which partners they worked for and what their rank was previously.

Executive Boards of Directors

Ventures are governed by boards comprised of representatives from their sponsors. Decisions regarding board composition provide owners with a unique opportunity to guide their venture's development. It is important to select the right people to serve on the venture's board of directors to oversee its activities as the venture evoluves. But instead of placing managers who could help the venture to compete more effectively on its executive board, some firms make board directorships an honorary position occupied by managers with experiences far removed from those activities that would be salient to their venture.

Board members should not be too highly placed within their owners' firms if the venture is still young. The best candidates for joint-venture boards are often managers operating so far down within owner firms' hierarchies that they would never be considered for similar honors within their own organizations. Yet their skills and insights may be more compatible with the needs of ventures, especially in the early years of a venture's start-up, than higher-ranking executives that are

more accustomed to dealing with firms' external environments and the complexities of multibusiness enterprise. The best directors for young ventures are themselves competent managers of people with substantial diplomatic skills. Because board members need time to follow up on the venture's activities, they should not be unduly distracted by other directorship duties. Although some venture managers attribute their success to their owners' willingness to leave them alone, these ventures are exceptions. Most ventures need more than just cash to succeed, and the closer their activities are to those of their owners, the more they need day-to-day contact with their owners' representatives.

A combination of continuity and rotation is needed in selecting board members. Continuity ensures that managers who were actively involved in negotiations remember the venture's purpose and retain personal friendships with their counterparts in partner firms. Rotation of board members ensures that the venture can evolve. Because different operating needs may require closer attentions as the venture develops its own capabilities, some of the board members selected to guide the joint venture should rotate in a pattern that reflects these changing needs. For example, as the venture graduates into an ongoing entity that issues equity securities in its own right, a different type of board composition will be appropriate than when the venture was a struggling start-up venture that emphasized product design questions. As the venture acquires more activities that make it tantamount to a stand-alone entity, more general management guidance will be needed, for example, than when owners limited the venture merely to manufacturing or research activities.

Owners of successfully coordinated, horizontally related joint ventures identify pressure points in product development activities that will require close coordination between owner and venture well in advance of the competitive conditions that make them necessary. Then they choose the venture's board of directors carefully to avert areas of potential conflicts between sponsor and venture. Most joint-venture board members in these successful alliances are in positions that are functionally related to the venture's activities, thereby ensuring that they have the knowledge needed to coordinate the decisions of owner and venture.

To maintain some continuity in partners' dealings with each other, some board members must retain their seats as others rotate off the board. No number of codicils can overcome the benefits of prolonged exposure by the permanent members of partners' delegations to each other. The longer that board members work together harmoniously, the less need they will feel for recourse to legal documents to establish a homogeneity of vision concerning their venture's purpose.

Many managers who participate in the creation of joint ventures never lose their identification with them in matters pertaining to dealings with managers in non-U.S. partners. Even when such managers are rotated to other duties, managers in other sponsoring firms continue to seek their help in resolving alliance difficulties. Executives from non-U.S. firms that cooperated with U.S. firms suggested that this identification persists because contacts beyond the management board are important to venture success. The need for frequent and close personal contacts also explains why managers from non-U.S. firms suggest that small offices should be established near the venture. They believe that the venture's managers will pay more attention to the viewpoints that

they encounter most frequently and understand most clearly when making policy decisions on behalf of the venture's sponsors.

Personnel Rotation

Sponsors can guide their venture's activities by choosing to send their most effective managers to work in their venture. But frequently these staffing decisions are unduly complicated because sponsoring firms are unwilling to commit these personnel to their venture's success. Too often sponsoring firms permit restive employees to use the "revolving door" back to headquarters and the security of the owner's organization when the venture encounters adversity.

No revolving door. The venture's general manager must be detached from loyalties to either partner in decision making, even if that means that managers must be recruited from the outside. (The general manager can come from either one of the venture's owners if that manager can maintain a neutral attitude and can win the confidence of all owners. However, since it is often difficult to persuade the other owners to trust a manager that comes from one partner, a more radical solution is often needed.) Because it is not possible for the best interests of the venture to be served by managers with unclearly focused loyalties and attentions, the venture's managers may have to be recruited from outside. Key positions, in particular, must have unswerving loyalties to the well-being of the venture. To combat the problems of split loyalties, some firms close the revolving door (thereby focusing a venture manager's attention on the venture's problems). Other firms hire talented outsiders -- with loyalties to neither owner -- to lead the venture and hold its critical jobs if they cannot close the revolving door.

Using the revolving door. The revolving-door policy encourages the bleedthrough of ideas. In some cases, this transfer of information may be desirable. Revolving doors are useful if owners seek to create their own in-house technological capabilities by repatriating knowledge to their factories and laboratories. If employees from the venture's owners are frequently rotated through the venture, there is a good chance that they will disseminate knowledge of the venture back to their respective firms' laboratories. Some aggressive owners even build parallel facilities and hold in-house seminars to emulate each experiment that their venture undertakes. Thus, if owners want to encourage knowledge bleedthrough, they will not give their venture a permanent complement of managers and technical personnel. Owners will treat the assignment of employees to the joint venture as part of their regular career path of experiences and will expect these personnel to disseminate knowledge in both directions.

Even as ventures develop their own management teams and assert their independence, they still benefit from the presence of employees that are on loan from their sponsors. Employees from each owner are still needed if the venture's activities are to be coordinated with those of its owners' because it is helpful for the venture to have someone on hand who knows the corporate people and where to go to get things done. It is helpful to have employees on hand who can call in old favors -- as when the venture needs something pushed through its owner's organization -- to make day-to-day operations of the venture run smoothly. But the message-carrier does not have to be the president of the venture.

Review Points

In theory, the bargaining contract that forms the venture will contain all of the necessary details of the management system that will bind the venture to each respective owner. In fact, it is unreasonable to expect owners (or their lawyers) to foresee and provide for all of the conditions that could make joint-venture relationships evolve. It is also unrealistic to expect the venture's managers to adhere slavishly to terms of the venture contract. Whether the contract is followed by the venture's managers or not, it should scarcely be surprising that terms of the original venture agreement must be fine-tuned and/or renegotiated as conditions surrounding firms' strategic alliances change.

Adaptive management systems. Many effective firms are in a constant state of fine-tuning with respect to their own management systems. It is unreasonable for these same firms, as owners, to expect their venture's system to be cast in concrete. Adaptive systems are needed to provide for the changes that may occur in relationships between joint-venture partners, between owner and venture, or within the venture's domain. Autonomous venture managers will make these changes without referring back to the document that created the joint venture. For this reason, sponsoring firms must continually adapt how their own activities and reporting mechanisms mesh with those of the venture.

Although the management systems that link owners to their venture should provide for the ways in which the venture's capital requests and budgeting cycle will mesh with that of its owners' planning cycles, sponsoring firms must be wary of overburdening their ventures with excessive reporting obligations. Paradoxically, the management systems used to govern ventures are often more detailed than the systems of

either owner because the venture must bridge the cultural differences between partners and must be consistent with the performance measures, review procedures, reward systems, and other needs of each owner. To attain this goal, a complex management system and organization design (often embodying some version of a matrix organization) has often been embraced. Such management burdens quickly cancel the expected benefits of cooperation and slow down the venture when it must move quickly, as in volatile industry settings. The paperwork involved in maintaining such complex systems can stifle creativity within the venture.

When ventures become of increasing strategic importance to their owners, the venture's information-reporting systems must be separated from those of its owners in order to facilitate better measures of its activity, free and clear of commingling with information about its owners' activities. Without such information, it is impossible to ascertain whether the venture is in good health. Allocations of costs, such as those of shared personnel salaries of other shared assets are frustrating, but these practices must change over time as the venture's relationship with its owners evolves.

Divorce Clauses

The fragile nature of cooperatives strategies requires mechanisms that will ensure that parity among partners is protected. If the relative value of partners' contributions changes, the management systems that govern the venture should (in theory) revalue owners' contributions regularly and adjust ownership (and managerial) shares to reflect current market values. Such valuations may be difficult to implement in practice, however, unless a reference point for pricing assets is readily available, as in the example of crude oil. Where there is no market,

partners could become deadlocked regarding valuation methods. To overcome such stalemates, partners may have to agree on unorthodox ways of resolving such disputes. Such mechanisms are typically defined by the divorce clauses of partners' agreements. Russian roulette buy-outs, for example, are one type of scheme whereby one firm evaluates the venture and proposes a price for the equity of the venture to its partners who choose, in turn, whether to be buyers of the evaluating firm's interest or sellers of their own joint-venture interests.

Using Venture Managers Effectively

Managers sometimes erroneously believe that they can set up ventures and let them run themselves. Most ventures require much more management time than many owners expect. A joint venture runs the risk of failing if it does not receive a tremendous amount of attention from its owners' executives as well as from the managers who run it. My research findings suggest that choices concerning who to appoint to the venture's management board and which managers to place in charge of the venture's operations are crucial to its success. The executive who shoulders these responsibilities need not come from the owners' organizations, but a central coordinator is needed to bring owners to rational agreements and avert dissension.

The importance of choosing capable venture managers should be self-apparent. Somebody must be responsible for coping with the many possible conflicts that arise concerning owners' egos, venture manager motivation, and other operating problems. Because these responsibilities absorb significant amounts of time and require finely-honed negotiation skills, people skills, and selling skills, the task of running joint

ventures can take twice as much time to manage as wholly-owned business units if sponsoring firms will not delegate sufficient decision making autonomy to venture managers.

Joint-Venture Management Style

The managers best suited to run a joint venture should be trained in diplomacy because they must approach the chief executives of all sponsoring firms to explain the venture's activities. Working only through the board members who oversee the venture's activities is not an adequate way to gain the trust and sponsorship of owner firms needed for the venture to thrive. Unless the venture's manager can capture the support of its owners' entire management team, the venture tends to be treated like an unwelcome stepchild. Failure to appoint a venture manager who can muster this support can doom the venture to failure.

Building consensus. The best joint-venture managers are those who do well within a matrix organization because they can deal with the political differences of owners in a diplomatic fashion while satisfying their diverse needs. One sure way for a joint venture to fail is for its managers not to consult all of the venture's owners on decision alternatives, planned expenditures, and other proposals. In managing points of obvious controversy between owners, it is important for the venture's manager to gather the opinions of the "experts" within sponsoring firms. (These are the managers within sponsoring firms whose opinions on a particular topic are most likely to be asked when a venture's proposal is evaluated whether the owner knows the venture's business or not.) These experts' opinions should be solicited and the venture manager's proposal should be modified to reflect them before

making an official recommendation to the joint venture's management board. If the venture's manager incorporates each owner's viewpoints into the proposal, these recommendations become the plan that the venture's sponsors' own experts have recommended and are more likely to be accepted by them.

Including sponsors. Earlier studies of joint venture controls found that autonomous ventures were more innovative than those that were tethered closely to the review of their sponsors' board. The implications of this result are mixed. Although giving joint-venture managers more of a free rein in decision making may improve the joint venture's return to its owners, venture managers should remember that owners' managers want to share in the venture's success, especially if founding managers' egos are closely tied to that success. (As one successful venture manager noted, not bringing owners along on a joint venture's decisions is like excluding biological parents from their child's wedding.)

A Human Dumping Ground

The choice of venture manager is critical to its success, even if that manager is an outsider with no loyalty to any particular venture sponsor. Owners miss an opportunity to tap their venture managers' entrepreneurial tendencies when they let the ventures be used as personnel dumping grounds. Sometimes owners undercut their venture's chances for success through such personnel policies because if owners contribute their burnt-out, low-potential, or politically-embarrassing managers in their ventures (and treat them accordingly), their failures become self-fulfilling prophesies. Failure is also likely if owners remove high

performers from the joint-venture assignment soon after the honeymoon is over and deny the subsequent venture management team the kind of high-level attentions reserved for managers of wholly-owned business units. Because they believe that a revolving door will bring them back to their old jobs in their respective firms, temporary venture managers tend to identify with their respective owner's interests rather than with the venture's success needs. If venture managers do not think of themselves as employees of the venture, their decisions will reflect this schism (as will the joint venture's ultimate failure).

Problems arise when the joint venture is treated as an inferior child or is not given the means to succeed. When they receive such negative signals, managers assigned to the venture tend to become jaundiced because they know that running the joint venture is not considered to be a great honor within sponsoring firms' organizations. Rather than making the joint venture a convenient parking place for senior executives awaiting retirement, sponsoring firms should make venture management a reward for enterprising managers and encourage them to engage in innovative behavior. Many sponsoring firms are unwilling to do so because they fear that venture managements will become unduly attentive to the venture's needs to their detriment.

A Serpent in Our Bosom

It should not be surprising to find that the venture's personnel develop a culture that differs from that of the venture's sponsors, especially if owners' managers have inadvertently encouraged a schism to develop between sponsor and venture. The longer that managers stay in a venture, the more loyal they become to the venture. When venture

managers become more loyal to the venture's success requirements than to its owners' preferences, conflicts with the owner's personnel are inevitable -- especially when past treatment of the venture by its owners has encouraged the development of a guerilla mentality on the venture managers' part. In many cases, the venture has been an underdog. Its management team started as a group of rag-tag people sent from the venture's owners because they were politically embarrassing. With time, this management team develops a closeness because they are the black sheep of their respective owner firms and receive little respect in their role as the venture's managers. For example, the venture may have operated for a decade but the owners' managers still misspell and mispronounce the venture's name. Perhaps the venture's organization has been kept lean (or understaffed) while important decisions are made at owners' headquarters.

Despite these deterrents, the venture's management team may thrive (sometimes to the chagrin of the venture's sponsors). When managers within owner organizations finally realize that their venture has grown into an independently minded entity with its own markets and its own priorities, their feelings of alienation are scarcely surprising. After all, the venture may have occupied a corner on one floor of its owner's sixty-story office complex for years, for example, and its revenues may have been a pittance when compared with those of its owners. Suddenly the venture is stealing top management talent from its owner and competing for resources. The compensation system used to gauge the venture's performance may exacerbate any sponsor-venture conflicts, especially when going back to an owner firm that resembles a paramilitary organization

after a decade of autonomy no longer appeals to the venture's "black sheep" managers.

Balancing the Venture's Autonomy Needs

As a venture matures, its managers often want freedoms, such as the freedom to enter into new ventures in its own right. Whether sponsoring firms permit managers to go to the stock market in the venture's own right, develop facilities that compete with owners' operations, or form their own ventures depends very much on what owners want from their alliance. While some sponsoring firms' managers believe that a joint venture should be terminated as soon as its goal is attained (project-by-project basis), others favor cascades of ventures (if appropriate) and are willing to let their ventures develop into autonomous entities. (If a venture is allowed to forge its own joint ventures, its experienced venture managers make excellent overseers of the subsequent joint ventures because they know what works and which policies owners tend to impose that make a venture's manager impotent.) The proper balance between venture autonomy and coordination with its sponsors depends upon what mission the venture was created to accomplish. Some tasks will naturally create conflicts between a venture and its sponsors.

Overcoming Impasses

Decision making can be cumbersome in a joint venture. It requires a different mentality on the part of owners to make a venture work because managers in sponsoring firms quickly become frustrated when they find it

more and more difficult to get something done quickly in their venture. Frequently owners find that they cannot simply call down to the venture to tell its managers that another 10 percent of a certain output is needed as they are accustomed to do in their wholly-owned businesses, for example, or to do this or that if the venture is jointly-owned. Sponsoring firms discover that an arm's length relationship with a jointly owned venture means that negotiations with the other sponsors are needed if they wanted to change how they draw outputs from the venture and they resent this inconvenience.

Restraints on managers from sponsoring firms are especially difficult to tolerate for managers that instinctively overmanage their subsidiaries, especially if they are unfamiliar with techniques for managing cooperation. They refuse to believe that a regular flow of requests from owners' managers to the venture's managers for figures, status reports, and other information overwhelms the venture managers, especially if the joint venture is small and the inquiring owner is large. Ironically, when frustrated managers in sponsoring firms slam against the constraints of the matrix organization they created for monitoring their venture, they do not change their own control mechanisms. Rather, they layer in more and more liaison people and add more procedures to solve their personality conflicts with the ventures' managers or with their partners. They do so to buffer themselves from direct contact with the venture and its other owners. As the situation grows more hidebound, owners lose track of the original benefits that motivated the venture's formation.

How can managers within sponsoring firms break out of this quagmire? Some managers prefer to negotiate step-by-step with their partners as

they face new challenges. Since they cannot foresee everything the venture will face and the success requirements of the venture's industry change so rapidly as to make the venture's products obsolete before owners' lawyers can write another contract to cover all contingencies, some partners simply trust each other. Or sponsoring firms give the venture's managers more authority and operating autonomy. But some sponsoring firm managers pull their ventures even closer to their firm's ongoing activities and run the venture as a part of their regular management responsibilities when they become frustrated. Other managers simply trash the joint venture when managing it from afar becomes too difficult.

Evaluating Joint-Venture Performance

Managers in sponsoring firms and ventures alike recognize that ventures are very complex to manage, that the probability of joint-venture success is low, and that the U.S. track record for running domestically-based joint ventures successfully is especially poor. Moreover, they recognize that every strategic alliance is unique because of the many possible ways in which firms might combine as well as the diversity of the owners themselves. Thus, attempts to make any two joint ventures work under identical constraints in time, size, profitability, and so on will probably yield very different results. Nevertheless, many managers realize that ventures are becoming increasingly important as a strategy option for their firms and they want to learn how to make them work.

Are joint ventures overrated in their usefulness? The managers I interviewed suggested that any evaluation of joint-venture performance

depends on the joint venture's purpose. The problems of coordination between owner and venture are formidable, and they rarely outweigh the benefits managers expect to receive through cooperation. But sometimes firms have no choice but to use strategic alliances. If firms can do everything themselves equally well without partners and are blessed with infinite cash resources, there is no need for them to form joint ventures.

More realistic expectations of joint ventures are needed in order for them to be used effectively by most U.S. firms. Ventures can be used to permit owners to make smaller investments in risky projects than they would otherwise have to tackle on their own. Hopefully the rate of return from cooperation will be the same as if firms had invested a larger amount alone. If sponsors are lucky, their returns on investment are higher than going it alone while their ticket to entry is smaller (due to their pooled sources). In addition, sponsoring firms are exposed to less risk. The net effect of the risk-return tradeoff from cooperation makes many joint-venture owners better off than if they had invested alone.

It is important to remember that joint ventures are a transitional form of management -- an intermediate step on the way to something else. Since ventures are best viewed as being a means to an end, their owners need to create a system of incentives among their respective managers -- both as partners and as owners -- that encourages them to cooperate in joint ventures. Acquisition is usually a zero-sum game, but joint ventures can be a nonzero-sum game if firms are trying to cooperate, not trying to coopt their partners. The fact that knowledge, products, or other necessary resources are obtained through a joint venture (rather

than through an outright acquisition) matters less in determining whether firms can attain their objectives than whether those objectives were attained.

The U.S. joint-venture success rate has been improving as more firms apply creative solutions to old issues such as how long ventures must last, who must be the operator, and what each player should bring to the party. There is ample profit available through joint ventures because of scale economies from pooling resources, because of integration economies from better balances between adjacent stages of production, and because of other cost savings that reduce the total cost of doing business. U.S. firms must learn to exploit the economies of cooperation because from a wealth-creating partner's perspective, the joint venture always offers an opportunity to improve on what firms can do alone. When managers have cracked the secret of how to maneuver within them, they are sold on the idea of joint-venture strategies as a means to attain successful performances for their firms.

Table 1
Motivations for Joint-Venture Formation

A. Internal uses

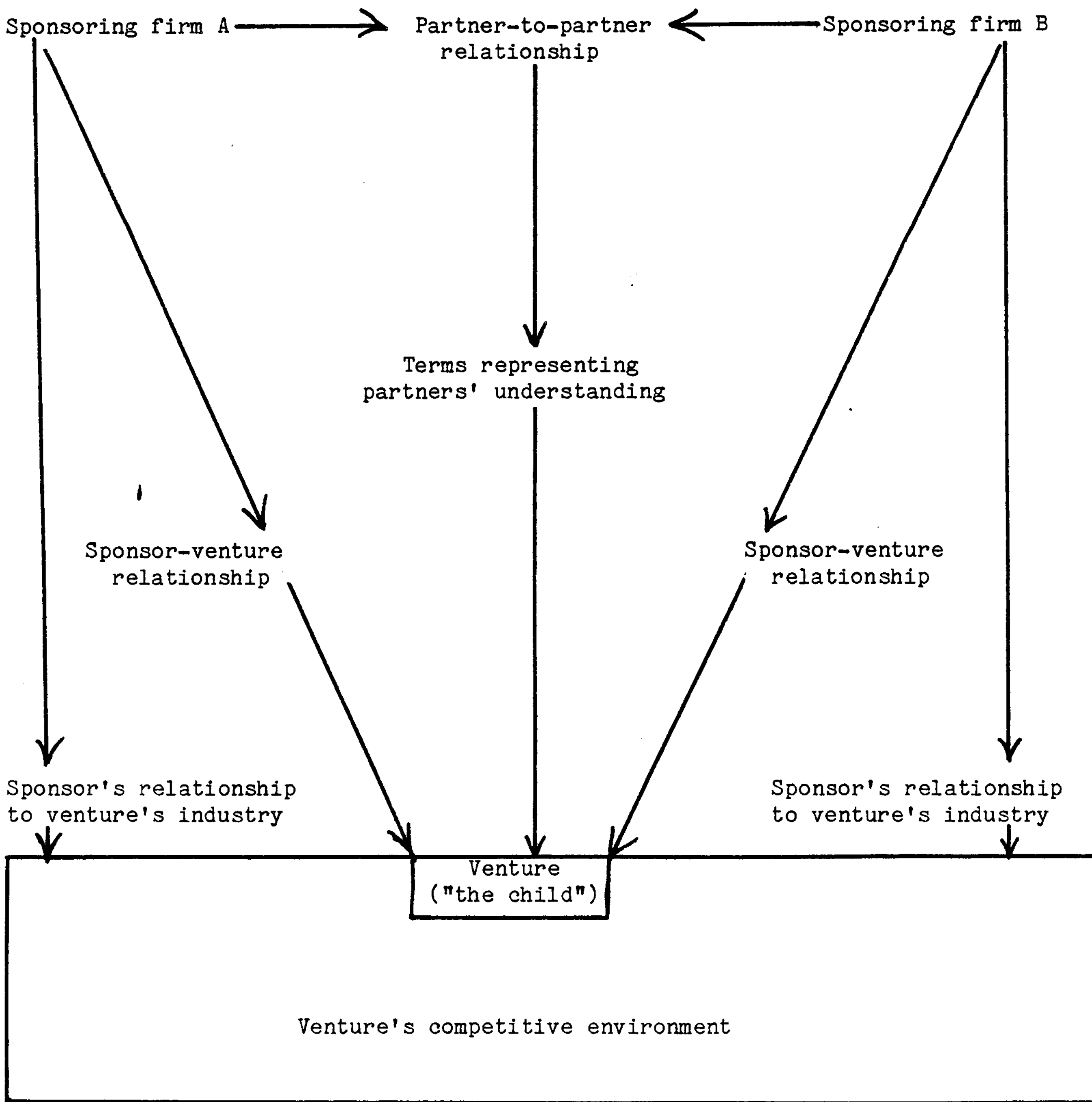
1. Cost and risk sharing (uncertainty reduction)
2. Obtain resources where there is no market
3. Obtain financing to supplement firm's debt capacity
4. Share outputs of large minimum efficient scale plants
   a. Avoid wasteful duplication of facilities
   b. Utilize by-products, processes
   c. Shared brands, distribution channels, wide product lines, and so forth
5. Intelligence: obtain window on new technologies and customers
   a. Superior information exchange
   b. Technological personnel interactions
6. Innovative managerial practices
   a. Superior management systems
   b. Improved communications among SBUs
7. Retain entrepreneurial employees

B. Competitive uses (strengthen current strategic positions)

1. Influence industry structure's evolution
   a. Pioneer development of new industries
   b. Reduce competitive volatility
   c. Rationalize mature industries
2. Preempt competitors ("first-mover" advantages)
   a. Gain rapid access to better customers
   b. Capacity expansion or vertical integration
   c. Acquisition of advantageous terms, resources
   d. Coalition with best partners
3. Defensive response to blurring industry boundaries and globalization
   a. Ease political tensions (overcome trade barriers)
   b. Gain access to global networks
4. Creation of more effective competitors
   a. Hybrids possessing owners' strengths
   b. Fewer, more efficient firms
   c. Buffer dissimilar partners

C. Strategic uses (augment strategic position)

1. Creation and exploitation of synergies
2. Technology (or other skills) transfer
3. Diversification
   a.Toehold entry into new markets, products, or skills
   b. Rationalization (or divestiture) of investment
   c. Leverage-related owners' skills for new uses



The Triangle of Strategic Alliances

Figure 1

FIGURE 3

Declining Industries in the United States*

Vacuum receiving tubes
Appliance control thermostats
Commercial passenger airplane propellers
Tinplate cans
Petroleum refining
Basic petrochemicals
Aluminum extraction
Cigars
Germanium-based semiconductors
Trolley car services
Metal gears (where plastic will suffice)
Adding machines
Slide rules
Old-style packinghouses
Windmill water pumps
Permanent wave machines
Acetylene
Rayon and acetate fiber (and fabric)
Leather-tanning services
Hardwood flooring
Passenger liner service
Hard eyewear lenses
Lead pencils and crayons
Milk carton cardboard
Power transmission cable
Power circuit breakers
Steam locomotives and passenger train cars
Boilers for fossil fuel plants
Leather belting for machines
Buttons and hooks
Silk stockings
Hand-held irons and ironing boards
Wringer washing machines
All-wool carpeting
Horse shoes
Millinery and millinery blocks
Corsets, girdles and brassieres
Buggy whips
Pocket watches
Steam radiators
Steel
Oilpatch services
Copper extraction
Whiskey distilling
Cigarettes
Residential oil burners
Domestic heating stoves
Linoleum
Fountain pens
Cork products
Wooden containers
Wooden furniture
Low greige cotton yarns
Synthetic soda ash
Percolator coffee-makers
Baby foods and baby products
Harpoons
Toys
Awnings
Evaporated milk
Hot breakfast cereals
Canned peas
Creamery butter
Venetian blinds
Lace and net goods
Straight razors
Gas lighting fixtures
Oiled, waxed and wax-laminated paper
Washboards
Metal crowns for home canning
Swiss watches, mechanical watches
Icing glass used in cars and stoves
Kerosene lamps
Carbon black

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* Declining demand in some industries (such as whiskey and petroleum refining) may be temporary. In other industries (such as vacuum receiving tubes), declining demand is not expected to resuscitate.