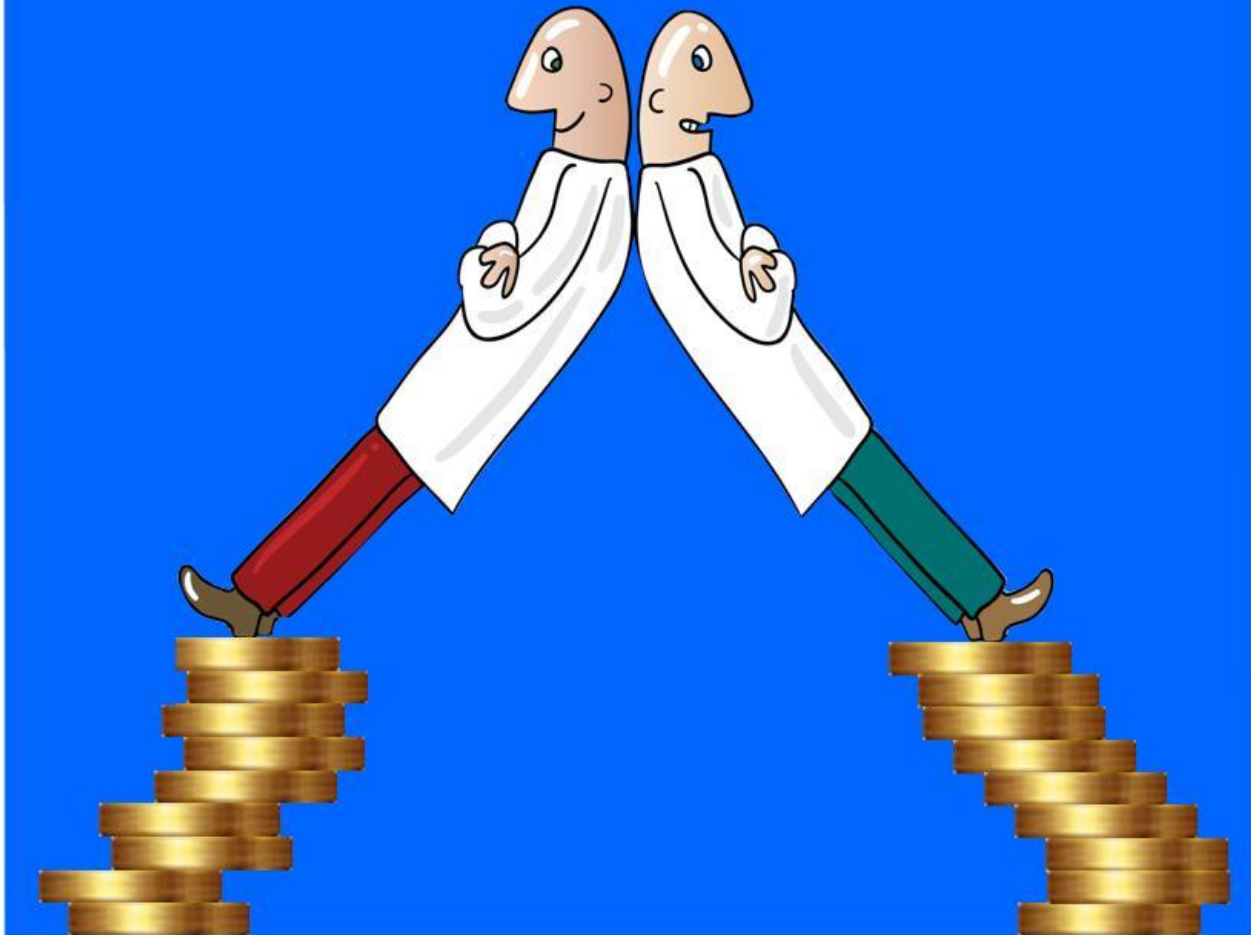


Alfred Griffioen

Creating profit through alliances



How collaborative business models can contribute to competitive advantage

Creating profit through alliances

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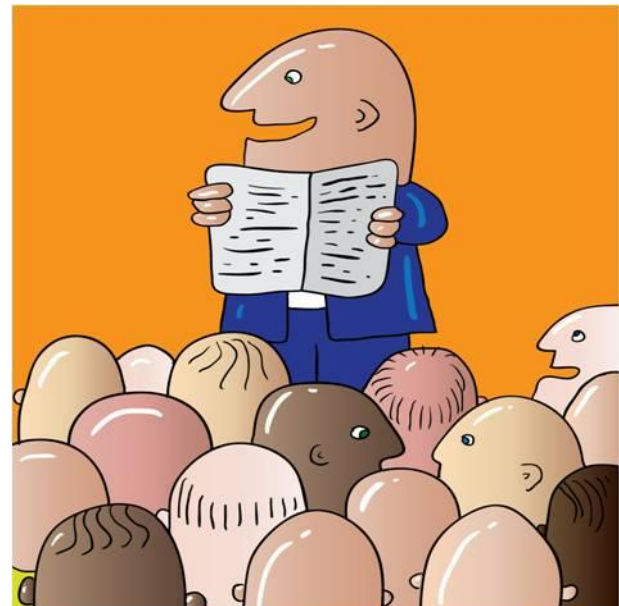
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Foreword

Strategic alliances can be a great source of competitive advantage. However, this only works if each partner has a clear understanding of its market, and the market for the joint proposition offered by the alliance, and if the two can devise a business model that benefits not only themselves but also the customer.

Over the last several years I have been involved in setting up a large number of alliances that helped Philips advance in technology, in efficiency, or in the way we meet our customers' needs. We sought partners outside our industry and created entirely new types of propositions, ones we could not have created just by ourselves. This has helped to create entry barriers for competitors: aside from meeting the technology challenge, they would have to find their own fitting partners, and then together with them agree to realise a new proposition....and then it still needs to be jointly brought to market!

Working with partners from different industries places extra demands on an alliances business model. For instance, the pace within the Fast Moving Consumer

Goods industry is entirely different from lifecycles in the electronics industry. How to split investments and revenue in such a case? And which partner captures the extra brand value and is awarded the intellectual property rights?

Numerous alliances exist, and a variety of collaborative business models is called for. The point is that few have been described. Therefore I welcome the author's initiative with this book. I hope and trust that it will help companies embark on partnerships much better prepared. In that way we may all enjoy new and innovative products and services, that would not see the light of day without collaboration, yet seem so obvious once they do.



Ivo Rutten

Vice President Corporate Strategy and Alliances
Royal Philips Electronics

Introduction

Why are some companies more successful than others and how can alliances contribute to this success? I have spent the past few years researching these questions, in search of practical answers. It's quite easy to perform analyses and to devise descriptive structures; but what guidelines and directives can be extracted from scientific research and the operational experience of companies worldwide?

Chesbrough¹ has formulated a definition of a business model that is extremely useful to keep in mind when assessing the possibility of an alliance.

Business models create value*
and capture a portion of that value

* by defining a series of activities from raw materials to the final consumer

In this book I wish to guide you from the theoretical background of the creation of value to the more practical considerations of forging an alliance, including the distribution of the newly created value. This book is written for those that are involved in forging and managing alliances, varying from board members and strategists to business development and alliance managers. The overall structure of the chapters and paragraphs is shown in Figure 1.

Chapter 1 starts with the principles of creating value for your company. The key to above average profits is differentiation. The concept of the value network – in contrast to the value chain – may help you decide where you want to differentiate yourself from the competition. Porter and Treacy & Wiersema are significant contributors to strategies on how to differentiate. However, the availability of information and capital has increased tremendously over the last decade, and some of their assumptions no longer

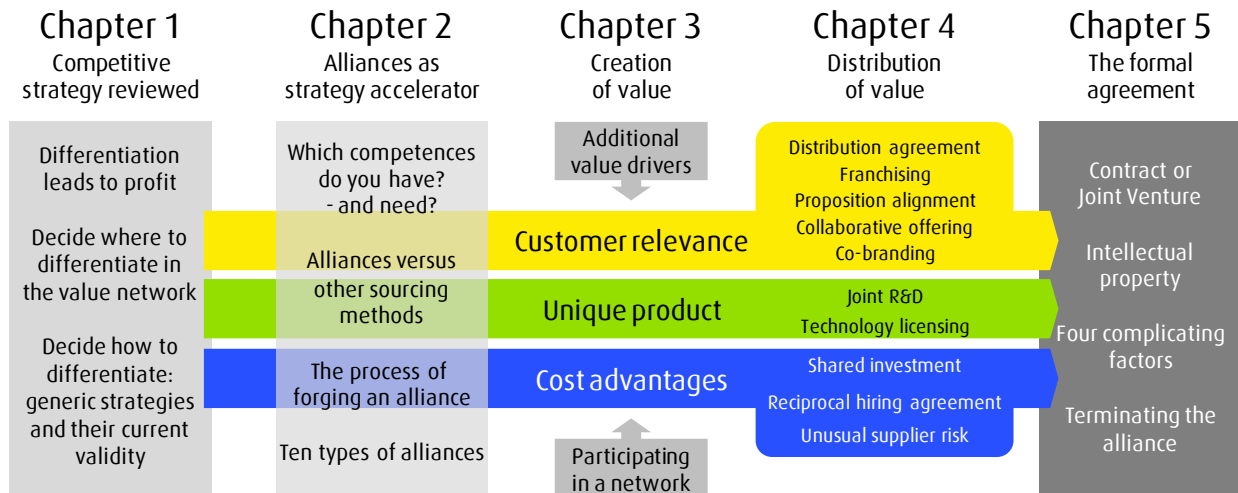


Figure 1. Overall structure of the book

hold. I therefore introduce three adjusted strategies for differentiation: creating customer relevance, having a unique product and – for the short term – achieving cost advantages.

Chapter 2 introduces the concept of alliances from a resource perspective. What competences do you need to successfully execute your strategy? Alliances are compared to other sourcing methods, and the process of forging an alliance is described step by step. With reference to the definition of a partnership, ten types of alliances are presented.

Chapter 3 elaborates the three strategies for differentiation introduced in Chapter 1. Exploring how the ten types of alliances contribute to these strategies, the focus is on the added value of an alliance compared to direct investment. Two further aspects are described: additional value drivers such as market dominance and recurrent turnover, and the value of participating in a network.

Chapter 4 delves deeper into the financial structure of each type of alliance. Ways of splitting revenue and costs and of allocating intellectual property rights are detailed for various situations. You can read this as a sort of cookbook for your own situation, and I suggest you treat it accordingly: if you do not need a dessert, just skip the corresponding recipes.

Finally, Chapter 5 addresses some of the legal aspects of forging an alliance. Most types of alliances can be arranged through a contract or a new legal entity,

that is, a joint venture. A practical arrangement for intellectual property rights is suggested and complicating factors are discussed, such as a partnership between two companies significantly different in size. And, finally, termination clauses should not be omitted.

In my research I found that there is hardly any case material available about the way alliances are structured financially. It therefore gives me great pleasure to include cases of 14 different companies that were open and kind enough to disclose their working methods. In addition to these companies, I had off-the-record interviews with alliance managers of Oracle, Ebay, Cisco, Alcatel-Lucent and Thales.

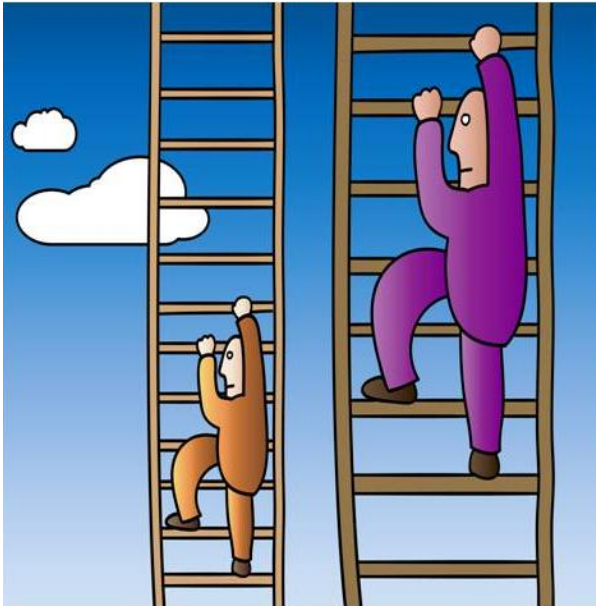
I regard this book as a working document. It will therefore be available as a PDF document and ebook, with only a limited edition in print. It is likely that a new edition will be published in 2012, and I would therefore welcome further input in the form of new models and cases.

The downloadable version of the book will have a broad margin for 'virtual' sticky notes. These can offer brief examples, suggestions for further reading, links to Internet sites or even corrections. All readers are invited to share their knowledge. This way the book can also serve as a discussion document.

Alfred Griffioen
January 2011

If you have any comments or additions, please email these to alfred.griffioen@allianceexperts.com and I will post them as sticky notes in the document within a few weeks.

1. Competitive strategy reviewed



How do you achieve growth, and how do you make a profit? That really is the question that is answered by your business model: a description of what you as a business do, who your target is and how you earn your money. The term became very popular during the late nineties, as every Internet start-up required a business model. This does not exactly define what a business model is, but it does give some indication. So if you are asked "what is your business model?", you could for instance say: I've got a printing company that produces advertising copy with very short delivery times.

The important thing is to think about the added value of your business. Added value can be converted into profit, growth, security for your staff or extra benefits for your customers. Whereas businesses will perhaps

focus more on making a profit, non-profit organisations are more likely to look at how to serve their customers or society better or cheaper, and dedicate extra resources to that.

A study² among 168 businesses shows what the most important factors are in order to be successful in a market. On the one hand, it is having the right resources, such as highly skilled people, protected knowledge, brand awareness or long-term contracts. On the other, it is having a highly distinctive strategy. These factors depend on each other: your knowledge and resources will largely determine your strategy.

It turns out that your strategy is the most important factor for success in the market, followed by your resources and to a lesser extent the competition intensity.

Your financial results are affected to similar extent by this success in the market and the power of your suppliers. After all, if they take care of a major part of your product or service, they can also claim part of your results.

This chapter elaborates on the relationship between strategy and profits. Key element in this is differentiation from your competitors. The concept of the value network is introduced to be able to think of opportunities that are new to the market. Generic strategies by Porter and Treacy & Wiersema are reviewed to see how you can differentiate yourself in a sustainable way.

Differentiation leads to profit

Every branch of industry has its own characteristics and, depending on supply and demand, their prices are higher or lower. If you are looking to buy a new car, you will have plenty of choice and the margins of the dealer and supplier are small. If you are looking for someone to repair your central-heating boiler in the middle of winter, supply is limited and prices are correspondingly high.

There are a number of characteristics that lead to more power for the demanding or for the supplying party. Those characteristics are shown in Table 1. A balance between supply and demand leads to a market price. Balance between supply and demand (because often there will be only one dealer per car brand in a city, and only a handful of installers per region) allows everyone to make a reasonable living. If there are too many suppliers, turnover drops and someone will have to close his business. If the number of suppliers is too low, it won't be long before someone tries his luck and opens a new business. If you are unlucky, you also have a cost disadvantage, such as 'standard shops' in excessively expensive locations, or consultancy agencies with overpaid staff. In other words, with a standard product your profits will always remain limited.

It is easy to perform worse than the average in your branch of industry, and a number of well-managed businesses will certainly earn more than that average. However, it will be difficult to earn significantly more than the average if you cannot set yourself apart from the competitors. As soon as elements of your clientele, suppliers, method, etc. become known, at least one of your competitors will follow your example. This competition will again reduce your advantage.

Southwest was the first airline company in the United States to introduce the low-cost principle: no coffee or meals during the flight, having to check in again for the next flight and no frequent flyer bonus schemes. In addition, everything was organised in such a way that the aircraft turnaround time could be kept to a minimum. This enabled them to keep ticket prices extremely low, and Southwest was very successful in doing so. In Europe, Easyjet and Ryanair are the biggest followers.

These days, every established airline company offers short flights at low prices and they often have a subsidiary operating according to the same principle: Singapore Airlines has Tiger Airways, Iberia has Clickair. This means that competition has become fierce in this market segment too.

More power to the supplier of products or services	More power to the buyer of products or services
• The number of suppliers is limited, so there is little competition • There are many differences between suppliers, it is difficult to make a comparison • To suppliers it is an unimportant product, they do not depend on it and do not have to sell at loss • There are no substitutes • It is difficult for the buyer to abandon or postpone his need	• The number of buyers is limited, every buyer represents a lot of turnover • Where he buys his products is irrelevant to the buyer, product variations are small • Suppliers are highly dependent on this product and cannot afford to miss a sales opportunity • There are plenty of alternatives • It is difficult for the supplier to keep the products in stock any longer and sell them later on.

Table 1. Factors that determine where the power lies between supplier and buyer

It is not as if certain branches of industry yield more return than others. This is on account of the investors. After all, virtually every business needs capital: for machines, for research or for day-to-day operational management. Aside from banks and the entrepreneurs directly, it is professional investors and - in the case of listed businesses - large groups of private investors who strengthen that capital. As soon as a branch of industry appears to yield a more favourable return on the invested capital in the long term, more investors will plough their money into this. This supply of capital will cause that branch of industry to grow, as a result of which prices, and with that the profit margins, will fall.

A possible answer to the question on how to derive profit is offered by elementary microeconomic theory. This concerns the demand curve for a product or service. If the price is high, the quantities sold will be small, and if the price is low, more products or services will be sold. This relationship is called the demand curve.

In a situation with competitors where everyone sells more or less the same product, you have to go along with the others. Because if your prices are higher than those of your competitor, everyone will go to him, and if your prices are lower you will deprive yourself and the competitor may also lower his prices. The price multiplied by the numbers sold is your turnover, and if you deduct your costs from that you are left with a (small) profit, as demonstrated in the first diagram of Figure 2. This typically applies to raw materials such as pig iron and diesel, objects

such as lighters and cotton wool, and services provided by hairdressers, smaller restaurants and cleaning companies.

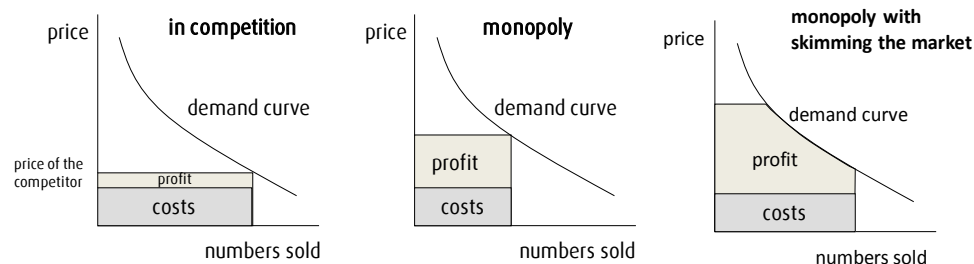


Figure 2. The effect of the demand curve with competition and in a monopoly

If you are selling a unique product, or if you know of another way to ensure customers choose you instead of your competitor, you will have a kind of monopoly. In that case, you are free to determine at which price you wish to sell your product. That price comes with a certain demand, which is how you can optimise your profits (second diagram). If you start off with a higher price and then slowly bring it down, you can make an even bigger profit. This is known as skimming the market (third diagram). Apple sold the first iPhone for approximately 300 dollars, and then gradually lowered the price.

So it is vital to distinguish yourself from the competition, in other words, to create a small monopoly. This principle is described by W. Chan Kim and Renée Mauborgne in their book *Blue Ocean Strategy*³. Instead of competing on existing markets, the so-called 'red oceans' where sharks fight each other for every morsel of food, you should find yourself a piece of blue ocean without competitors, and build up your business there. They propose a practical method whereby - assuming an existing product or service - you can look at which aspects you

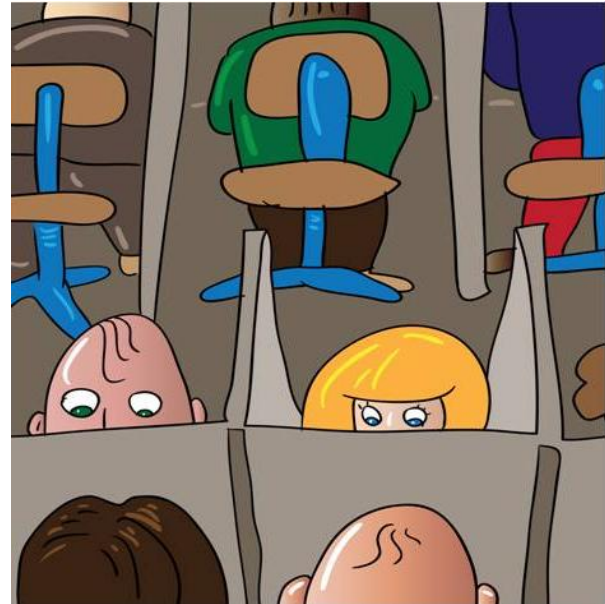
may leave out, reduce, enhance or create. The objective is to develop a completely new market area without competitors.

There are many search engines such as Google, but it has achieved a level of name recognition everyone else can only dream of. Thanks to that name recognition, Google draws lots of visitors, and so a lot of advertising revenue, and so a lot of opportunities to develop new services and, with that, new business models.

Who might be able to knock Google off its throne? There's Ixquick, a search engine that was the first to be awarded the European Privacy Seal, which deletes search data after two days. Ixquick offers privacy that you cannot (or no longer) get from Google, and that is what makes it stand out. However, Wikipedia too could develop into a search system based on a completely different business model, with volunteers keeping the knowledge up-to-date, while it yields more relevant results because of manual selection.

In short: successful businesses create new supply in those product groups or markets where they are the only ones. They bring their business model in line with customer needs not yet fulfilled by others. This is how they develop a small monopoly, enabling them to set the prices themselves and to maximise their profits accordingly.

Decide where to differentiate in the value network



In order to work up to a specific distinction, you need an insight into the activities before and after you. This knowledge will help to identify unserved needs in the market, which offer the potential for profitable business. The value chain or, as we will see, the value network will help you with that. In addition, you need to know what you are really good at.

The value chain is the succession of activities needed to supply a product or service to the ultimate consumer. To that end, the terms 'product column' or 'business column' are used. A generic value chain for a product is shown in Figure 3.

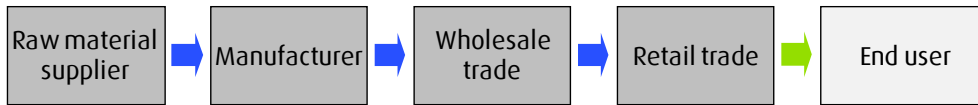


Figure 3. Generic value chain for a product

The value chain in its original setup is a highly simplified representation of reality. The concept is convenient if you want a quick overview of a business within its sector, but the value chain is not usable for gaining an insight into new business opportunities. To that end, the concept must be augmented with the four insights outlined below.

1. The value chain consists of more than goods and money

The concept seems simple: goods and services move through the chain from raw materials producer up to the consumer, in return for money. However, the economic truth is much more complex. Banks furnish money for money, and insurers cover risks. Knowledge streams also form an important part of the economy in the form of patents, copyrights and databases. Experiences, ease and reputation add value as well. Finally, there are a lot of intangible 'assets' such as goodwill, reputation, customer loyalty and community formation that are vital to a business, but are not made manifest in the traditional chain⁴.

Relevance to your customer is one of the most underestimated assets a business can have. Imagine you have developed a magnificent new pollen filter that can stand on your bedside table and do its job without making any noise. A lot of hay fever patients could benefit from this. However, if you were to offer this under your own name, it takes a very long time for the product to break through. Were the product to be produced and distributed by Philips Healthcare, it

would be presented as part of a marketing framework that is trusted by the public.

Active promotion by family doctors would also help, as they often see hay fever patients about their complaints.

Only in some cases is having customer contact truly financially appreciated. If someone clicks on an advert next to the Google search results for mortgages or insurance, Google charges the advertiser multiple dollars. In the electricity and gas supply securing a new customer can cost up to 100 dollars and these costs are activated on the balance sheet and depreciated over three years.

2. Primary and support activities in the chain influence each other

If you work out the details of the value chain further, you will distinguish different activities within one link (often one business). These activities influence each other:

- The decision of the purchasing department to work with a far-away or nearby supplier directly affects the logistics process.
- The decision of the marketing department to focus on far-away or nearby customers will affect shipment or delivery and the service.
- The personnel policy and investments in buildings and ICT networks of the business influence productivity.
- Product development influences almost all activities.

In addition, decisions within the link may affect activities in other links:

- The decision to use semi-finished products instead of raw products leads to a shift in activities and perhaps also a choice of other suppliers. This may be more efficient for the entire chain if the new supplier has a better process for this than the company itself, or if the transport costs are drastically reduced as a result of that.
- The way in which the product is packed directly affects the logistics process in the next link.
- Introducing additional quality control to the operations could lead to extra costs in the own link, but will lead to large savings in subsequent links due to a lower amount of rejected products.

So links in the value chain and activities outside of it cannot be treated separately. Only when you look at things more closely will you be able to see hidden costs and find a solution to that. In some countries, for example, electronics supplier Samsung outsources maintenance on printers to Microfix. This required a lot of coordination between the department at Samsung with customer contact and the schedule of Microfix engineers. That is why it was decided to outsource the entire process of making an appointment with the customer to Microfix, integrating customer contact and scheduling. This led to efficiency on both sides.

3. The value chain doesn't end with delivery

The value chain does not end with the delivery of the product or service to the consumer. Various activities take place at the consumer as well, and this is where a lot of opportunities to create added value can be created. Let's take the sale of a microwave. This is a

product that a lot of consumers buy in the shop and take home with them straight away. The microwave must be transported, taken out of its packaging, inspected, installed and tested, the user manual must be read and the packaging must be disposed of.

All these activities harbour opportunities to add value, without it costing substantial amounts of extra money. A delivery service is an obvious idea. A smaller box or a different type of packaging would make it easier to carry and reduce waste. Three 'IKEA-type' pictures on the box could immediately simplify the installation process. A well-designed operating display could render a user manual virtually superfluous. And as soon as a seller of microwaves starts promoting a certain model because he never receives any complaints about it, the price of that product could be increased by ten dollars.

Another underestimated element of the value chain at the consumer (but also at a company's purchasing department) is the effort made to come to an informed choice. This begins with focusing on potential suppliers, finding information on the product, and taking a decision that can also be explained to the partner or manager. The process continues up to placing the order and making the payment. A customer may perhaps spend more time making his purchase than you do in the sales process.

Adding value is possible in this part of the process too. By being findable, having transparent sales material, offering tailor-made suggestions, collecting positive references and simplifying the ordering process, you can make it so much easier for the customer. A good example of this still is the amazon.com website, which gives you personalised tips each time you log in and which allows you to browse books.

4. The value chain diverges and converges

The value chain is not straight. Each product is made of components, and in order to run a business you need various investments and services. Apart from staff, a hairdresser also needs premises, chairs, wash basins, trimmers and hair care products. The services of the interior designer and the coffee machine also contribute to the value added by the hair dresser.

Naturally, a purchaser's attention is mainly drawn to the largest expense items. For a steel plant, they will be the iron ore and coals. So you can be sure that the negotiations on the delivery contracts in this respect will be fierce. But what about security services? The steel plant may not be interested in this, but the security company is.

Not only does the value chain operate as a funnel, it also branches out. First, because a plant can manufacture different products for different buyer groups. But residual streams also have their value or price. Energy companies supply CO2 to market gardeners who use it to improve crop growth. By separating waste, some residual streams can be recycled and processed or even sold at a lower price.

Use these four insights to look at your business activities in a wider context. We are no longer talking about the value chain, but your place in the value network.

The value network is in effect the diagram of the complexity within which a business and its activities operate. You can start by drawing the value network around your business by looking at the most important suppliers and buyer groups (see Figure 4). Who else supplies your buyers, and do your buyers sell on your product unmodified, in combination with other products or processed in another product?

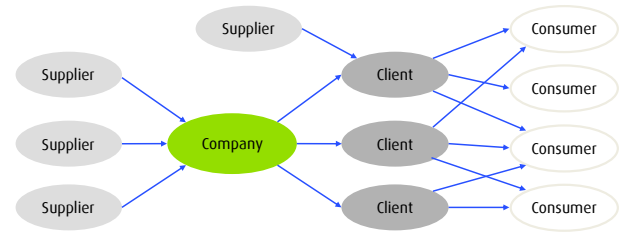


Figure 4. A possible value network around a business

The next step is to quantify the identified streams. What percentage of your turnover can be found in each buyer group and what percentage of purchasing do your buyers spend? What are the most important end products that your activities contribute to and how important is your share in this? Are there any costs up the chain that you can easily prevent?

Packaging costs are a good example of costs that can often be reduced. A semi-finished product is packaged in a certain way because that is standard in the industry. This often is packaging that is cut open and thrown away. Why is that packaging not returned? At one point, the cable and plastic pipes trade replaced the wooden reels with removable steel reels. This substantially reduced the freight volume for the collection of reels.

If you take the network of business activities that yields a certain product or service, you can - using the right data - also reconstruct where the biggest profits on this product are made. This will of course not always be completely successful, but if you collect information methodically, you will arrive at a certain insight as shown in Figure 5.

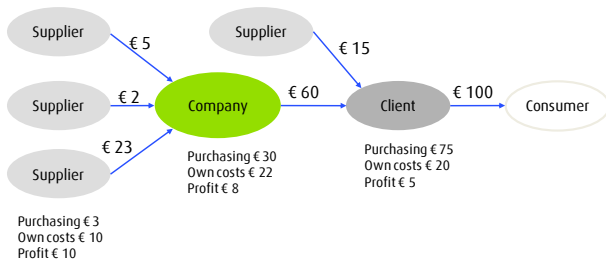


Figure 5. Analysis of where the profits in a value network can be found

Drawing the value network also helps you to visualise smaller contributions to an end product. Not every business provides a product that the consumer can recognise. Accounting software for instance is untraceable, but the role of accounting software in a generic process such as 'financial administration' can be visualised, including contributions from other suppliers and the results for the different departments and stakeholders (Figure 6).

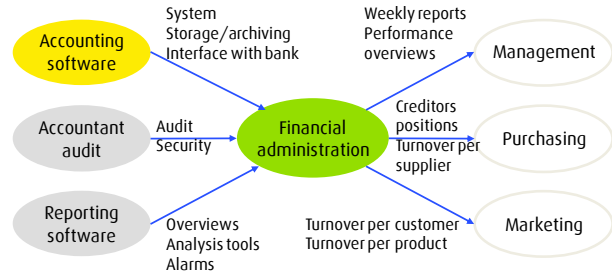


Figure 6. Qualitative contributions in a value network

The objective of drawing a value network is to gain insight. This insight should lead to recognising the opportunity to structure a chain differently. It is by taking advantage of those opportunities that you can add value as a business. The supplier of accounting software may, for instance, also develop integrated reports if it emerges that these are important for the buyers of the financial administration.

Eastcom Systems

Eastcom Systems is a Singaporean company established in 1992, as a vendor providing productivity solutions to help customers manage their telecom expenditures. One of their main products was a call accounting solution to help companies to analyse their PABX telecom costs, e.g. by breaking down the call charges in terms of departments and employees and types of calls (internal, long-distance, etcetera). In 2007 the management decided that selling licenses only was not the way to stabilise revenue, which was declining due to competing services 'through the Internet cloud'.

The company therefore chose to offer cost management services such as Telecom Expense

Management, targeting large companies like Fedex, Citibank and Standard Chartered Bank. Such companies generally have no overview of how much money is wasted or overspent on telecom costs. Eastcom's business model is to help these companies manage and reduce their telecom costs. For large global companies, telecom costs can reach as high as 1 or 2% of their turnover.

Eastcom Systems can supply its software products as licensed solutions or through a comprehensive service for companies wanting to outsource this part of their cost management. The core of the product is a business intelligence system with data mining

functionalities. The revenue consists of licensing fees, monthly service fees or a percentage of the savings.

Business development manager Peter Hum explains: "As Telecom Expense Management is a niche market and is designed for regional and globally focused enterprises, we have to look beyond the borders of Singapore. We call ourselves a global company, and have arranged our presence in other countries through partners. Our overall strategy can be characterised as customer intimacy, so we have to work closely with these partners to deliver a customised product to our clients.

The value of the partnership for us lies in the partner's network. We can add specific knowledge and our products. We have some protected intellectual property and our business intelligence system is a result of many man-years of R&D and software developmental efforts."

Finding the right partners is always difficult. Peter: "We see a lot of companies with a background in IT, but in most cases they have access to the potential customer's IT manager, and not the financial director.

We are looking for partners that are willing to invest in a long-term relationship with the CFO or any senior level managers who focus on operational P&L. Partners should see that we can help them set themselves apart."

One of Eastcom's most important partners is in Malaysia. The partnership is formalised with an NDA and a partnership agreement. The partner does the sales and system integration, Eastcom provides the sales support, cost management technology, cost management domain knowledge, and technical support. Revenue is shared, with the partner receiving a percentage of the contract value for Eastcom. There is a model for intercompany price setting, in which every partner has to defend its markup.

Eastcom maintains a partnership in Belgium as well, with a company called Convergent Strategies. Peter Hum: "We are very closely aligned with Convergent Strategies, and the collaboration turned out to be useful for European companies with branches in Asia or Asian companies with branches in Europe. This adds another dimension to our offering."

Decide how to differentiate: generic strategies and their current validity

If you know where your opportunities in the market lie and what your strengths are, you have to do something in order to further differentiate yourself. If you continue doing what you have always done, you will get what you have always received (such as poor profits).

In order to differentiate, various generic strategies were developed during the previous century.

However, as accessibility to information and capital has increased strongly over the past 10 to 15 years, these strategies have lost part of their basis. In this section I will discuss which elements continue to offer permanent competitive advantage.

Generic strategies

Porter and Treacy & Wiersema are the most important authors that explain how you can flesh out your distinctiveness in relation to the competition. In

addition, one of the most important models used portfolio matrix of the Boston Consultancy Group.

The Porter and Treacy & Wiersma concepts (see the boxed text) both provide three strategies and are

indifferent to which strategy you should choose. Their only guideline is that any choice has to be made with dedication. Pursuing two or three strategies at the same time will result in 'middle of the road' offerings.

Porter Competitive Strategy

Porter⁵ indicates that there are three successful generic strategies for achieving an above-average profit:

- Supplying a (standard) product at the lowest cost, in order to achieve the highest margin in relation to the market price. Porter calls this cost leadership.
- Supplying a product that deviates from the standard: this renders a direct price comparison impossible. Porter calls this the product differentiation strategy.
- Supplying a clearly delineated group of customers: the focus strategy. This enables you to meet the specific wishes of the customer group and to align your products and delivery accordingly.

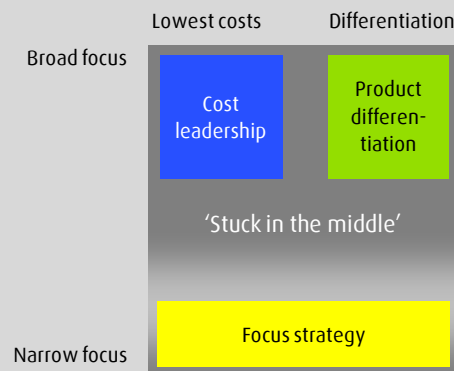


Figure 7. Porter's generic strategies for competitive advantage

Porter plots this in a spectrum, with the width of the customer focus on the vertical axis, and the choice between low costs and product differentiation on the horizontal axis (Figure 7). He argues that if a business fails to make a clear choice between one of the three options, it will be stuck in the middle. That makes sense, because if no choice has been made for a long while, implementing the options will take a lot of effort. To give a few examples: Ryanair pursues cost leadership, Rolex pursues product differentiation, and with the CL75 Poppy cell phone, BenQ Mobile aims at the trendy female, a typical focus strategy.

Treacy & Wiersema's Discipline of market leaders

In 1995, Michael Treacy and Fred Wiersema published the book "The discipline of market leaders"⁶, subtitled "Choose your customers, narrow your focus, dominate your market". The key message in their book is to choose a clear direction for your business, and to subsequently have the discipline to concentrate on just that direction.

Treacy & Wiersema, too, recognised three generic directions for a business to be successful, which are to some extent comparable to those of Porter:

- Operational excellence: supplying a product at the best possible total costs, also taking into account the efforts to be made by a customer. The latter is the addition compared to cost leadership. McDonalds is a good example: certainly not the cheapest supplier of

hamburgers, but its formula offers short waiting times and, above all, a guarantee concerning the product's quality. This saves the customer time in searching and trying out. By standardising the business processes and even the premises, McDonalds keeps its own costs down.

- **Product leadership:** supplying the best product. This is not the same as product differentiation. There is a host of suppliers of sports shoes, and their products differ to quite an extent. Only a company such as Nike manages to stay one step ahead with new innovations, such as the Nike Air, a new type of fastener or its collaboration with Apple.
- **Customer intimacy:** adjusting your business operations around a certain customer group, and supplying it with all required products. This is similar to Porter's focus strategy. An important aspect in this respect is good customer relationship management and being able to adjust your products and services to their wishes. This strategy demands decentralisation of competencies in dealing with customers.

Treacy & Wiersema indicate that each of the three aspects should be present at a minimum level, but that you should differentiate with respect to one aspect only (see Figure 8). For instance, a consultancy agency may decide to focus on a select customer group and offer it a tailor-made range of services (focus on customer intimacy). Nevertheless, it is still important to execute jobs efficiently and at reasonable rates (operational excellence) and to introduce new knowledge or concepts on a regular basis (product leadership).

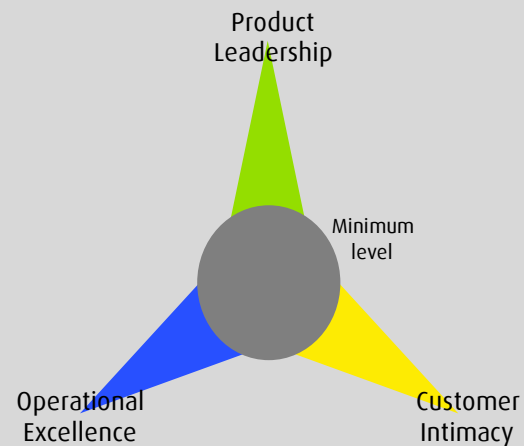


Figure 8. Three strategies according to Treacy & Wiersema

A relatively limited study⁷ among the 25 most important American Internet companies provides us with an initial picture of the success of each of the Treacy & Wiersema strategies. Among other things, the study looked at turnover development in the years 2005 and 2006. The group of companies with a customer intimacy strategy and a product leadership strategy both experienced an average annual growth of 20%, while the companies with an operational excellence strategy experienced an annual growth of approximately 8%.

Whereas Porter and Treacy & Wiersema provide tips for individual business activities, the Boston Consultancy Group matrix is particularly popular when making choices within a portfolio of activities. The underlying assumption of this matrix is that having several activities within a single company is a means to secure a more stable flow of income and that you can move money from one activity to the other.

If a product is relatively new, the market for that product will still have to grow, while the increase in production and distribution demands a lot of money.

Once a product has reached the maturity phase, the market will stabilise or shrink with it, and money becomes available. In addition, the thought behind the BCG matrix is the belief that if you are market leader, you can make more profit because you can achieve benefits of scale.

The strength of the BCG model is its directional simplicity: you use the money from the cash cows (high market share, low growth) to finance the stars grow (high market share, high growth), you say goodbye to the dogs and keep a close eye on the question marks (both low market share in low growth or high growth markets). This way the cash flow is distributed within the corporation in the most optimal way.

Porter's theory dates back to 1980, that of Treacy & Wiersema to 1995. The BCG portfolio matrix was first used in 1969. The fact that these models are still being used proves their strength, but it is the emerging information society that may not have changed some economic laws, but has put them on edge.

The accessibility of information and capital

If there is one development that, during the past few years, has been dominant in the way in which consumers and businesses do business, it is the immensely improved accessibility of information. Consumers, purchasing companies and government institutions are now much more aware of what is for sale, and it is becoming increasingly easier for them to compare products and suppliers. It only takes a couple of mouse-clicks and telephone calls with suppliers from all over the world to meet their demands. Online searches and even online auctions are steadily replacing relationship-based sales⁸.

Due to the increasing availability of information, it is also easier for smaller innovative businesses to offer their services and to start competing with the large established players. This promotes continued product rationalisation. By a simpler spread of technology, the number of competitors for a product grows quickly and prices drop. A good example of this is given in Figure 9, which concerns two reasonably comparable products: the video recorder and the DVD player. The video recorder was developed during a period when information was exchanged relatively slowly, as a result of which competitors took longer to market a similar product. This was markedly different in the case of the DVD player⁹.

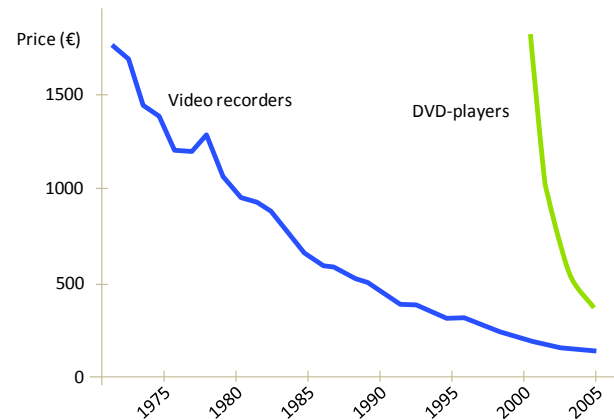


Figure 9. Price development of video recorders and DVD players

These developments force providers of products and services to concentrate on those activities in which they can stand out, and for which they can maintain that distinctiveness for a longer period of time. If a product is relatively easy to copy, such as a DVD player, prices will drop fast and it will be difficult to recoup the investment.

A second major development is the change in flows of capital. During the twentieth century, the objective of virtually every business was growth. Growth enabled them to achieve benefits of scale, it made a lucrative position as market leader possible, and above all: the business' growth and the related investments were a sensible way of reinvesting the profits that were made. The only thing that left the company was a bit of dividend.

As the financial sector globalised, it became easier to invest profits from one business in the other if the latter yielded a better profit or had a lower risk profile. During the past few years, transparency has increased under pressure from large private investment funds (some of whom are 'activist shareholders'), making it possible to decide per business activity rather than per business whether or not to invest. The added value of a holding or head office is a permanent point of discussion.

Seen from the investor's side, new opportunities arise as well. Through the internet it is possible to lend small amounts of money to entrepreneurs in emerging countries; real estate funds like the Canadian Homburg frequently run marketing campaigns to sell their bonds. There are various networks for so-called 'business angels', mainly seasoned entrepreneurs who invest amounts from 25,000 dollars up to millions in start-up companies and help them with advice and new business relations.

All these developments make it is easier to attract capital on the basis of a good idea. Active investors determine in which activity they invest and which knowledge and expertise must be combined. As a result, it is specialist organisations rather than large businesses that become leaders in the new economy. As such, the internal reinvestment of money in accordance with the BCG portfolio matrix is no longer

self-evident, and synergy between products becomes so much more important.

So how to make a profit in such a transparent world, given the fact that:

- the availability of information is growing;
- the payback period of new products has to be increasingly shorter, and;
- shareholders and financiers are increasingly critical to invest their money in the most lucrative activities.

Early in this section, I indicated that the chances of profits are linked to achieving differentiation from your competitors. That is why I will study the different options provided by Porter and Treacy & Wiersema in that respect, and evaluate them against the help they provide in a transparent economy.

1. Focus strategy (Porter) and Customer Intimacy (Treacy & Wiersema)

With the focus strategy of Porter and customer intimacy as defined by Treacy & Wiersema it is all about being relevant to the customer, despite the fact that you do not sell unique products.

A good example is private banking: specialist banks offer their customers a permanent account manager who has an overview of all the financial affairs of a customer and who can also offer a solution to everything. Private banks offer a wide range of normal products such as mortgages, investment accounts and insurance, but they mould this into an integrated package for the customer.

Knowledge of the customer and the relationship with a customer are hard to copy. Additionally, the habits and way of doing business with that customer may

become interwoven. Private banks may have a small group of customers, but to those customers they are highly relevant.

Customer intimacy could also be construed more widely as a thorough knowledge of what a customer group is concerned with or what needs they have. For example, Live Nation is a market leader when it comes to organising rock concerts. All they do really is bring artists, venues and visitors together, but they manage to do this in such a way that many of the concerts are sold out.

I therefore propose to replace the terms focus strategy and customer intimacy with the term 'customer relevance'. Customer relevance is the extent to which you are important to customers, know how to appeal to them and to catch their attention. It is that attention that makes it possible to sell products and services. Because of customer relevance, customers opt to also buy standard products or services from you, instead of from your competitors (Figure 10).

The big difference between customer intimacy and customer relevance is that the latter is argued from the perspective of the customer, and as such goes one step further. Today, a lot of businesses have a suitable range of products for their buyers, and they

try to bring this to their attention. You will not be relevant until that what you promise is exactly in line with the needs of that one particular buyer at that time.

Brands are the carriers of customer relevance. This is owing to the various functions of a brand, of which recognisability is the most important. Users will attribute certain values and features to a brand, partly based on advertisements, and fill in the rest of the picture with their previous experiences with products and services offered under that brand.

Being relevant to a market is a sustainable competitive advantage, whether it is a small group to whom you are very important or a large group that values you for certain aspects. Customer relevance is linked to your business name or brand name and can be protected by committing your most important staff, by sharing customer and market knowledge in protected databases, and by translating this knowledge into the right combination of products and services.

If a business targets the market under various names brands, then you need to assess the relevance per brand. Thus, to most customers Unilever may not be relevant as a company, whereas brands such as Lipton or Dove may well be.

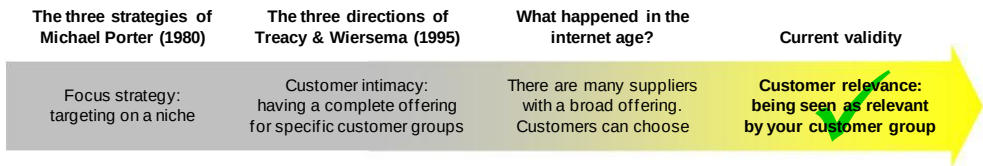


Figure 10. Development of differentiation on customer focus

2. Product differentiation (Porter) and Product Leadership (Treacy & Wiersema)

The difference between the product differentiation strategy and product leadership - as Treacy & Wiersema emphasise - lies in not introducing a product different from the rest just once, but to structure your organisation in such a way that you can introduce a distinctive product time and again. As such, they acknowledge the fact that new products too can be copied and become obsolete.

Differentiation in the sense of offering a different (or the best) product may at times bring advantages, but given the speed at which products are copied, it is often not a sustainable competitive advantage. Product leadership is sustainable, provided you continue to invest in new knowledge, protect that knowledge with patents as much as possible, and work on retaining your most important product developers and product managers.

Apart from that, a product these days should not just be different or better, but it should have a differentiation that can be communicated clearly and transparently. This means that this strategic direction must be refined further as: (continuously) having a unique product or unique service (Figure 11).

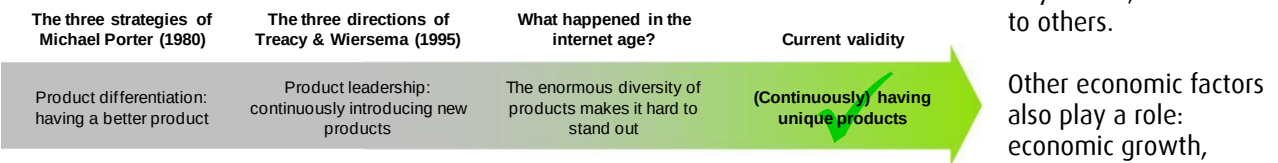


Figure 11. Development of differentiation on product

In the event a business has a broad portfolio, the criterion is that the majority of turnover is generated by unique products or services. Having a single niche product is not enough: the remainder of your portfolio will still experience price competition.

3. Cost Leadership (Porter) and Operational Excellence (Treacy & Wiersema)

The main difference between cost leadership and operational excellence lies in the fact that with operational excellence the customer's efforts in buying, using or maintaining the product are also taken into consideration. Both Porter and Treacy & Wiersema attribute competitive advantage to having the lowest price or the lowest overall costs.

Cost advantages may arise in different ways: through scale, by completing the learning curve quicker than someone else, by having the right suppliers or partners, or by having a tightly-run business. They can be significant and may form a good source of profit. The question is to what extent this type of advantage is sustainable in a world where knowledge can be shared swiftly.

Scale size that, according to the Boston Consulting Group, can only be achieved by being market leader, is also possible by collaborating, or by outsourcing your production process to a party that is familiar with that line of business. This will help you complete the learning curve faster. The suppliers and partners of your competitor also want to work with you and vice versa, and they may even introduce innovations

movements and trade restrictions may lead to sudden shifts in the cost pattern. A lot of markets experience a status quo for a number of years, only to descend into a price war later. In this day and age, cost-based strategies are therefore no longer sustainable by definition (Figure 12).

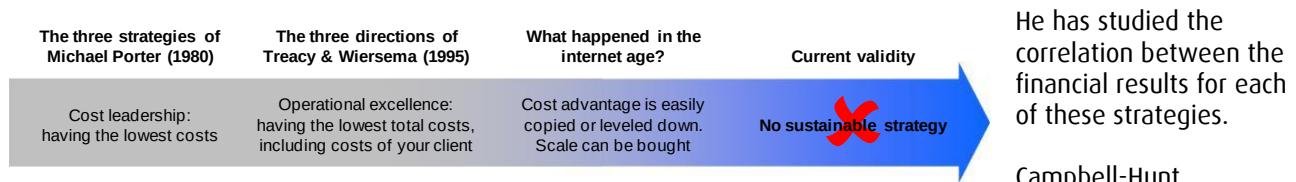


Figure 12. Development of differentiation on costs

This is not to say, incidentally, that operational excellence or the quest for lower costs is unnecessary. On the contrary, for a lot of businesses it is a condition for their existence. However, it no longer is a means to permanently differentiate yourself. Today, operational excellence is a commodity: something we simply need.

McDonalds and the German discounter Aldi are often cited as successful examples of operational excellence. These businesses operate extremely efficiently, without a doubt. In addition however, Aldi offers its customers a very transparent guarantee of quality at a low price, and McDonalds also has a strong brand name and the promise that you will always get the same product. So having the lowest costs is not all that matters. Supermarket chain Tesco proves that cost leadership can go hand in hand with offering a wide range of products.

The three strategies and their profitability

The relationship between a company's strategy and actual profitability has been the subject of a large number of scientific studies. The most important studies carried out before 2000 have been combined in a meta-analysis by Colin Campbell-Hunt¹⁰. From these seventeen studies he distils six generic strategies, each with components (such as a high price, a lot of advertising or operational efficiency) that are often used in combination with each other.

those generic strategies have a positive effect on profitability: he defines them as 'Innovation and operations leadership' and 'Leadership in broad quality and sales'. The 'Cost efficiency' strategy has a significant negative effect on profitability. The main components of these strategies are outlined in the Table 2.

The 'innovation and operations leadership' strategy mainly seems to focus on marketing new special products (described earlier as unique products) at high prices. The 'leadership in broad quality and sales' ties in nicely with the term 'customer relevance'. This is about brand awareness and being highly capable of serving a wide group of customers with a lot of products.

Another conclusion drawn by Campbell-Hunt is that these strategies do not exclude each other, whereas Porter for instance claims that combining a Cost leadership strategy with a Product differentiation strategy will lead to being 'stuck in the middle'. Innovation and operations leadership on the one hand and leadership in broad quality and sales on the other each affect profitability in their own way. This would suggest that a business can successfully try to develop unique products and become relevant to its market at the same time.

The conclusions of Campbell-Hunt, as well as the research about the Treacy & Wiersema strategies cited earlier, are based on averages. Individual companies in stable markets, oligopolies or markets with high entry barriers might have reasonable to

excellent profits. On the other hand, even if a company does not pursue a low price strategy, cost advantages will hardly be rejected.

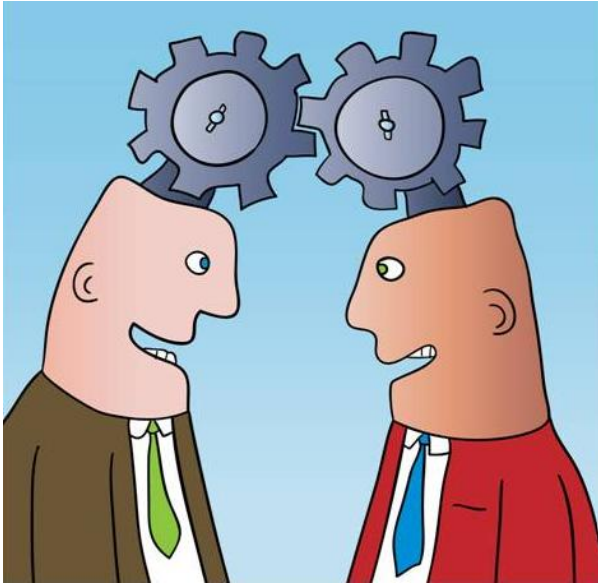
Therefore, in the continuation of this book, creating cost advantages will be treated as a valid reason for

entering into an alliance. It is only as an overall strategy that it will prove less sustainable and less profitable than being relevant to your customer or having a unique product.

Innovation and operations leadership	Leadership in broad quality and sales	Cost efficiency
High prices New products Special products Operational efficiency	Promotion Large sales organisation Quality of service Product width Width of the target group	Efficiency through: - new products - low prices - advertising

Table 2. Strategies as defined by Campbell-Hunt

2. Alliances as strategy accelerator



In the first chapter we discussed the relationship between strategy and profitability. However, strategy can only be executed with the right resources: people, knowledge, machines, brand names or shops. In case not all resources are available for the strategy you have chosen, forging an alliance could be a way to obtain them.

This chapter is about the decision to choose for a strategic collaboration. With the value engineering model, you can select which competences can best be obtained through an alliance and which not. The process of forging an alliance is summarised and to make things clearer, the definition of a partnership is introduced. The chapter closes with list of ten common forms of alliances, which will be elaborated in Chapters 3 and 4.

What competences do you have? – and need?

Alliances are an important means to obtain new competences for your organisation. However, the choice to enter into an alliance should arise out of the strategy of the company. With the strategy in mind, the first question should be: what competences do you already have? And which do you still need?

An internal analysis to assess your own competences should result in a list of strong and weak points. The necessary information can be derived from various sources:

- an analysis of your market share or sales figures;
- customer satisfaction surveys; but it can also be illuminating to ask your customers why they choose to purchase from you, and to ask non-customers what you need to do to persuade them to make that choice;
- differences as compared to your competitors, for instance in terms of company resources, products, distribution, personnel qualifications, or the quality of your marketing;
- improvements that you are implementing in your company, or deteriorations as a result of personnel turnover.

When identifying your strong points, there is always the risk of being insufficiently critical. The Resource Based View¹¹ can then prove useful, by subjecting each strong point to the following questions:

- Is it a valuable strength? The ability to build perfect carriages became worthless once automobiles captured the market.
- Can the strength be utilised within your business context? Knowledge of microbiology may be valuable, rare and hard to imitate, but quite useless within a simple production firm.
- Is the strength rare? Is it something only your company is capable of, or is it a basic prerequisite for market operation?
- Is the strength inimitable? Distribution through the Internet is not a particular feat any more, now that everyone can open an online shop within a day.

Depending on how you score on this list, you may be in a situation of competitive parity (equivalence), or of having a temporary competitive advantage, or of having a durable competitive advantage. Figure 13 offers an illustration.

	Valuable	Organisable	Rare	Inimitable	
Knowledge of automotive technology	✓	✗			Competitive parity
Familiar brand name	✓	✓	✓	✗	Temporary competitive advantage
Customers can track courier on the Internet	✓	✓	✓	✗	Temporary competitive advantage
Prestigious customers	✓	✓	✗		Competitive parity
Patented packaging technology	✓	✓	✓	✓	Durable competitive advantage

Figure 13. Resource based view assessment

It is important for companies to focus on the areas in which they truly deliver value-for-money. If you can convert competences into value for the customer, and you can do so at relatively low costs, then you're better off keeping these competences under your own roof. But if the competences deliver value for

the customers but only against high costs, and someone else can do so more efficiently, then it makes sense to seek a partner. This is illustrated by the value-engineering model¹² (Figure 14).

- Components of your product or service with a low customer value and low costs (for instance the transport packaging) can best be purchased.
- Components with a high customer value but relatively low costs for you should certainly be developed and supplied by your own company. For example, right now it would not make sense for Apple to have the user interface of their iPods and iPhones developed by a third party.
- Components with a low customer value and high costs for you had better be left out of your product or service. As an example: a ten-year warranty on a watch which most customers will tire of in five years and replace with a new one.
- For components with a high customer value and high costs for you, it is worthwhile looking at a partner: this party may have a better understanding of the customer's need, or be able to produce or distribute the component more cheaply, and can thus deliver more value-for-money.

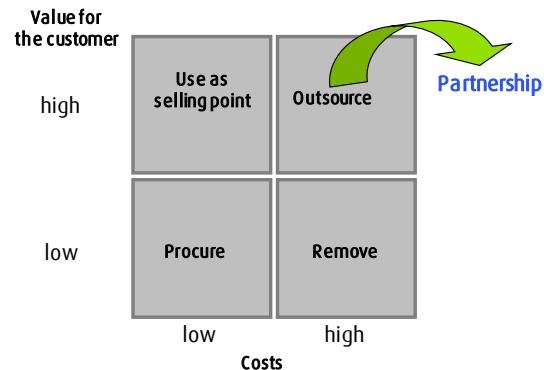


Figure 14. What activities to perform in-house and which to have another party perform?

Particularly for a component of your product or service that is important to your customer, a partnership delivers greater value than a purchasing relationship. In a purchasing relationship you get

what you ask for, so nothing new. In a partnership you set a common goal with high customer value, and then seek the right resources to achieve that.

Logistics Executive

Logistics Executive is part of Logistics Recruitment Solutions, an international specialist in Executive Search and Recruitment for Logistics & Supply Chain management. The company has around 40 employees, its own offices in six countries and has a database of around 70,000 candidates. Darryl Judd, Vice President Global Strategy, explains what role partnerships play in his organisation.

“The usual executive search process can be a highly transactional one, based on a job description that is sent to a several different intermediaries. With the vast majority of executive searches paid on a retained basis, you must deliver results and ensure that a suitable candidate pool is identified from a global perspective. The opposite applies for lower level roles, where payment is made once a candidate has been hired.

We try to arrive at a more collaborative approach with our customers and, initially, leave out the job description component. We discuss which competences are missing in the organisation, why there is a vacancy, as well as the organisation’s current management structure. This leads to a better understanding of what is required in terms of suitable abilities to complete the assignment.

To take part in this type of dialogue, business consultants need to be experienced enough to add value in this field, and customers must have enough confidence in them to open up. In organisations in Asia you need to start at the right level. When talking

to employees individually you get different and sometimes conflicting messages than when talking to them in a group because they are very loyal to their boss. The bosses, on the other hand, want to be challenged and this is a role an outsider can play.”

Whereas the normal recruitment business process only pays when a candidate is hired, the model for this more consultative method works more to the advantage of the executive search agency. One third of the total fee, which can add up to 30 or 40% of an annual salary, is paid when starting the search. Another third is paid when a candidate is found and the last third is paid when the candidate is hired. Other business activities such as benchmarking, organisational design and talent management activities are charged on a hourly or project basis.

Logistics Executive’s recruitment activities involve a number of partners in various countries such as Japan, Vietnam, Korea and China. Darryl explains: “We have no footprint in Japan but we do have international clients with operations there. For us it is relatively easy to find expats in Japan but difficult to find local candidates. That is why we collaborate with local partners; in a country like Japan it is difficult for us to set up an office due to language barriers and cultural differences. In India, on the other hand, the costs for setting up an office are lower and English is widely spoken. So we have our own office in Mumbai.

The fact that we work with partners does not affect our customers; our fee structure remains the same.

We divide the activities among our partners and they are paid for their specific tasks. In most cases, Logistics Executive takes care of the front end with the customer and the partner is responsible for the back end with the candidates. If a partner proposes a candidate who is already in our database but had not been noticed by us yet, the partner is paid in full.

Which of us will conduct the meetings and final negotiations is decided upon on a case-by-case basis.

We guarantee our customers a retention period of two to twelve months. If the candidate leaves within that timeframe we will repeat the process for free. However, out of 900 placements a year, this only comes up two or three times."

Alliances versus other sourcing methods



To introduce new competences in your organisation, there are generally four options to choose from:

- By investing in the training of personnel or by hiring the right people and deploying them in either portfolio management and marketing communication, or in product development.

- By outsourcing these activities to parties that possess the right competences. But then the question is, can your competitors not do the same, or have they not already done so?
- By taking over a company that has the right market position or the right products. But then the question is, why have your investors not already taken their money from your firm and invested it in the other party?
- Entering into an alliance with such a firm, and partly combining your people and resources, sharing your knowledge, and approaching your clients with a broader offer.

The option you choose depends on a number of preconditions that occur in any market:

- the time available to bring a new product to market;
- the extent of investment and whether a firm can afford it;
- the acceptable measure of risk.

Direct investment in development activities or broader marketing requires a lot of time, certainly if it calls for new competences. Outsourcing is quicker, but requires additional resources due to overhead and your supplier's profit margin. Both run the risk of investing in a client group that barely responds or in a product that fails to succeed.

A partnership is hard to combine with a standard purchasing relationship. In such a relationship, the contacts between companies are managed by buyers and sellers, so that the users' wishes arrive on the desk of the product developers or service providers in somewhat filtered form. The reason for this is that such wishes are translated into requirements suitable for a formal purchasing document, and these requirements are subsequently interpreted in the process of developing a solution. So at the end of the day, the solution that is offered often does not meet the original users' wishes.

Moreover, a standardised purchasing process such as a public tender often defines a minimum quality level, and the cheapest bidder to satisfy that level is selected. There is thus no incentive or even the option to offer a more expensive product, which might yield considerable benefits to the customer further down the line.

A take-over or merger directly guarantees access to an existing customer base or an existing unique product portfolio, but often also implies investing in overlapping people and resources or non-strategic activities. Given the market preconditions, an alliance with a complementary party is therefore preferable. Competences are made available immediately, the investment sum is often limited, and the risk of the joint activity is shared.

The best collaboration results from both parties contributing unique elements, such as:

- geographic spread;
- contributing market or product knowledge;
- eliminating risks;
- arranging the financing.

The essence of a partnership is that it is to both parties' benefit. It is important to determine the

extent to which your contribution is unique and not easily copied, otherwise the collaboration will soon lose value.

A partnership also has its drawbacks: it means making your company partly dependent on the performance and continuity of your partner company. This demands careful partner selection, mutual trust and a solid contract. Additionally, you need to share the revenue of the collaboration. The task is thus to jointly increase the size of the cake, rather than obtaining a larger piece of the cake.

It can be difficult for employees to view another company as a partner, particularly if there is a strong we-feeling and the partner is a competitor in certain areas. It requires a lot of communication and explanation by management, and some supervision of how the employees of both companies get to know each other. Moreover, acknowledging that the other party perhaps has a better idea or better work method implies that your own performance in this respect is lacking. The tricky thing about working with a (possible) competitor is that there are always nuances to observe; adamantly exclaiming that "These are my new friends with whom I can share everything" is not going to work either.

In 2006, the major competitors Microsoft and Novell embarked on a collaboration in which they would adjust their software to one another in such a way that their products became more compatible within computer networks. Microsoft chief Steve Ballmer was very pleased about the alliance with Novell. Nevertheless, the two enterprises remain fierce competitors. As Steve Ballmer remarked: "If someone asks me what operating system is best for their company, my reply is: Windows, Windows, Windows!"

In some cases, sufficiently significant partnerships demonstrably have a favourable impact on a company's stock price. A study conducted between 2000 and 2002 into almost 900 announcements of alliances involving German listed companies revealed that, on the day of the announcement, the stock index rose an average of 3.8%. After two days that figure still stood at 2.5%. The increase was strongest in high-tech sectors and for smaller companies entering an alliance with a larger company. Licensing agreements and R&D alliances were valued more than marketing alliances¹³.

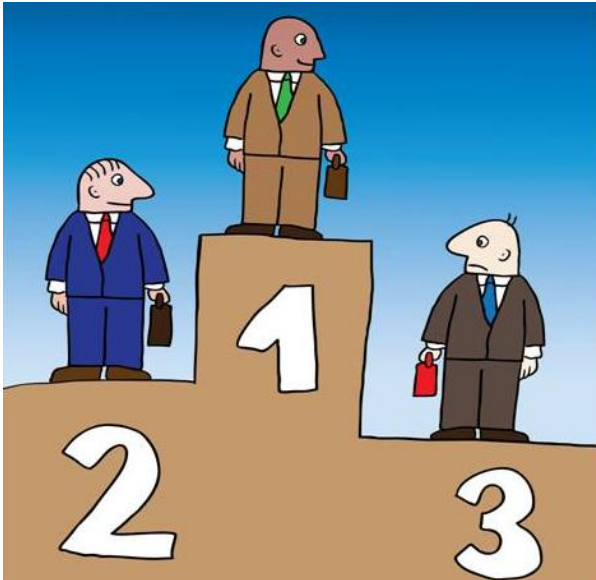


Figure 15. Steps in the process to entering collaboration

You will already possess some of the competences or resources, or they can be developed with relative ease. The contrast with the competences you need to obtain help define what your prospective partner should contribute. This is the basis for partner selection, in which you determine what company offers the best potential for collaboration. This should lead to the selection of one or two parties that seem promising candidates for a partnership. The next step is to draw up an agreement to formalise the collaboration. The actual implementation of the partnership will still require attention, however. Although the company boards may soon find themselves in agreement, people on the work floor still need to get to know each other and make practical arrangements.

As soon as you have established what competences you possess and which you still need to build, you can consider developing these in-house or obtaining them by working with a company that already has that knowledge. The result of this deliberation depends on the extent to which that knowledge or those resources help you to consolidate your unique market position.

The process of forging an alliance



Partnerships can be an effective way of achieving your business objectives. But then your strategic

In the partner selection phase, you need to determine with which company you can achieve the best collaboration. Here, the three most important aspects are translated into search criteria:

- Business model: Which enterprise possesses the competences that I lack to be successful in the market? What else does the company do? Is there an overlap in activities or will I actually be moving into a wholly other sector?
- (Contractual) Basis: Is the company willing to enter into an alliance? Does it suit their strategy? Can we agree upon a suitable form?
- Balance between partners: How is the relational 'click'? Is it a party with a comparable culture and corresponding priorities? Is there scope for trust in this collaboration? Will I retain sufficient influence in this collaboration and is it possible to preserve the character of my company?

This "3-B model" is supported by research by Michigan State University¹⁴ into the steps that successful businesses take in their partner selection.

It is first of all important that a partner can provide the lacking competences. This means that the partner possesses patents, knowledge, people or resources that are valuable to your company. Here, two aspects need to be taken into consideration:

- The knowledge must connect to the knowledge already available within the company. If there is too much distance between the two companies' knowledge or working methods, then it will be difficult to set up a successful collaboration.
- The two companies' scope should be sufficiently distinct to avoid getting in each other's way. The collaboration often has little value for overlapping areas, and can instead frustrate a straightforward competitive situation.

Ideally, a partner possesses knowledge or resources that lie just beyond the reach of your own company, or that would require too much time or money to build up (Figure 16). Through the interaction with your partner you can then acquire knowledge of these resources and develop your company one step in that direction, without posing a threat to your partner.

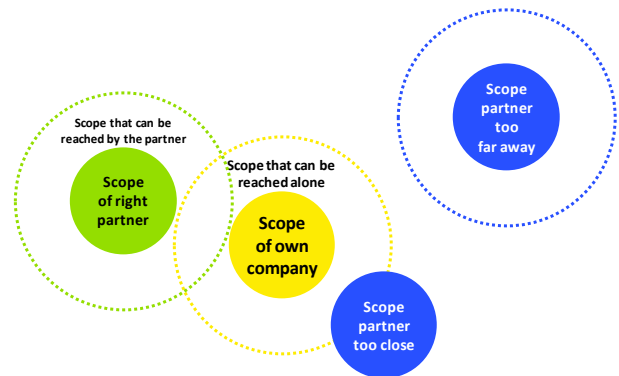


Figure 16. Finding the right partner based on business scope

The contribution of valuable competences should always be reciprocal: your company must also contribute knowledge or resources that are valuable to your partner. If not, then the collaboration lacks a solid foundation.

An essential step in the partnering process is to draw up a collaboration agreement or partnership agreement. In this agreement the partners define how they wish to work together, for how long, and how the costs and revenue will be divided. In the partner selection stage, one of the questions is whether the strategies of each of the partners allow for a model with shared governance and long-term dependency. How is the partner company structured and how will the alliance be positioned? Is the

partner open to the key contractual arrangements that you want to see in place, and what are his non-negotiable demands?

A partnership is built on the belief of two company boards that working together will deliver benefits, even if the risks and returns are not entirely clear yet. Seeking to make a 'watertight' contract therefore makes little sense. For example, very promising products may suddenly lose a large part of their value for a variety of reasons. The emergence of mobile phones dealt phone booths a crippling blow. Amended legislation put an end to certain equity insurances, and to mediation agencies in children's day-care. This can also have unexpected consequences for underlying collaborative frameworks.

Part of the process of arriving at a definitive contract can be to conduct a 'due diligence' investigation, as is not uncommon in takeover situations. The purpose of this investigation is to confirm the validity of assumptions underlying the collaboration, such as:

- Have the rights to the technology been sufficiently established?
- Are claims concerning customer numbers and distribution channels accurate?
- Is the partner truly capable of achieving a cost benefit?
- Is the partner sufficiently robust financially to meet his obligations of the collaboration?

This investigation can for instance be conducted by a neutral external consultant, to prevent any trade secrets from passing from one partner to the other.

Finally, it is advisable to gauge what influence your company can exert on the collaboration or alliance¹⁵:

- Is your company sufficiently relevant to the success of the collaboration?
- Is your company also formally authorised to take important decisions, or is this authority entirely in the hands of your collaborative partner?
- Do you have direct access to customers, and will they be able to see your added value?
- Do your people have a leading role in customer relations, and will they be the first to hear of significant developments?

If the majority of these questions must be answered negatively, then it is wise to pursue a different form of collaboration, or to seek another partner.

Various surveys have shown that relational aspects have a major influence on the success of a partnership. Does working together feel good? Is there a sense of trust between the partners? The initial meetings and talks are often enough to get a feeling for these aspects.

A reliable test can be incorporated by organising a workshop, before the signing of the collaboration agreement, in which the people operationally involved at both sides work together to establish a project plan for the first period. A neutral facilitator may be appointed to lead the workshop. If a first and basic step, such as making a plan within a clearly defined context, already runs into problems, then it is important to review the collaboration plans, at least with regard to its form.

REAAL / De Goudse

The collaboration of the two insurance companies REAAL and De Goudse started in 2006, and it offers a good example of how an alliance like this requires a lot of attention at the operational level to be successful. Though profitable, the alliance has a lot more potential which the alliance managers on both sides are striving to realise.

De Goudse is an independent insurer with a history dating back to 1924, when Geert Bouwmeester founded the company. Today, his descendants still own almost all shares in De Goudse. The total annual turnover is about € 720 million and it employs around 900 people. The company is focusing increasingly on small and mid-sized enterprises, without losing its strong position in the market of private insurances. De Goudse holds a particularly prominent position in property, income and life insurance. As a family-owned company, De Goudse can afford to pursue a long-term, aiming for long-lasting relationships with its clients and intermediaries.

REAAL has a long history as well, starting with the merger of two insurance companies that were active from the start of the 20th century. The REAAL group was formed together with three banks, and has continued to grow through the merger with the SNS group and the acquisition of five smaller insurance companies. This makes REAAL one of the largest insurers in the Netherlands today. REAAL typically pursues a low cost/operational excellence strategy.

Frank Rensen, commercial manager at REAAL for the small and mid-sized market, and Rene de Peuter, alliance manager for De Goudse do the day-to-day management of the alliance. They have been putting a lot of effort into the alliance since 2008. Rene: "For De Goudse this is primarily a distribution agreement to strengthen our position in the market and to

ensure that we have enough economies of scale to be competitive." Frank: "For REAAL, combining our portfolio with De Goudse was a good way of cutting costs, while retaining part of the upward potential of our occupational disability portfolio."

The reason for starting the collaboration was a change in Dutch law regarding occupational disability insurances in 2007. A large part of the risk of paying wages during the first two years of illness was transferred from collective funds to the employer. The employers had the option of insuring themselves for these costs. The risk for the period after two years is partly covered by collective funds, and employees can insure themselves against loss of income for the remaining part.

De Goudse is active in both types of insurance, and for them it is an important product. REAAL was active in the employee insurances sector only because they had taken over the portfolio of a small insurer. There was little knowledge about the product within REAAL, but they did feel that this type of insurance should be part of their portfolio. This made the option attractive to partner with another insurer. In the Netherlands there were only five companies with a large enough occupational disability portfolio. De Goudse was the only one that was independent, as the others were brands of larger competitors.

Since the board members from both companies regularly met at business events and social occasions, it was easy for REAAL to establish contact. There was certainly a match at a personal level, and both sides were willing to let the other gain as well. It only took a short time to draft an agreement and to set up an alliance that propelled the combination into the top-10 of collective occupational disability insurances in the Netherlands.

How is this alliance structured? The concept of the insurance, including coverage and fees, was developed by De Goudse. REAAL arranges the distribution through its intermediaries and takes care of all commercial activities. De Goudse draws up the policies and handles all the administration and claims. For these kinds of insurances REAAL works exclusively with De Goudse.

The financial model differs somewhat for the two kinds of insurances. For the employers' insurances bearing the risk of payments for up to two years of illness, REAAL is paid a fixed percentage as provision. De Goudse carries 100% of the risks of the portfolio. There is no bonus structure, but REAAL shares in the profits of the portfolio, not in the losses.

For the employees' insurances after two years, the portfolio risks are shared. De Goudse accepts new customers, but REAAL is consulted whenever bigger risks are involved. De Goudse gets a percentage of the fees to cover the costs of administration, and every quarter the portfolio results are shared with REAAL. These results are calculated as the insurance fees minus costs and damages, plus the mutations in funds due to reservations and investment results. Costs for product development and IT for De Goudse are traded off against the sales costs for REAAL. Provisions for the intermediaries are directly deducted from the insurance fees.

The agreement is not perpetual: every three years the parties can decide to break up. In that case an external party will estimate the value of the portfolio and each party can bid on it. Up to now the investment results have been good.

The prices are set by De Goudse, and are no different than those for their own sales or for other partners. Discounts are decided on together. Even volume discounts that customers of REAAL get are shared with De Goudse. Frank Rensen: "I think the power of this alliance lies in the processes that are clearly described, combined with sufficient room to interpret them in a practical way. Before 2008 there were only meetings at board level, but that was not enough to make the alliance successful. At the operational level the alliance was not perceived as important. Rene and I started holding regular meetings in 2008, speaking to each other every week. We put a lot of effort into communicating the purpose to the sales representatives and into making the processes run smoothly. That has had a clear impact, but we still have work to do. The portfolio has grown since 2006, but not as much as we wanted to see.

REAAL hardly has any other alliances, but for De Goudse setting up alliances has become part of the strategy. Rene: "The goal has been from 2009 to start one or two distribution alliances each year. We prefer to take the lead rather than being approached, and with our board and part of the management we select the parties that we wish to collaborate with."

Ten forms of alliances

There are many definitions of partnering or partnerships, each from its own angle. A frequently used definition is as follows¹⁶:

An alliance is any governance structure involving an incomplete contract between separate firms and in which each partner has limited control.

Features of a partnership are¹⁷:

- It involves two or more companies that pursue a common goal, yet remain independent. This can be pursued by means of an agreement, or within a separate legal entity: a joint venture.
- Both parties manage the alliance and share in the revenue. Costs or revenue are not necessarily known beforehand.
- Each of the parties contributes in strategic areas, such as technology, products, distribution channels, etc.

A partnership may be viewed as an intermediate form between an open market and bundling activities within a single company. This is shown in Figure 17. In the market the parties work together on the basis of individual transactions. The mutual dependency does not extend beyond supply and payment, and there are no separate operational costs, aside from purchasing and sales activities.

The organisational form at the opposite side of the spectrum is the bundling of activities within a single business, for instance through a merger or take-over. This yields full control over all required resources, and also makes it possible to sell off certain activities.

Organisation form	Market	Alliance	Company
Collaboration mechanism	Transaction	Agreement/ joint venture	Merger or take-over
Features	Agreement with a clear scope Limited mutual dependency No separate operational costs	Open-ended contract Mutual dependence to achieve goals Parties remain separate companies Shared decision making	One single company Control over all resources Internal operational management Option of divestiture

Figure 17. Alliances as intermediate form between market transactions and an integrated company

Partnering often involves sharing risks. For example, a customer-supplier relationship may develop into a true partnership if both parties decide to bear the risks that they are best able to manage, and if they both commit to improving the shared product. This can sometimes require a different mechanism than setting a fixed price for a predetermined amount of products or activities.

The remainder of this book will employ a classification of alliances into 10 basic forms, each with its own goal, structure and intensity. This may represent a wider scope than most other authors use. However, all these forms occur in practice and meet the definition given above. The basic idea is always one of the three aforementioned competitive strategies: increasing customer relevance, creating a unique product, or seeking cost benefits (see Figure 18).

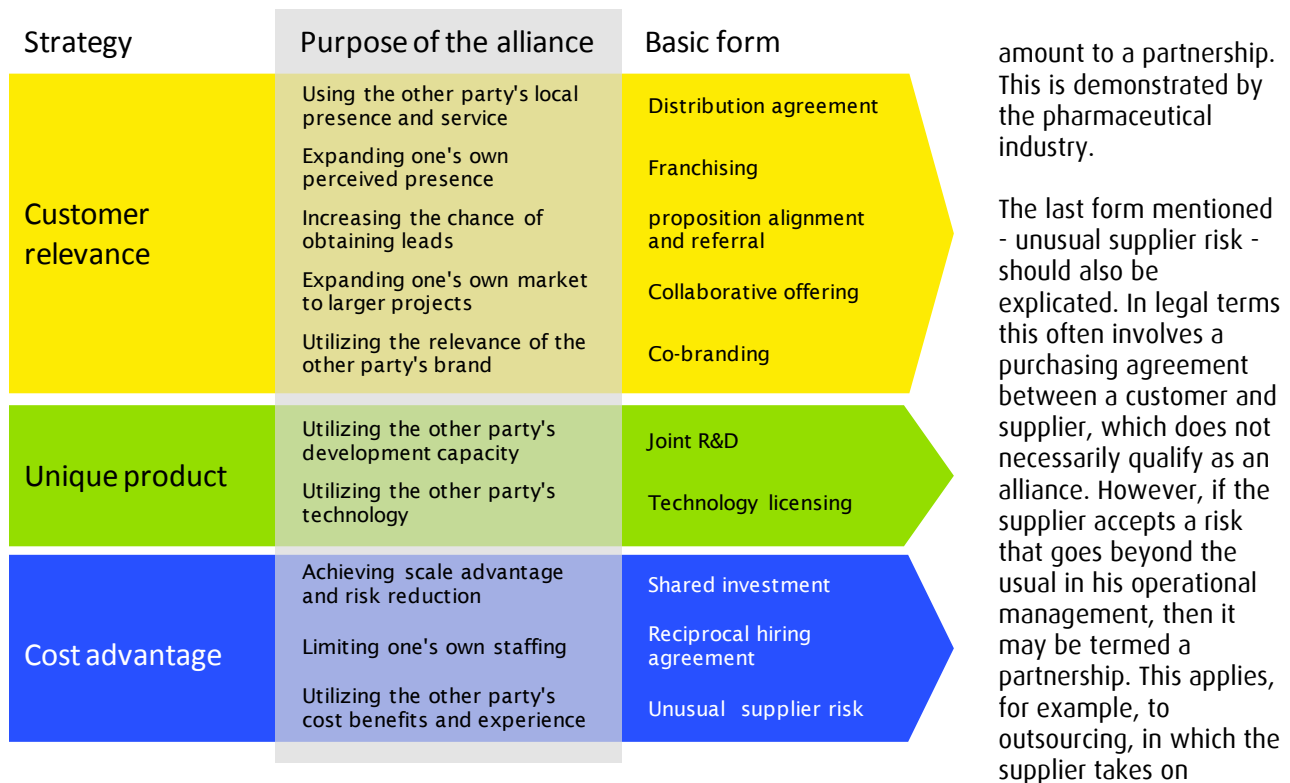


Figure 18. Ten forms of alliances

Some forms require further explication. Distribution in itself does not necessarily imply a partnership, certainly if it concerns the purchase and resale of goods and standardised services. However, as soon as the supplier and distributor jointly devise a plan to place goods and services in the market and to increase the market share, we may speak of a partnership.

The same applies to technology licensing. This may amount to nothing more than reselling a use right to a patent or to software. But as soon as this is complemented with knowledge transfer or if exclusivity agreements are made, this may certainly

3. Creation of value



In Chapter 1 we examined how companies can set themselves apart and in that way enhance their profitability. Three generic strategies emerged here: increasing your relevance for customers, offering a unique product, and achieving cost benefits. Particularly the first two yield a sustainable competitive advantage.

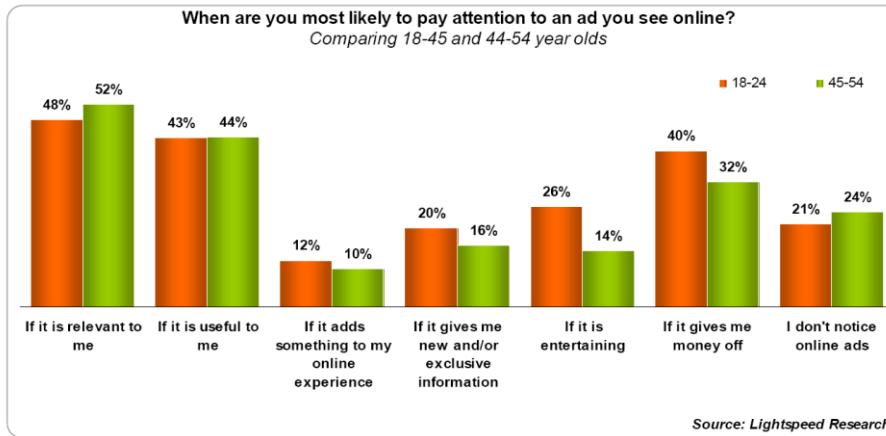
Chapter 2 discussed the importance of alliances as a means of accelerating your strategy. Specifically when a partner possesses competences that your company cannot develop easily but that do add much value for your customer, it is wise to enter into an alliance. We subsequently identified ten basic forms of alliances.

This chapter explores the question what the specific value of an alliance is, and how this value can be quantified. This is a requisite component of any business case when seeking to collaborate. The three generic strategies -- customer relevance, having a unique product and striving for cost advantages -- will serve as a classification structure.

Increasing relevance for your customer

The term 'customer relevance' pertains to the access a company has to offer its products and services to its target group. After all, any target group, whether it consists of consumers or people with purchasing responsibility within a company, are exposed to so much information and so many opinions and offers, that they have built up a highly effective filter in response. In addition, they exercise a great variety of tactics to rid themselves of unwanted promoters, collectors and salespersons.

Customers will pay attention to your product if your message is relevant to them at that moment (see Figure 19). This means that the promise held out by your brand, and its elaboration in products, service, marketing communication or distribution, connects to their actual need. Customer relevance thus begins with a clear brand promise.



several other brands, and is found to be, say, more powerful than 30% of those brands, and less powerful than 70% of the other brands. Research by Frank Verbeeten and Pieter Vijn among 70 brands has shown that there is a statistical relationship between brand power and that brand's profitability¹⁹. For every 10% of brands that you leave trailing, your increases by around 0.2%.

Figure 19. When does an online ad get noticed?

As mentioned in Chapter 1, brands are the carriers of customer relevance. A brand need not necessarily be a registered name with a logo. Even a trade name, a family name or even the name of a region can be seen as a brand.

Consumers group products and services under such a brand name and attribute value to it. Customer relevance is therefore measured per brand.

Relevance is also one of the four pillars under the Brand Asset Valuator of Young & Rubicam¹⁸. Various researchers have –partly on basis of this model– studied how the different components of brand value relate to a company's financial results. All studies emphasise the predictive value of relevance and brand stature for financial results.

These studies always measure relevance on a relative scale. This means that one brand is compared to

A brand is relevant if the fulfilment of its promise connects to actual customer need. This will happen if their actual need is answered by the promise that your brand makes, and how this is fulfilled in products, services, distribution or your marketing communications (Figure 18). Customer relevance always starts with a clear brand promise.

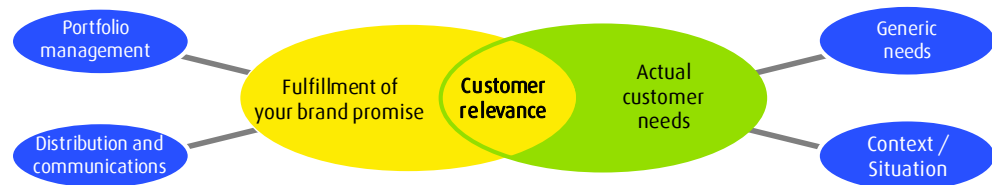


Figure 18. Customer relevance increases to the extent that brand promise and actual customer needs overlap

Every person has a number of generic needs: security, friendship, relaxation, efficiency and success. Depending on the context or situation you are in, these generic needs are translated into actual needs. Again depending on the situation, one or more of these generic needs will be dominant, complemented by needs that arise through a customer's expectations with respect to a certain

situation. For example, when spending the night in a hotel you do not expect anyone to enter your room unasked (privacy), that drinks in the bar are charged to your account (convenience), and that there is wake-up call service (efficiency). At higher-end hotels you will expect a laundry or dry-cleaning service (give me comprehensive solutions) and personal attention.

The other aspect is the brand promise and how this is fulfilled. If you want to have a meal, that need will differ depending on whether you're alone or with your family. A company's response to this may lie in the right portfolio management of the products and services it offers. It also makes a difference whether you're in town or in an amusement park, and a company's solution here lies in its distribution management. And finally, in this particular case, you do not have this need for a meal at each and every moment. Thus, being relevant means that companies must present you with their offer at the right time. Marketing communications and personal sales are important means to achieve this.

Businesses that deliberately invest in relevance also try to flesh out that brand promise: by formulating the promise, communicating the promise, and especially also by living out this promise in different ways. BMW uses the slogan "BMW makes driving great". The company tries to sustain that promise by putting only truly well-designed products in the market. For example, when all car brands had already launched an SUV, BMW also had one in the pipeline, but it wasn't thought good enough. It wasn't until BMW had thoroughly developed the X5 that they rolled it out into the showrooms.

According to a Booz Allan & Hamilton article entitled 'How to brand Sand'²⁰, you can differentiate your offering through the product or through the service

that you provide as a company. These company service 'promises' could be:

- supply reliability,
- applications knowledge
- assuming responsibility, e.g. for part of their supply chain process.

Christopher Lovelock, in his book 'Services Marketing'²¹, gives 8 ways to differentiate on service aspects:

- Providing information (e.g. about the products, how to apply them)
- Advising customers (tailored to their specific needs)
- Making exceptions (handling special requests, complaints, restitution)
- Delivery (speed, timeframes)
- Fulfilment (planning, flexibility, change orders)
- Invoicing (EDI, clarity of the invoice)
- Payment and payment conditions (local bank account, payment term)
- Hospitality (is the client welcome, how is he treated)

Both with commodity products and unique products you can apply one of these differentiators to become a relevant supplier for your customers. This can lead to differentiating brand promises such as: "We deliver on time", "Clear contracts", "The best advice".

Alliances can help achieve relevance for customers more quickly. The value of alliances can best be quantified by considering the costs your own company would have to make to accomplish a comparable boost in relevance. This is elaborated further for the five basic forms of alliances that aim to enhance customer relevance.

Distribution agreements and franchising

These forms of collaboration each seek to increase the number of sales points for your product or service. This can be in the form of your own shop, an Internet channel, or by being included (as brand) in the assortment of a larger store. Your distribution channels ensure that the customer encounters your products or services more quickly and can purchase them more easily.

Generally speaking, a distribution channel fulfils the following functions:

- Information: to gather and spread market research and intelligence
- Promotion: to develop and spread announcements about special offers
- Contact: to communicate with potential buyers
- Matching: to adjust the offer to a quantity that meets the needs of the buyer, including assembly and packaging
- Negotiation: to reach agreement about the price and other conditions concerning the offer
- Physical distribution: transport and storage
- Financing: applying capital to maintain stocks and incur costs before payments are received
- Risk taking: to maintain stocks of products and invest in processes without guaranteed sales.

If distribution takes the form of a distributor placing a number of the supplier's products on his shelf and adjusting his purchase depending on the sales, this does not meet the criteria of a partnership. There is hardly any risk sharing, and certainly no joint operational management. This changes as soon as the supplier and distributor decide to work together in marketing, sales and delivery. As a result, the distributor will take a greater interest in the supplier's product or service. It may be that the distributor, in

return for taking a greater interest, will demand the exclusive distribution rights for his region or customer group.

In case of franchising, the relationship becomes closer yet. Here, the distributor enters into an exclusive bond with the supplier, no longer working under his own brand name but only under that of the supplier. It is no longer or hardly possible for the distributor to sell products or services of another supplier, and the distributor/franchisee is bound to strict rules with respect to shop interior and marketing communication.

For both exclusive distribution and franchising, the parties share in the risk that sales may disappoint and thus not justify each other's efforts and investments. In case of a distribution agreement the distributor holds the reins, and the supplier will want to steer along through generic marketing. In case of franchising it is generally the supplier that holds the reins, and the franchisee will want to steer along with respect to his own sales area.

The value of a partnership for a supplier can be quantified by considering the effort the supplier would have to make in order to set up an alternative means of distribution that achieves the same effect. Relevant aspects to consider here are:

- elaborating a shop concept;
- leasing or buying and then furnishing commercial space;
- leasing or buying and then furnishing sales offices;
- hiring, training and managing sales personnel;
- conducting local marketing campaigns and developing sales promotion activities;
- tending to the financing and possibly the storage of goods.

Working with one's own distribution is particularly an option if the sales activities require little shop or office space, the work can easily be scheduled, and extensive travel is unnecessary. In virtually all other cases, working with distribution partners or franchisees will be a cheaper option, even if these partners only spend part of their time on the product portfolio.

From the distributor's point of view, the value of an (exclusive) partnership with a supplier is that it enlarges his portfolio (for the quantification, see next paragraph), it offers better marketing and sales support, and it enables him to set up a good purchasing process. The advantages for a franchisee are even greater: he can participate in a comprehensive and proven shop concept, will receive coaching in his operational management, and only needs to concentrate on local marketing and sales. This does come at a price, however, as will be discussed in Chapter 4.

Proposition alignment and collaborative offering

Portfolio management is an important means of increasing your relevance for a target group. By including more special, complementary or even lower priced products or services in your offer, you are substantiating your brand promise. However, this need not necessarily be the offer of one single company; if two or more suppliers decide to align propositions, or to refer to each other, or to collaborate in the offering, they can achieve greater relevance for their market.

Yet to remain relevant, it is important that the portfolio displays some measure of synergy. Thus, it wouldn't make sense for McDonald's to start selling vegetables, but it would if they started offering veggie burgers. Also for a company like Office Depot,

portfolio management constitutes the core of their marketing policy.

By choosing for one or a few alternatives at most, rather than selecting all products, the customer is offered a pre-selection. This saves the customer from making complicated choices, and regardless of the precise purchase, the quality is satisfactory. Combined with the availability of the products and the certainty of not needing to go somewhere else afterwards, this makes Office Depot a relevant party for many entrepreneurs.

Portfolio management also applies at a larger scale, when choosing in what activities the company should invest. Thus, the Boston Consultancy Group portfolio matrix concentrates mainly on market growth and market share in a certain activity. This activities portfolio need not be relevant for the customer, however, so there is little of synergetic value for shareholders here. A company should therefore seek products and services that represent a relevant and mutually reinforcing combination for customers.

Entering into a partnership may be an attractive alternative to developing and producing or purchasing and reselling a product or service in-house.

If two businesses decide to align their portfolios and to refer to each other, this may represent added assurance for the customer: he may assume that the supplied products or services are compatible, or that he will, at the very least, be informed of any necessary adjustments. This assurance is of value to the customer, and may thus justify a higher price.

An alternative would be to calculate how much it would cost the company to purchase the goods or services directly and to resell them. In case of goods one should also consider the costs for storage and

physical distribution, and in case of services the costs of matters such as quality inspections and idle time/unused hours of personnel.

If two businesses decide to collaborate in their offering, this yields even more value for the customer. Provided all is specified properly, it offers the customer a contractual guarantee that the two firms' products or services are compatible, and that he is saved from having to coordinate the delivery. He is furthermore purchasing from a larger entity, which offers greater delivery assurance. This may prompt the collaborating firms to increase the prices, or it can enable them to bid on orders that would otherwise be beyond reach.

Here again, the alternative is to calculate what a company would have to do in order to offer the entire product, if at all feasible. In purchasing and

reselling part of the offer, the company must either run greater risks, or must pay a higher price to cover those risks. Moreover, such a construction often lays claim to working capital, since suppliers generally wish to be paid for their part before the customer pays for the whole.

Determining the value of collaborative offering is generally independent of the chosen legal framework. It can be done through contractual collaboration, or in the form of a new legal entity. Chapter 5 will look at this more closely. The most important variance in calculating the value concerns the risk of having to pay a substantial customer claim, whether or not jointly with the other partners. However, under normal circumstances this risk ought not to dominate the scenario when entering into collaboration.

Global Workspace Alliance

Getronics is one of the largest IT service providers in Europe and has been part of the telecom operator KPN since 2007. It was split off from Geveke Electronics and taken to the Dutch stock exchange by Ton Risseuw in 1983 and grew rapidly in the nineties through various acquisitions. In 2001 Getronics took over Wang Global, but was affected heavily by the collapse of the internet bubble and the financial construction. Getronics shrank from 35,000 employees in 35 countries to 13,000 employees in 13 countries and tried to sell as many assets as possible, to be able to keep on refinancing debt made to buy Wang Global.

The rapid shrinkage had a major impact on servicing large internationally active companies like Shell. Competition with IBM, HP/EDS and CSC was strong, and just having field service partners in countries

around the world was not a convincing way to proceed. A new model was needed with better aligned partners. Selling off a number of country-based organisations, in a number of cases Getronics retained a minority share. This made it attractive for Getronics to collaborate with these specific companies and to jointly strive for growth.

The alliance was formalised in early 2009, with Compucom in the U.S., Service One Getronics in China, Getronics Middle East, Tecnomcom in Spain and South America, NTT Data Getronics in Japan and APX in France. The fact that companies in China, the Middle East and Japan continued to carry 'Getronics' in their name was a provision made during the sale of the companies, but aside from Getronics' minority share, these are independent companies.

All partners have different types of shareholders, ranging from stock-listed companies like NTT Docomo to private investors as in the Middle East to family-owned businesses as in France. The size of the companies varies as well: Getronics and Compucom are large companies, while in Spain, China and France the partners have just over 1000 employees. Each of the seven alliance partners have different field service partners in their region, together covering 35 countries and 80% of the global economy.

The alliance is structured with one contract, and there is no legal entity. The CEOs of the partner companies meet twice a year to discuss strategic issues, while a more operational steering committee meets every two months. Every partner dedicates some employees to the alliance, which adds up to around ten sales persons and one marketeer. In addition, in July 2009 Ivan Vogels was appointed as alliance director, responsible for the further growth and promotion of the alliance.

Ivan explains: "One of the first tasks was to position the alliance as a separate entity and as an alternative for our large competitors. Apart from the ongoing business wins, one of our first successes was that the alliance was mentioned in the Magic Quadrant of Gartner. This is one of the leading market intelligence agencies in our industry. Furthermore, some basic things had to be arranged such as a website and marketing materials."

Whereas Getronics has a customer intimacy strategy, the alliance has more of a product leadership strategy. Ivan: "We strongly focus on providing IT workspace solutions, otherwise our attention gets scattered. There are not many companies with a worldwide offering like ours, and this enables us to offer unique functionality."

In a commercial process there is always a prime contractor, and that is the partner in whose area the head office of the client is located. There are a few pricing principles to prevent uncompetitive as result of the partnership structure. These are:

- There is no margin stacking, every partner only makes a profit on his own contribution;
- Every party bears all risks associated with his scope of work, these risks are not forwarded to the prime contractor. The only exception is when turnover for a subcontractor is very low.
- Only the prime contractor can include costs for overall project management, for the rest he only takes profit on his own activities and own risks.

The prime contractor will conclude an outsourcing agreement with the client. Between the partners there is a reciprocal general service partner agreement, supplemented with further client-specific agreements.

As Getronics holds minority shares in all the partners, it has an inherent interest to do business with these companies. This does not apply the other way around, but here the exclusivity of the partnership is arranged through the alliance agreement. Ivan Vogels: "Equity swaps could be an interesting tool, especially with new partners, but it currently does not have the highest priority. My first aim is to let the smaller partners grow to a more substantial size, so that the alliance is more balanced."

The various partners particularly need to be stimulated to focus their sales efforts on international rather than local business. This needs to be achieved by incentive schemes. At the moment these schemes are based on the turnover in the respective countries

of the sales persons. Ivan has recently received approval for a proposal to pay 5% of the gross margin of the first year to the alliance partner that did the commercial work. This money can then be used to reward the sales persons involved.

The value of the alliance for Getronics lies in the extensive sales network and the brand value of the partners. Ivan: "When we sold our activities in the U.S., we lost 150 salesmen as well. By collaborating in this alliance, we partly get them back. It would be

very expensive to build up this sales power ourselves. On the other hand, through the pricing policies in the alliance we avoid margin stacking of 15% or more, as would commonly occur if we worked with other types of partners. This makes us more competitive, and that is something we see reflected in our results. Our international activities are doing well. The alliance has over 300 large customers throughout the world, of which 35 truly global customers that could not have been served without the alliance."

Co-branding

Co-branding involves utilising the value of two different brands. Co-branding closely resembles two other forms of alliances. If it concerns the combined promotion of two different products, each belonging to a different supplier, in a single offer or in one marketing campaign, then this is referred to as joint promotion. This is actually not a form of co-branding but of collaborative offering.

On the other hand, it may be that two companies collaborate to develop an entirely new product, such as moisturised shaving by Philips and Nivea. Another interesting example is the collaboration between Biodermal and Davitamon to develop tablets that care for the skin from the inside. This is an example of joint R&D as described further on in this book. This need not necessarily result in co-branding; it might be handier to market the product under the brand name with which the product is most closely associated. If the other brand's contribution is only partly visible, this could create some confusion.

Between these two extremes we find the two most common forms of co-branding²²:

- Symbolic co-branded products: the product of one of the brands is augmented with just the exterior features of the other brand, such as a cereal that is linked to Disneyworld, or the Ferrari laptop by Acer. The actual product is not altered.
- Ingredient-branded products, in which an ingredient, component or technology of one brand is added to the other brand, with explicit reference; for instance Dr. Pepper soft drink with NutraSweet or Liga Yobreak children's biscuits with Danone Yoghurt.

A number of aspects are important in co-branding. First of all, the brands should fit together in terms of their values and appeal. The collaboration between Swatch and MSN, which lets you receive messages from friends on your wristwatch, is a successful match because both brands engage a young target group. The earlier example of the 'fast' Ferrari teaming up with somewhat 'nerdy' Acer is not as good. Since a brand's product portfolio supports the brand experience to a significant extent, the portfolios should also fit together intuitively. Thus, a McDonald's sales outlet inside a clothing store is not a good idea.

A new product that is the result of two brands collaborating should primarily mesh with the values of those brands, rather than with their other products. It wouldn't be such a surprise if Hummer were to start making sturdy kids' strollers, even though the firm mainly builds cars. Engaging in a collaboration may help improve the plausibility of 'brand-alien' aspects in the customer's perception.

Philips entered into collaboration with, among others, Swarovski for the manufacture of a luxury, crystal-studded USB stick. Their goal was not so much to sell large numbers, but rather to adjust their respective positioning. The partnership enabled Philips to enhance the status of its products, while Swarovski's association with a high-tech company allowed it to upgrade its somewhat old-fashioned image.

Consumers often see one of the two brands as more important than the other. This is termed brand dominance. This is generally due to the fact that one brand triggers more associations in the consumer's perception, for example thanks to brand familiarity, the promotion upon introduction, the function of the product, or the distribution. Considering tablets with beneficial properties for the skin: should we associate these with skin creams (such as Biodermal) or with vitamin pills (such as Davitamon)? It may therefore prove useful to make one of the brands dominant, and to give the other brand a supporting role.

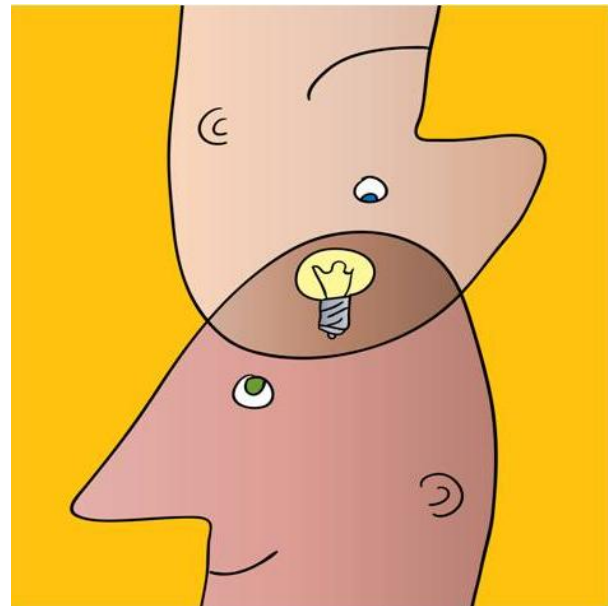
Co-branding actually means relying on the value of the added brand. The independent value of this can be calculated reasonably well using methods such as the Brand Asset Valuator (see above). Usually, the added brand is used to highlight certain aspects of the product. Accordingly, the added value should only be seen in relation to this aspect.

Suppose, for instance, that the Disney brand on a DVD cartoon makes it possible to ask a 50% higher price in

comparison to other cartoon movies, then it might add only 10% to a box of cornflakes. The reason is that the 'entertainment' aspect for which Disney is famed plays a subordinate role with respect to cornflakes, where other aspects dominate such as nutritional value, flavour and convenience.

In addition one must ask what the position of the added brand is in comparison to the main brand. For Macbooks by Apple, for instance, having an 'Intel processor inside' may not carry as much weight as for a weaker computer brand such as Toshiba.

Developing a unique product



Having a unique product is an important means of setting yourself apart on the market and of keeping your competitors at bay. It actually means that you have a small monopoly. This gives protection for

higher pricing strategies, since there are no competitors offering a similar product. Despite the lower demand for higher priced products, this position is often very profitable.

A unique product always has a significant, not easily copied advantage when compared to competing products. So this is not about a coffeemaker in a new colour, a camera with a few more megapixels, or a mid-range car with a slightly different design. This is about more than just 'differentiation'. Being different is not good enough; the point is to be exceptional.

Examples of a unique product are the Nespresso coffeemaker, a Harley Davidson, Viagra, music by Elton John or the 'beyond first class' private cabins in the latest aircraft operated by Singapore Airlines. To imitate such products would require the right technology, patents, extreme creative efforts, and/or huge investments.

Many unique products are therefore protected in one way or another by intellectual property rights: patents for technology, copyright for books and music, drawing and model rights for design. These property rights ensure that competitors cannot copy the product and enjoy the advantage of not having suffered the development costs.

A unique product will not remain unique for ever. Despite the protection of a technology or model, new technologies can be developed that offer the same or similar functionality. Patents expire and music becomes outdated. Changing needs among consumers and businesses, or new legislation, can cause a product's popularity to decline.

The point is therefore to run your organisation in such a way that it does not produce a one-off unique product, but that you can constantly come up with improvements and innovations. A unique product can

result from leading the field in certain competences, such as technological know-how, design skills or market understanding. The point is to develop these competences further and to excel in them, so that you can create unique products time and again.

Collaboration is an important means of ensuring that you have the right competences and knowledge in-house. An example of a unique product as a result of a collaboration is the Senseo coffeemaker. The Nespresso coffeemaker had been around since 1986, but it never became a widely used product, partly due to its pricing of 200-plus euros. Precisely because the Senseo was positioned in the lower price range of 59 euros upon introduction, it became a unique product in a wholly different market, namely that of the 'regular' coffeemakers.

There are basically two forms of alliances that can result in a unique product: joint R&D and technology licensing. In the first case, different competences from the two partner firms are brought together, and the risk primarily pertains to the actual development process. For technology licensing, the firms conclude agreements about the use of existing intellectual property rights. The two forms are discussed below.

Naturally, having a unique product does not mean you can dispense with all kinds of marketing communication. Collaborating with a number of good distributors is essential, and they will need to be persuaded of the utility and uniqueness of the product in question.

Findability on the Internet is also vitally important. A good example here is the Checkout cashier system developed by the Amsterdam-based company Sofa. This is a software application for Apple computers, developed out of frustration about the sluggishness and lack of user-friendliness of traditional checkout systems.

When Sofa put the Checkout test version online, they noticed through the discussions on Internet forums where most interest was to be found: among smaller starting-up shops with just a few cashiers. In less than 2.5 years since then, some 3500 shops have purchased a license, 95% of them outside the Netherlands²³. Unique products, once they acquire some degree of name recognition, are therefore picked out and promoted by the market itself. But for this, search engines and Internet forums are essential.

Joint R&D

In an R&D alliance, product development or innovation can be achieved if both parties have something to learn from each other. The more knowledge the firms share, the greater the chance of achieving success, but if there are no clear arrangements in place with respect to sharing the revenue, the greater, also, the chance that your partner will forge ahead on his own. This is particularly true for the initial explorative phase in the collaboration, and less so during the subsequent phase of marketing the invention or innovation.

An R&D alliance implies an interaction between:

- the structure of the alliance: this structure should offer both a partnership form to share knowledge, but also protect against the partner's opportunistic behaviour, and
- the breakthrough or innovation that is either sought or found: which of the parties stands to benefit most, and who has the greatest influence on its successful marketing?

The unpredictability of what the research will achieve demands a lot of flexibility from the partners²⁴. Often, the business model needs to be modified during the

course of the development process, for example because just 1 of the partners stand to gain commercial benefit from a research result.

It has been studied to a slight extent how this process can best be managed. For innovative ICT services, the 'Freeband Business Blueprint Method'²⁵ has been developed, which can seemingly be applied to other fields as well. It involves a process in which information is added gradually (see Figure 21). In the first step, a business model is sketched in rough outline using a number of basic questions about the service concept, the technological architecture, the organisation and the financial arrangements. This first step can be seen as a Quick Scan.

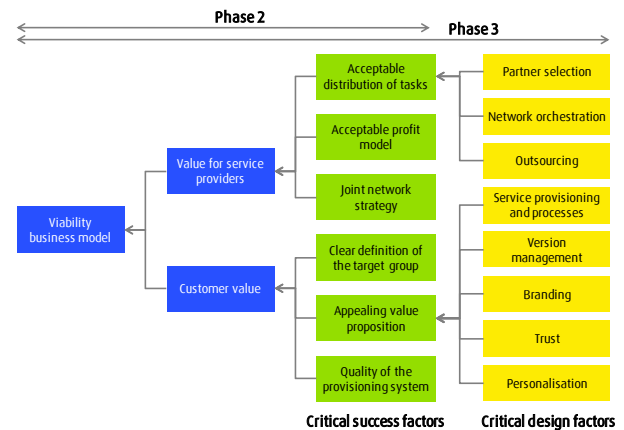


Figure 21. Freeband business blueprint method

In the second step, the rough sketch is evaluated in the light of six critical success factors. The third step is devoted to the further refinement and detailing of the business model, with reference to critical design factors. Some of these factors, such as staffing and network orchestration, may require some more explanation in branches outside ICT.

Nevertheless, it remains difficult to determine the value of a joint research project in advance, given the unpredictability of results. Timing plays an important role here, too, since an invention that is patented just one day earlier by a competitor can render one's own research entirely worthless. On the other hand it is possible to estimate the effort it would take to find and hire and motivate people with the same knowledge and experience as are made available by the partner.

Technology Licensing

In 2003 Henri Chesbrough introduced the concept of 'open innovation' in his book 'Open innovation, the new imperative for creating and profiting from technology'²⁶. Chesbrough builds on what is known as the 'funnel' model, in which companies start with a large amount of ideas of which just a small selection is elaborated, and an even smaller portion ultimately reaches the market (Figure 22). The ideas that are not elaborated into a product remain unused, and are sometimes even inaccessible to others because they are patented.

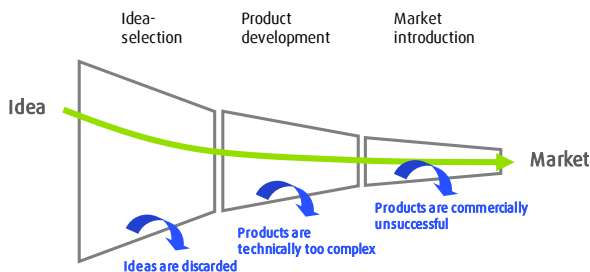


Figure 22. Usual 'funnel' for product development

Chesbrough's proposal is that companies sell their unused knowledge to other companies, thereby generating extra income (Figure 22). They can also

elaborate the ideas in new start-ups. Conversely, they can buy technologies and patents from other companies in order to achieve a shorter time-to-market for their own new products.

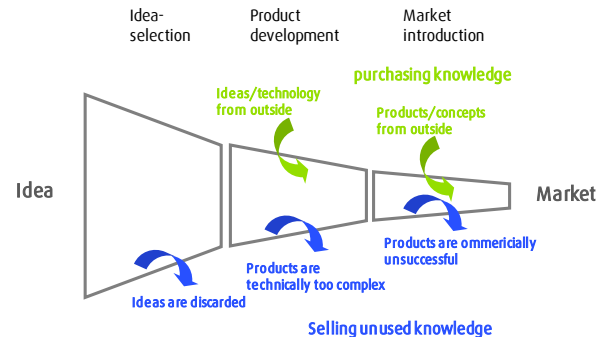


Figure 22. 'Funnel' for product development according to Chesbrough's concept of open innovation

In most cases, technology and intellectual property rights are acquired through licensing. In this form of alliance, you benefit from the knowledge, competences, technologies and perhaps patents of another party, or instead you make such knowledge available. Chapter 5 takes a closer look at the settlement.

The Galapagos bio-technology firm is a typical example of open innovation. The company develops biotechnology for new medicines, but is too small to process that technology into medicine and to embark on the costly process of getting the medicine approved through clinical testing in the US and Europe. So instead they sell patents and procedures to partners such as Astra Zeneca, Eli Lilly and Janssen Pharmaceuticals. Galapagos is generally remunerated directly, and subsequently shares in the profits if a medicine makes it to the market.

The price payable for a certain technology will depend to a large extent on its direct applicability,

the number of parties offering similar technology, and the number of potential customers. Since 2006, several large auctions of patents have been held that attempted to bring together as many providers and potential customers as possible, with a view to

creating a more predictable market and more transparent pricing processes. This could yield an initial guideline for comparable patents. However, the vast majority of intellectual property rights are still traded privately.

SAP

SAP is best known for its Enterprise Resource Planning and supply chain management software system. In recent years the company has evolved into a multi-product company, with software to support all kinds of business processes in all major industries. The mission is: 'help companies of all sizes to run better'. "A strong and growing partner ecosystem is one of the cornerstones of the company's strategy", as Erast Wortel, alliance manager for SAP, explains.

"We are a real engineering company, with many product innovations, such as the recently introduced In Memory technology by Hasso Plattner, one of the founders and largest shareholder of SAP. He was one of the five ex-IBM engineers that started to build software for ICI, which was the starting point of SAP. Since then SAP has grown through the focus on specific industries and through our partner strategy."

SAP has a global alliance organisation with a close alignment to the local country strategy. Most effort is focused on large enterprises in a parallel selling model. SAP sells its software products, the partner does the implementation. There is no referral fee, as the cost of implementation is in many cases at least three times the cost of the software. This gives enough incentive to the partners.

In the Netherlands, where Erast Wortel is based, there are around 6,000 SAP consultants. The largest system integrators have around 500 consultants each. The competition for SAP's products comes from

Microsoft and Oracle and many niche players. Traditionally clients first select the software suite, and after that the implementation partner. However, as the implementation partners have extensive customer contacts, they can influence the software selection process as well.

Wortel explains: "We try to influence the customers through a combined effort of the SAP (pre-)sales and partner sales team. One of the key goals of our alliance strategy is to create a compelling joint offer. This joint offer should change the traditional acquisition process of customers by demonstrating that it creates more or faster value than the individual offerings of the partners and that of the competition.

For example with Accenture and Ordina we have an integrated solution for mortgage providers. This is not an exclusive agreement, but we jointly approach all relevant banks. We now have some dozens of these solutions. If we are able to do this well we do not need to compete with individual software companies, but only with other (mini) ecosystems that can offer a better joint offering."

The customer decides who has the lead in the implementation project. Often one of the parties is asked to be the main contractor for the services. In the large enterprise segment SAP delivers the software directly

SAP PartnerEdge is the SAP's umbrella Partnership program that was originally developed for channel partners (resellers) and has been extended to all partner categories such as software partners and service partners. It consists of a tiered system with commitments and associated benefits: Associate, Silver, and Gold Advancement from one level to the next depends upon earning Value Points in two categories:

- Business performance and transactions – SAP license sales to new or current customers for channel partners and SAP software sales positively influenced by a Service partner in Large Enterprise
- Capability building – Submitting success stories or technology white papers, providing customer references, taking part in the SAP PartnerEdge P2P Network for business collaboration, adding trained and certified employees, taking higher-level sales or technical exams, and more.

Service partners can specialise based on their value point in Industries and Solutions through Vertical and Special expertise Partnerships.

On the development side, SAP has an open ecosystem allowing software partners to integrate their solutions with SAP, and SAP then certifies these interfaces.

One step further are the Endorsed Business Solutions that fill in the white spots in the portfolio. There are higher requirements for integration, and a shared roadmap. SAP promotes the use of these solutions in its extensive client base; in return SAP receives a fair percentage of the turnover.

The last category comprises Solution extensions: these are sold and supported by SAP. Examples are Open Text, Adobe, Streamserve. To be able to deliver solution extensions a company must have worldwide presence, 24/7 operations and considerable support and presales. In this case SAP receives more than half of the turnover.

Erast Wortel: "The revenue from these solutions is a limited part of our turnover. We have no target to significantly expand it. The key of these partnerships is that business processes supported by SAP can be extended with functionality of partner products and therefore provide value and better integration for our customers and help us to compete in the best way."

Creating cost advantages

Enlarging your customer relevance or developing a unique product yields durable competitive advantage. However, alliances can also be used to achieve cost advantages, though these are often easier to copy. In this paragraph we discuss three forms of alliances that are geared to costs: shared investment, reciprocal hiring agreements, and unusual supplier risk.

Shared investment

In some cases scale advantages can be achieved by jointly investing in means of production; for example, two construction companies that decide to operate a cement factory together. Alternatively, parties may choose to merge a number of supporting activities such as administration, personnel affairs or ICT (for companies with offices in a shared building).

It may be advantageous to enter into a production alliance with one of your competitors: if it means that you both stand to benefit from a cost advantage, this will thrust both of you ahead of other competitors. A single competitor grows in tandem with you, while the rest are left lagging behind. This form of alliance for example occurs in the automotive industry, since setting up a production line is a very costly affair. Certainly outside the domestic market, sharing capacity is an attractive option. For instance in the US, Toyota Camrys are finished in a Subaru plant in Indiana.

Another example is the collaboration between the two low-cost airline carriers Air Asia and Jetstar. This alliance is primarily targeted at defining the new generation of single aisle aircraft, as well as the joint procurement of these aircraft. Where the traditional airline alliances focus on commercial agreements and passenger benefits such as loyalty programmes, this alliance aims to cut costs by sharing some operational functions. Air Asia and Jetstar want to make sure that the new airplane types, which will be around for 40 to 50 years, are designed in a way that fulfils their own requirements.

Generally speaking, this type of collaboration does not carry much risk, and the important risks that do occur can be insured against. Depending on the settlement structure, there is a risk in the exploitation of the shared investment, yet that risk would be far greater if one of the parties were to make that investment on his own. The joint operational management, particularly of shared service centres, tends to be a trickier aspect. Many managing directors of shared service centres get a taste for independence and start to focus more on expanding their activities than on achieving the lowest possible costs for the partners.

The value of collaborating in this way is usually easy to calculate: the costs of investing directly and of investing jointly are generally quite transparent. The only hard part is to estimate the extra efficiency achieved by scale size. One should also take into account that joint purchasing often enables the negotiation of larger discounts.

Reciprocal hiring agreement

In a reciprocal hiring agreement, the partners share their resource pools in order to achieve a better staffing. This may involve consultants with a particular expertise, but also installation technicians with diverse abilities. Deploying each other's people is settled applying market-level rates, but the collaboration gives partners the advantage of not needing to keep extra people on the payroll with a view to peak periods. This form of collaboration is distinct from shared investing in that there are hardly any costs up front, and the collaboration is easily arranged, also in terms of operational management. The main condition is to share information, particularly regarding planning.

The value for both parties is better capacity utilisation, and being able to keep fewer people on the payroll.

A good example is the collaboration of TNT in Germany. In Germany there are around 150 regional mail service providers, all working within a confined geographical region. This is a viable business model, for with a lot of local governments, banks and insurance companies present, most of the mail is sent within the region. The mail services accept all mail from their clients and use the nation-wide firm Deutsche Post for the portion destined for outside the region.

TNT has bundled a large number of these mail services within a network, the Mail Alliance. This alliance mainly competes with Deutsche Post and has the purpose of distributing mail that has to be delivered outside the borders of an individual region, to other parties within the Mail Alliance. All participating companies work together on the basis of one IT system and one set of sorting rules, which enables the 'roaming' between the networks. The conditions to have one's mail delivered in another region are similar for all participants.

Unusual supplier risk

Contracting-out work to a supplier generally does not qualify as an alliance. It usually concerns a purchasing transaction, with the service or product and its costs specified beforehand. Thus, there is no question of shared risks or joint management.

There are some exceptions, however; for instance in outsourcing, where the client's personnel are transferred. The result is that the supplier's production capacity increases, without any solid guarantees of higher sales. The collaboration is based on the assumption that the supplier has more options of putting people to work than the client. The client transfers a large portion of his knowledge and work processes to the supplier, that puts his business operation at some risk. He will therefore want to have a certain measure of operational control in return.

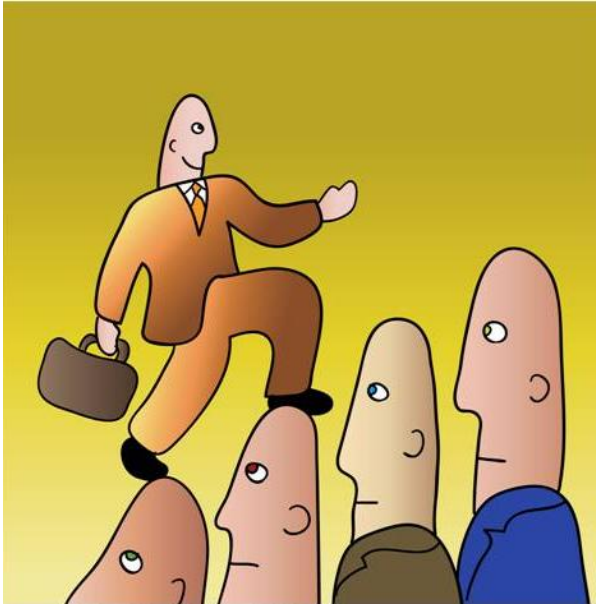
Public-private partnerships sometimes entail an above-average risk for the supplier as well. Imagine, for instance, a construction company that not only undertakes to build a road, but also to be responsible for its maintenance, the financing, and its operation. This clearly creates a strong dependency on the commissioning public authority, which for example

decides on the surrounding infrastructure and thus can influence the number of cars using that road. On the other hand, the multiple-year contract means that the public authority has a lot less control over the operation of the road, and will therefore seek assurances with respect to its operational management.

Here, too, the cost advantages of collaborating are generally easy to calculate, taking into account the risks associated with the dependence on the partner. The collaboration hinges on the fact that the supplier is better able to plan, organise and finance certain activities. The specificity of these activities makes it possible to have several suppliers bid against each other in a public tender process.

The extent to which commissioning companies are open to the tendering of work in the form of alliances differs per country. When we look at the construction of infrastructure (roads, gas pipes, water purification facilities), this appears to be quite common in the United Kingdom. In the Netherlands, the Ministry of Finance has set up a knowledge centre about public-private partnerships, and this approach is gradually becoming more familiar. In Germany the commissioning party tends to divide the work into small functional parcels, in order to contract these out at the lowest possible cost.

From normal value to top value



In the paragraphs above we discussed three strategies for differentiation, and how various forms of alliances can contribute to competitive advantage. Bundling resources results in a new and more powerful business model.

In their book 'The Profit Zone'²⁷, Adrian Slywotzky and David Morrison describe a number of generic 'sources of profit protection' that allow a company or partnership to durably set itself apart from competitors. The main competitive advantages are identified as:

- controlling a standard (as Microsoft does with Windows);
- controlling a value chain (Intel captures the most profitable part of the computer chain with its chips);

- having market dominance (e.g. Coca Cola's omnipresence);
- owning the customer relationship (as Dell does, as PC assembler).

They also note that most companies produce standard products without any cost advantage, or even at a cost disadvantage.

A number of the most powerful business models as described by Slywotzky and Morrison can be realised more successfully as a partnership than on one's own. These models are discussed below.

Controlling the standard

Certainly in a market (segment) that doesn't yet have any clear standards, you can develop a new standard jointly with others. Successful examples include Apple and Nike with the integration of the iPod and running shoes, and the current attempt by Chrysler with Mercedes, General Motors and BMW to develop a hybrid car engine.

If a standard has been set already, it may be an option to work with the party controlling that standard to develop distinctive supplementary products, such as accessories for the iPhone.

Controlling the value chain

To draw profit from controlling a value chain, there are various options:

- Collaborate with a partner that owns the same scarce resources in the value chain, and to make price agreements where possible and permitted. For example, two companies with

comparable technology decide to develop this further and sell it together.

- Collaborate with a partner that owns other scarce resources, in order to control the chain together.
- Collaborate with a supplier to obtain alternatives for scarce resources, and help spread these in the market. For example, if process operators for the chemical industry are hard to come by, then offer acquisition guarantees to a training institute in return for developing a dedicated training program.

If you are the party supplying volume to the market but not earning much in the process, then make compensation arrangements with links in the value chain that benefit strongly from your volume; for instance with the instalment company that installs and maintains your products.

Looking at the construction sector, we see that a large share of the costs is due to the required steel. For steel company Corus, a subsidiary of Tata, a considerable portion of its turnover derives from this, yet with on average just a slight profit margin. The profits are made elsewhere in the chain, by the distributors and processing companies. Corus developed a response to this situation with what is termed Ympress steel. This steel is produced specifically for laser cutting, requiring fewer corrections when processing the steel further. By offering training courses for operators of laser cutting machinery, Corus is able to penetrate the value chain to a far greater extent than previously, and at the same time gain a position from which it can advertise the advantages of Ympress steel.

Market dominance

If you wish to pursue market dominance, there are several ways to go about it:

- Entering into licensing agreements, so that a product or brand name is used in multiple ways. The Disney corporation is very good at this, with Donald Duck, Mowgli and many other characters appearing in many different products.
- Finding a partner with a large production plant or distribution network.
- Collaborating with a partner that supplies complementary products. The combination of strong brands can generate additional purchasing power, as demonstrated for example by Karl Lagerfeld and H&M.

This strategy characteristically entails using the channels or name recognition of the other party, who generally also stands to gain from it. However, the products or brands should be compatible to form a relevant combination for the buyer.

Owning the customer relationship

Owning the relationship with the customer offers such advantages as being the first to hear of customer wishes and developments, being able to directly influence the customer, and being able to directly promote other products. Companies that do not own customer relationships to any significant degree can opt for the following:

- Find partners in parties that have extensive customer knowledge.
- Collaborate with parties that can help build customer knowledge in a functional sense, for instance through their ample experience with

CRM (customer relationship management) systems, with distribution or with marketing. For many food companies, collaborating with marketing expert Procter & Gamble would be a major help.

- Collaborate with parties that can help you supply or service the customer in a flexible and customised manner, and so to boost your relevance for that customer.

Many distribution channels have a customer relationship to some degree, and can be a good partner here. But bear in mind the importance of making agreements about exclusivity and customer ownership (see Chapter 5).

Recurrent turnover

Recurrent turnover, as through razor blades, printer cartridges and vacuum cleaner bags, but also maintenance contracts for a variety of appliances also represent an excellent source of profit. As it can be quite challenging for a company to supply both the initial product and the disposable items, this is an evident area for partnerships to be forged. Where it concerns complementary products (for instance rechargeable batteries and the recharger, paint and paint brushes), agreements can be made between the complementary suppliers to ensure that these products are compatible. Although this requires coordination and perhaps some after-care, this can constitute an important and distinctive sales argument.

Little beats the pleasure of knowing for sure that two components will work together; for example that a drill bit will fit your electric drill, a DVD will play in your DVD player, and that your Samsung hard disk will interface with your Dell computer. Many of such potential problems are solved by international

standardisation committees, who will formulate an ISO standard that defines the diameters, shapes and network protocols, which all manufacturers will then apply to their products. Other industries deliberately choose not to: because HP ink cartridges only work in HP printers, HP can afford to market the printer at very low prices, and then make a profit selling more expensive cartridges.

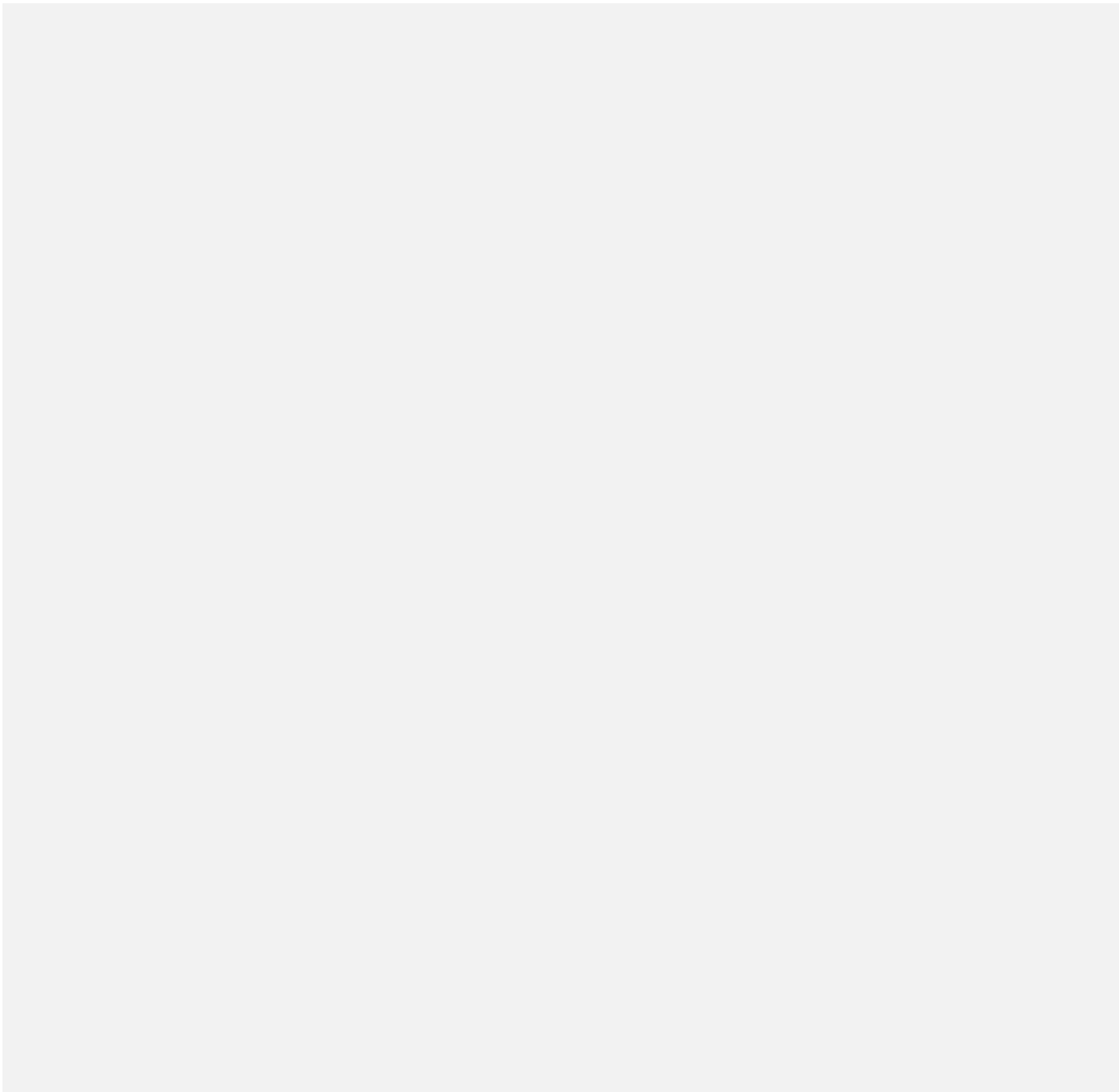
Network-related profit

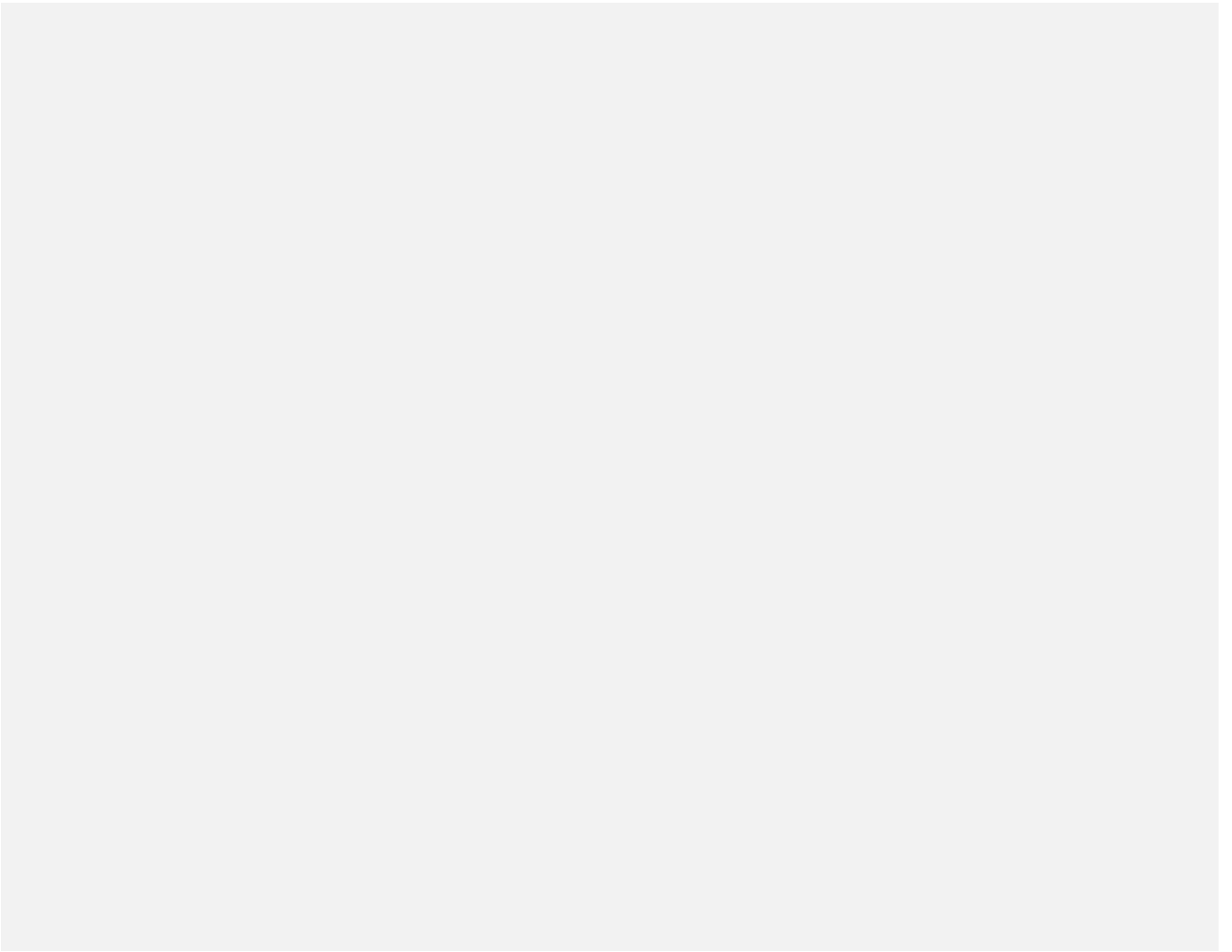
The value of a network is equal to the number of users squared²⁸. This already became clear at the time of the introduction of telephone and fax. The first person to own a fax could not put it to any use; owner 2 could fax 1 other person, and by owner 10 there were 45 fax connections available. With the advent of the Internet, all sorts of networks, market places and user groups could emerge and grow rapidly. Examples are sites such as YouTube, Hyves and LinkedIn.

The business profile site LinkedIn has some 90 million users, while the more informal profile site Facebook has over 400 million (as per 2010). Then there are sites such as Flickr, Myspace and Hyves, and Plaxo and Naymz for the business world. Such (business) sites allow one to upload some sort of CV and to establish network links with your relations. However, users tend to engage with just one or two networks, which means that not all relations can be reached.

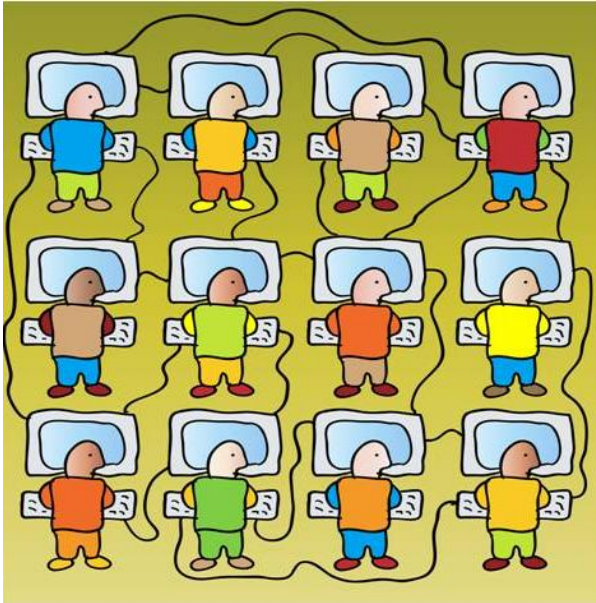
If two or more parties bundle their customers or connections in a new network concept, the immediate result is a much wider reach of relations for the customer. This increases the value of the network, but can cause a loss of Internet traffic and hence of advertising revenue for certain providers. The impact will be less for larger, more established players than for newcomers.

Philips case still to be released





Value of participating in a network



The preceding paragraphs basically assumed a collaboration between two companies, with a view to what this may be worth. Analogously, we can examine the value for a company of participating in a network. In a network, multiple parties collaborate and have more complex relations than in two-party alliances. The profit made by the company through the network should be compared against the profit that it would make on its own.

One reason to collaborate with others in a network is the expectation that the participating companies can complement each other, for instance in research and product development, or in production or reaching customers. This synergy should ensure that the profit of the network exceeds the sum of individual profits. At times a network can achieve negative results for the participants, for example because the

collaboration turns out to restrict one another's possibilities.

In 2006, a number of Dutch companies active in the field of electronics, optical equipment, injection molding and metal working decided to start collaborating under the name of Mechatronics Partners. All are relatively small in size and turnover, but together they have around 600 employees, of which 100 engineers in the field of designing, engineering and constructing electronic equipment like DVD players, control cabinets and industrial machines.

The basis rules for the partnership were set out on just three sheets of paper:

- Every company does acquisition through its own network. Joint sales and marketing activities are paid together.
- Every month representatives from the companies sit together to discuss the market opportunities and to decide in which combination a bid will be made. Each participating company will calculate its cost price, and the margin is decided jointly. External quotations are used to monitor the competitiveness of the prices.
- In case of a successful bid, one of the companies will provide a project leader, who coordinates the joint efforts and is contact person for the customer.

The expected extra turnover for 2009 as a result of this team approach was between 3 and 4 million dollars, which is relatively small on a total joint turnover of around 100 million, but most of it is annually recurrent revenue. Apart from that, the sharing of contacts and market information has helped the individual companies expand their own activities.

In practice it appears that participating in a network is mainly advantageous for companies that are relatively small in their market or industry, and thus benefit from the advantages of scale or scope offered by collaboration. Three factors cause certain companies to be less inclined to enter into alliances:

- Being a market leader: this provides sufficient scale size in itself.
- Having a technological headstart: this is a condition for supplying distinctive products.
- Being a supplier to a limited number of large customers: this diminishes the need for distribution partners and customer knowledge.

Aside from the absolute profit achieved by the network, a significant issue is the share that each of the participating companies will receive. The size of this share will often be a matter for negotiation, with a view to what each partner contributes. The more essential a partner's contribution in achieving synergy, the greater its negotiating power to claim a larger share of the added revenue.

Taking into account synergy and negotiating power, the profit that a company can make in a network can be expressed in a formula²⁹:

Company's profit in a network	=	Company's individual profit	x	Synergy factor	x	Negotiating power factor
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The possible outcomes of this formula are given in Figure 24. With a synergy factor of 1 (neutral) and a negotiating power factor of 1 (equivalent), acting in a network yields a profit equal to what the company would make independently. At the upper right of the curve, network participation is attractive (a lot of synergy and/or negotiating power), at the lower left it is not.

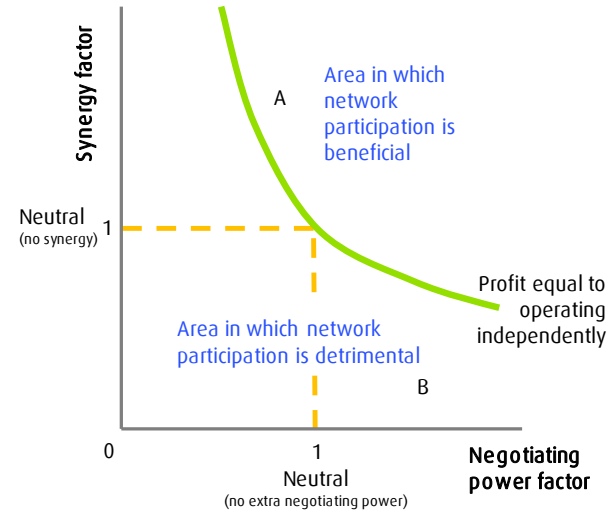


Figure 24. Benefit of operating in a network based on synergy and negotiation power

In Figure 24, Company A might contribute a small component of a compound product and thus not wield much negotiating power in the network, but the network is sufficiently effective for A to benefit from participating, rather than to operate on its own. Company B might be a relatively large player that shares his production capacity with others, and has

therefore succeeded in negotiating a disproportionately large share of the network's profit. However, since

they are all part of a network, the individual companies are less committed to marketing efforts. For that reason, it would better serve Company B to leave the network.

Participating in a network also entails certain risks:

- Loss of control: the core of any partnership or alliance is sharing the control over activities undertaken in collaboration. Although that control may initially work fine, as more parties join in this is something to watch closely.
- Networks may start to lead a life of their own, for instance because the participants get to know each other and may launch new initiatives.
- The distribution of revenue may take a turn for the worse for a particular company. For example when one company sell a machine and the other companies sell the consumables, and the sales of one consumables is less than expected. In joint ventures this drawback is shared with the other parties, in the event of licensing it depends on the actual agreements whether this is compensated.

In all cases, it is important to carefully consider whether to join a network.

Another case is when you see a project in the market and it makes sense to bid with a networks of partners.

Obviously there are multiple players in the market. Some partners offer a better chance of winning the deal than others. Differences can exist in the relationship with the client, in technology, and even in experience with selling a combined offer.

Last but not least: the potential to make a profit can differ per partner. What are their project management capabilities? Do they have experience with working with a partner? And how tough will you have to negotiate for your share of the profit? Your partner may even be cheating on you and leave you with nothing.

Just as you will evaluate your potential partners, they will evaluate you against the others. The two things that you can influence in this process are:

- your own attractiveness, for example by investing in innovative solutions
- your contacts in the market, to enhance your visibility for others and to get more information.

As soon as you have identified your 'perfect' partner you must aim for exclusivity. But often everyone waits to play his cards up to the last possible moment. A careful partner selection that starts even before the project is announced can help to make the added value of a specific network clear.

Making a good offer is a complex process, especially if you want to combine skills from multiple distinct companies. A tight timeframe with some slack is important, as it wouldn't be the first time that one of the parties backs out just before submitting the offer. To agree on exclusivity is one, but you can't force the other party to sign the offer. So make sure you have time for a backup plan.

The advantage of participating in a network is having additional opportunities in terms of turnover and profit, but the disadvantage is the loss of control. One of the best methods to increase your own influence is to limit the number of partners. This implies that, for each further partner, the benefit of admission to the network needs to be weighed against the loss of influence. When setting up a network it can therefore be a good strategy to choose a partner who is perhaps not the best there is, but who is able to contribute two or more different essential disciplines.

Being the one to initiate a network would seem to be an effective way of maximising control over that network. Recent research using games theory supports that assumption³⁰. Suppose that it would

make sense for Company A to form a network with two other parties (B and C), and that there two important negotiating factors, namely the distribution of profit and the number of board members to be appointed per party. A now has the options of:

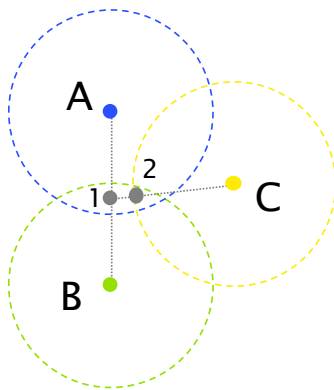
- concluding an agreement with one of the parties, and then to invite the third party to join;
- to enter negotiations with both parties at once;
- to wait to be asked by B and C jointly.

Figure 25 schematically represents the negotiating process. Points A, B and C indicate the ideal outcomes for each of the parties in terms of the two negotiating factors (plotted horizontally and vertically). The circles indicate their negotiating room. If A and B first negotiate together, they will arrive at point 1. If they then involve C, negotiations start from this point and end up at point 2. If all parties start negotiating from the start, equilibrium is reached at point 3. This is more advantageous for C than point 2. Therefore, it is to A and B's advantage to take the initiative.

Still, it appears that this does not always apply. As soon as C's ideal position approximates the compromise between A and B (point 1), then it is advantageous to become involved at a later stage. This also makes sense intuitively: in order to get C on board, A and B can make concessions relatively easily while still remaining clearly within their negotiating room.

It is often less worthwhile for a market leader to join a network, certainly if this party is technologically ahead of the rest. Suppose that a leading company as TomTom were to join a network of navigation equipment providers working together to improve the availability of road network information. TomTom would then immediately lose the advantage of having its own Internet platform to report road situation changes. Moreover, as a late entrant it would not have much extra negotiating power, and thus not obtain a larger share of the profit.

First A and B, then C



A, B and C simultaneously

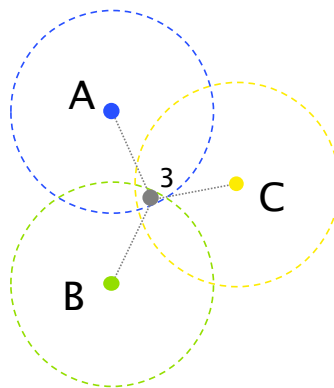
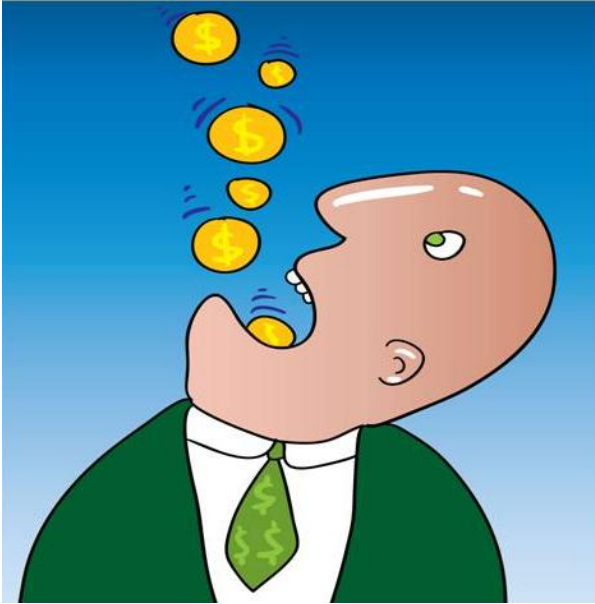


Figure 25. Different order of events in forming a network between companies A, B and C

4. Distribution of value



The previous chapters dealt with ways to create value. In case this works better through an alliance, or this is the only way to obtain specific resources, this extra value needs to be split among the partners. This chapter revisits the ten alliance forms that were introduced at the end of Chapter 2. After some general considerations, for each of these forms the possible distribution of revenue and costs is discussed, along with the consequences for each party's behaviour.

General

In any collaboration, it should be clear where each of the partner's responsibilities lie. This is sometimes

fairly obvious, for example in a distribution agreement one of the partners is responsible for the product and the other for the sales. Yet even in this example, it is important to establish who is responsible for market information, for technical sales support, and for marketing communication.

It may be that each partner's contribution depends on what part of the portfolio is commercially most successful, or on the setbacks that are encountered. Each partner's contribution can then be arranged per situation. In any case it should be avoided that the collaboration implies obligations for just one of the partners.

Sharing the costs

Many of the costs involved in a partnership bear a direct relationship to the revenue and can thus be compensated in that way. However, particularly at the start of the collaboration there will be (investment) costs that are not immediately counterbalanced by income. Agreements will therefore need to be made:

- Does each company bear its own costs until revenue starts flowing in?
- Are the costs shared proportionally or according to a certain key?
- Are costs incurred compensated as soon as money is available, or do made investment costs (and thus risk-taking) correspond to a share of the profit?
- Costs can also be distinguished according to type: for example, sales and development costs are not shared, investments in materials are.

Disputes often arise as to the allocation of costs. It is advisable for that reason to agree on tariffs and cost allocation rules ahead of time.

Many smaller partnerships, for instance when two companies decide to make a collaborative offer in a public tendering process, operate on the principle of minimum cost settlement. In making the offer, the partners each bear their own costs. Then, if a joint venture agreement is concluded, the leading party can have its efforts compensated in the form of a fixed sum or a percentage. Such an agreement means dispensing with the trouble of checking the efficiency and accuracy of costs reported by the partner.

Sharing the revenue

Where it concerns direct financial returns, it is important to share these as much as possible proportionate to each partner's contribution. Chapter 3 described how each type of contribution, such as people, production facilities, patents or financing, can be compensated. This is a matter of negotiation and of calculating the various options. What will happen, for instance, if a joint project disappoints and there is no money to fully compensate each partner's contribution?

For all distribution mechanisms, the following questions apply:

- Has its application been described clearly and unambiguously?
- Can all input variables, such as hours worked, be properly measured and monitored?

- What if the revenue is substantially higher than expected? Will you still be content with this agreement?
- What if it disappoints? Who will be the first to forego income? Does that feel right?
- Suppose your partner is ill-meaning and will even disregard his own interests: how can you respond and how can you protect against that?
- How does it work if one of the parties wants to quit the partnership?

Aside from the immediate financial returns, a partnership can also offer other benefits. These could include:

- access to new customers or an improved relationship with existing ones; or a greater name recognition;
- access to new market information or databases, or the acquisition of new copyrights;
- a stronger purchasing position thanks to larger purchasing volumes or a leading position in the market.

These benefits can often be utilised directly by one of the parties. Although they may fall outside the scope of collaboration, they are nevertheless related to it. If such benefits are distributed very unevenly, this may be accounted for in the distribution model.

The agreements made about the settlement of costs and revenue will affect the behaviour that each of the partners demonstrates within the collaboration. This certainly applies where businesses are involved, where the profit motive tends to be the principal concern. For each of the ten basic forms of alliances, the commonly applied settlement models are discussed below along with the variable options.

Imtech

Imtech ICT is a subsidiary of Imtech, a European technical services provider in the fields of electrical engineering, mechanical engineering and ICT. Imtech, with almost 25,000 employees, achieves an annual turnover of over 4.3 billion euros. As part of the ICT division Imtech ICT Communication Solutions focuses on supplying communication solutions for organisations with 250 to 5000 employees; mainly government ministries and agencies, educational institutions, utilities, industry and service providers. In the majority of cases Imtech relies on Cisco technology, making Cisco an important partner.

As do many other equipment and software vendors, Cisco has an extensive partner programme with audits on service delivery and product implementation. Pascal Rijs, Alliance Manager with Imtech ICT, describes his experiences with this approach. "Cisco helps us with new product development, combined marketing, and business development. On the support services side, we prefer the model of joint service delivery: we take care of the first, second and even third line service calls, and in return we get a discount on the service fee.

The partnership with Cisco requires a lot in terms of training, processes and communication, so it should deliver good value for us as well. The most important component is price differentiation. Cisco has a large market share, supported by a strong local presence. The number of opportunities is in line with the number of Cisco partners in the Dutch market; as such that there is enough profitable business for everyone.

We can receive an extra discount if we are the first to register an opportunity in the Cisco customer

relationship system. As this discount is only given to the first, we can use this extra discount for extra margin or to lower our price to secure the deal (usually a mix of both). Cisco furthermore has technology migration programmes for the exchange of equipment or discounts for new technologies, and Cisco funds part of our business development programmes."

Every year Imtech and Cisco make a joint plan with revenue targets, goals, strategies per goal, a communication plan, and a set of 'conditions of satisfaction'. These are 'softer' performance indicators like lead sharing, knowledge development, joint marketing and the perceived profitability of the alliance. A Channel Account Manager from Cisco works at the Imtech office two days a week and has a Cisco incentive on revenue with Imtech.

The parties collaborate on long-term opportunities as well. Pascal Rijs: "Imtech is involved in the development of smart grids: networks for the efficient distribution of energy from for example wind-energy parks to office buildings. Here we work with Accenture, IBM, Cisco, General Electric and ABB. Cisco provides specific network components for substations, for example. Together with them we have enough volume to design a grid for a whole town.

These kinds of collaborations fit within a trend. Instead of products, we will increasingly be selling solutions. Therefore we need others. In this case Accenture comes with the concept, IBM with the software, and together with Cisco we take care of the infrastructure layer."

Distribution agreement



In many cases, a distribution agreement contains a reward in the form of margin that the distributor can achieve on reselling the product. In the simplest scenario the distributor works with a fixed purchasing and fixed sales price, but there are several variants.

In most cases, the distributor is free to determine the sales price. In Europe and the US this is often even a statutory requirement in order to prevent cartel formation; local exceptions are books, cars or medicine. This allows the distributor to determine a premium price depending on his marketing, sales efforts or distribution, or to offer discounts under certain conditions. This is the optimum mechanism from the perspective of value enhancement.

In the sale of products, the difference between purchase and sales price will define the distributor's

profit. Where it concerns services, or products with a service component, there may be a direct contract relationship between the supplier and the buyer, for instance when selling insurances or supplying photocopier equipment on the basis of a certain price per print. In such cases, the distributor's reward is paid retroactively by the supplier.

There are different methods to determine that reward:

- A fixed sum per type of product
- A fixed percentage of the turnover
- A percentage of the difference between the sales price and a purchasing price to be determined by the supplier
- Or a combination of the methods above.

To the extent that the reward is more related to the sales price, operations will lean more towards the margin than the turnover. This can tempt a distributor to neglect less lucrative sales opportunities. For a supplier this may mean a decline in his market share or production capacity utilisation. That is why a reward as a percentage of the turnover can be effective. However, if this takes the form of a fixed commission per product, a minimum sales price will need to be set.

In other cases, the supplier will pursue some sort of policy in determining the purchasing price. This could be by offering volume discounts per order, by introducing purchasing discounts depending on the annual volume, or by introducing a bonus scheme that accumulates benefits with each individual sale. In a network of comparable distributors, another option is to introduce a competitive element: the best selling distributor is entitled to a sum of money or some prize like a holiday trip.

In a number of industries such as IT, the large and lengthy sales processes make it customary to offer additional discounts on the purchasing price to the distributor that first discovers and registers a sales opportunity in the supplier's administrative system. This allows supplier and distributor to respond more effectively to an opportunity, for instance by approaching the buyer even before he issues a Request for Proposal. This discount, which is for that one distributor exclusively, enables him to reduce his price even further and so to increase his chance of winning the order, or to better maintain his own margin. With Oracle, for example, this discount is 5% but only applies if the order is confirmed within six months after registration.

A number of preconditions need to be observed for these types of price structures to work properly:

- The price structure must be established beforehand and be entirely transparent.
- Differences between distributors may occur, but they need to be objectifiable: it is fine for a certain distributor to obtain an additional discount for a large volume or on account of a specific agreement, but then this should, in principle, be attainable for other distributors.
- Any channel conflicts must be tended to: it should not be possible to obtain a greater discount via a longer or different channel, on the basis of certain agreements, then when making the purchase as directly as possible from the supplier. The supplier should carefully define the application of any exceptional arrangements.

A good example is how Oracle operates. As one of the largest software suppliers worldwide (and also of hardware, since its takeover of Sun), Oracle has developed an elaborate policy that is, for the most part, open to examination by third parties.

The Oracle Partner Network consists of three membership levels -- Silver, Gold and Platinum -- that are each associated with different demands and different annual contributions. Partners are supported in different aspects, including an unlimited number of demonstration licences or development licences, access to knowledge databases, and certain forms of technical support. Partners may use the Oracle logo and can specialise in certain competences.

Partners can move up through the membership levels based on their development of certain competences to a certain level, the number of successful implementations, and the number of leads contributed. The amount of technical and marketing support increases accordingly, as does the discount offered when purchasing licences.

Oracle collaborates with partners/distributors according to two models:

- Reselling: the turnover is recorded in the partner's bookkeeping
- Co-selling: the partner advises but does not sell licences, which need to be purchased directly from Oracle.

Oracle applies an 'open market model': all distribution channels are given the same discount on the standard price list. A distributor gets a 30% to 40% discount, depending on the turnover. Higher discounts may be offered if Oracle is directly involved in a deal, but the principle remains that partners need to achieve a margin of at least 5% on the resale of licences.

When a customer buys Oracle licences, he is given an Unlimited Licence Agreement, including the right to upgrades and support. The discount applies to the entire package, in terms of the purchase as well as support. Support is always 22% of the purchasing

price per year, and is billed directly by Oracle from the 2nd year on. This has no bearing on partners' reward.

Oracle supports partners with its own university for the training and reschooling of new consultants. A partner's loyalty may be increased by investing in training and marketing. Every alliance plan is supported by an Enable Plan, which provides KPIs that are reflected in the reward structure for alliance managers, for example the number of trainings and of certified consultants per partner. There is even an HRM programme for partners: for 2000 dollars, Oracle will recruit and train new consultants for partners. Finally, Oracle strives to get ex-employees assigned to marketing posts at its partners.

More in general, a distributor will be inclined to sell those products or services that yield the largest reward proportionate to his sales efforts. This makes increasing the reward an important method, but there are also a large number of non-financial methods that can incentivise the distributor. The easier it becomes to sell a product, the more such methods will be applied, even though it means a somewhat lower financial reward.

Important is first of all the attractiveness of the product or service. This is certainly also a matter of packaging, the documentation and the guarantees. Packaging that is easy to stack or to ship, a clear manual that reduces the number of customers calling the distributor for help, and an effective complaints processing procedure and guarantee policy, preferably arranged without the distributor's involvement, can help limit the required sales effort.

Second, a supplier can assist in the marketing. By advertising the product it can generate a pull-effect, stimulating customer demand. Additionally, the supplier can help in terms of product-push: for

instance by providing in-store displays, the design of the packaging, or by offering samples or trial versions.

Investing in training materials can be useful, particularly where more complex products are involved. The supplier usually assumes that the distributor has all the knowledge and skills required to sell the product; yet often enough the distributor even lacks commercial skills, let alone technical skills. Or perhaps the entrepreneur is sufficiently capable, but is assisted by employees that are just starting out. Good training materials, perhaps even videos to demonstrate how to sell a certain product, can significantly boost sales figures.

Non-financial factors are particularly relevant for distribution across a number of different links: here, the margin between the supplier's sales price and the sales prices for the end user is stretched across the various links. Although the supplier can set the price for the supply to the first distributor/wholesaler, he has no control over the price and discount structure applied further down the chain.

In such cases, non-financial methods such as providing promotion materials, in-store displays, training materials or arranging proper complaints procedures are much more effective than lowering the sales price. Projects in which the supplier's representatives talk to distributors far down the line, just one or two steps removed from the end user, can also prove more cost-effective than a discount campaign. Finally, the wholesaler can be rewarded for offering information and training to retailers.

For example, Coca-Cola supplies its raw materials to bottling companies, but supports the sales through mass marketing campaigns targeting consumers and by providing an infinite number of signs, banners and vending coolers to retailers all across the world. It is

not without reason that Coca-Cola's brand value is immense, and their product is available virtually everywhere. This even forced Unilever to team up with soft drinks giant Pepsico for its Lipton tea brand. The clear distinction between tea/ice tea and other soft drinks means that the partners do not interfere with each other, even though they share the same target group and distribution channels. These channels can now be utilised jointly, which generates a considerable cost benefit on account of the huge volume.

There are also challenges for the distributor. Especially with custom-built products or with services, the contact between the supplier and customer cannot be avoided. After making the deal with a specific customer, the distribution partner has to

sustain his added value, which in most cases is based on relatively easy to copy knowledge. This can be done in several ways:

- By sustaining a broader relationship with the customer than for this solution only. The added value of the distribution partner then lies in his product portfolio and his further arrangements with this customer.
- By continuously bringing new one-off customers into the alliance.
- With a contractual arrangement, stating that all business of the supplier with the distributor's customer base has to be done through the distributor.

Comsoft Direct

Comsoft Direct is one of the biggest large enterprise resellers of Microsoft software and, as such, a specialist in licensing structures and agreements. Headquartered in Switzerland and active in a number of European countries, the organisation offers software management services in addition to the licenses sales.

For the small and medium enterprises market, Microsoft works with distributors that sell to a large range of resellers. For the large enterprises market (up from 250 employees), Microsoft sells directly to the customer directly, and Comsoft then receives a fee from Microsoft.

Comsoft works with a large number of commercial partners for the hardware and consultancy that complements the software licenses. Partnerships are classified as 'managed' or 'unmanaged', with managed partners having their own alliance

manager. In some cases Comsoft takes a partner's licensing consultant on its payroll, which is fairly unique for a reseller. Usually, only software providers tend to do this.

Vincent Lukken, alliance manager at Comsoft, further explains the approach: "New partners are selected with a three-month trial period, mainly to see whether the partner is sufficiently competitive. All resellers receive from Microsoft the same discount on the list price for the licenses. So what part of that discount does the partner have to offer to the customer and how is the remainder split between him and us?"

The next step is to conclude an agreement for six months during which the partner will obtain its licenses exclusively from Comsoft. In return, partners demand a larger discount. In most cases a 50%-50% split of the margin is agreed. This can vary, as the

activities to win and serve the customer lie more with one party. This structure encourages us both to concentrate on obtaining the most profitable deal.

Some of the managed partners are actually strategic partners. In such cases, the collaboration incorporates joint activities such as newsletters and seminars. Sales personnel from both sides meet up to share opportunities. With some partners Comsoft receives a fee for lead generation, in case only services are sold.

Vincent has several ideas on how to promote partner loyalty. "First of all we have to further enhance our reward structure with proper lead registrations and incentives. The second action is to further share knowledge about customers. We receive marketing funding from our vendors, and a third option is 'to apply that money in consultation with our partners.

Finally, we can organise events for our potential clients and promote our partners there."

Apart from distribution partners Comsoft has alliances with complementing companies to make collaborative offerings. In these cases no fees are paid. One example is the collaboration with IT specialist Inter Access. Inter Access will source all its software licensing activities with Comsoft, and Comsoft will be the preferred implementation partner for Inter Access.

He sees a major challenge ahead: "As Microsoft offers more and more solutions 'through the cloud', the need for software licenses is bound to decrease. We already notice it in the market. We will have to adapt both our business model and our partnerships to these changing circumstances."

Franchising

Franchising is an important growth strategy for many organisations, particularly in retail. Franchising can also be applied in the business-to-business market to expedite the sale of products or technology. In return for the brand name, the service concept and often the purchase of products, franchisees pay a fixed sum or a percentage of the turnover. This often concerns long-lasting contracts in which the franchisor and franchisee clearly depend on each other.

For a franchisor it is often important to grow rapidly through the number of franchisees, as this yields cost benefits in three respects:

- He is better able to spread his investments in the concept.
- Marketing communication generally becomes more effective since there are more sales outlets.
- Scale size enables him to negotiate better purchasing conditions.

Additionally, it is a way of establishing a brand name that requires few extra own investments.

Nevertheless, the value of the franchise format is somewhat doubtful. Many franchise formulas collapse relatively soon because the concept is not embraced by consumers, or even because it proves impossible to find sufficient franchisees.

To determine how attractive a franchising formula is for the franchisees, three cost components are important:

- the size of initial investments to set up a shop or sales office;
- the size of the monthly payment in return for using the formula;
- the margin obtainable through sales, based on purchasing costs and freedom to set prices.

Pioneering franchisors will need to keep the franchisee's initial investments low and possibly refrain from asking a one-off compensation. This reduces the starting-up risks for the franchisee. This risk will also seem less if the franchisor agrees to share in the investment; this will have a positive impact on the formula's growth rate.

Research has shown that the size of the monthly payment does not seem to influence the growth rate. However, this payment should be such that it combines with the profit margin of the turnover to produce a profitable franchise. As the formula ages, the pressure will increase to reduce the monthly payment: franchisees become more experienced and less dependent on the formula, for example because they know their customers and their needs better, and mutual competition increases³¹.

In many cases, the franchisee will need to finance the launch of his or her company. The furnishing of a location, hiring and training personnel, a sub-optimal staffing at first and building and maintaining stocks all cost money. These financing costs also need to be incorporated in the business case.

Where it concerns an established franchise formula, the costs for a franchisor usually concern the consultations and part of the shop furnishing. The major investments have been made before, and the most important risks have been taken. At bottom, he is the party that stands to gain most from the negotiations.

Aligning propositions and referral

Where two companies align their propositions and refer to each other, this will generally not see much in the way of cost settlement. In most cases both parties bear their own costs for the alignment and possible product or service modifications. Aside from that, the expenses of joint marketing campaigns may be shared; see also the paragraph about co-branding.

In the services sector it is still common to work with a lead fee. Simply contributing a potential client or arranging an assignment can be reason for the contracting party to remunerate the contributor. For a single lead this may be a few percent, but for an entire sales trajectory percentages of 10 to 30% are customary.

Also referring Internet users through links or banners on another website, known as affiliate marketing, can be regarded as partnering; the more so if payment is offered for each completed sales transaction, rather than for each 'click' as Google does with Adwords.

Chuchawal Royal Haskoning

The Thai-Dutch joint venture Chuchawal Royal Haskoning was set up in the late sixties by the engineering company De Weger to supervise the design and construction of the new Bank of Thailand headquarters. To gain access to local knowledge, a US-educated Thai architect by the name of Chuchawal Pringpuangkeo was hired as an advisor. In 1974 the ongoing collaboration was formalised in a joint venture named Chuchawal-De Weger, and after De Weger was incorporated by Royal Haskoning in 1998, the alliance changed name.

From the start the joint venture has been managed operationally by a representative of Royal Haskoning. Currently this is Alko Plas, who sits on a board of directors with two representatives of Chuchawal and a division director of Royal Haskoning. This board reports to the shareholders meeting, attended by Chuchawal Pringpuangkeo and a board member of Royal Haskoning.

Alko explains the strategy of Royal Haskoning: “We always start from the customer's request, and then see what kind of expertise is required to arrive at a solution. This need not always be technical expertise: we recently won an assignment for the renovation of seven bridges thanks to the fact that we also took into account the communication with the municipalities involved.

To obtain all the necessary expertise we frequently collaborate with various partners. That can be either one-off or for longer periods. With Nedeco, a combination of Dutch engineering agencies, we have been active in Thailand for more than 20 years and have, among other things, developed a large port complex. More recently we acquired an order for the

design of a tunnel plan between Hong Kong and Macau, together with engineering consultant Witteveen+Bos.”

The collaboration is sometimes formalised as a new legal entity, and in other cases bids are made as a consortium on separate purchase orders. Chuchawal Royal Haskoning is a Thai legal entity that was active in other Southeast Asian countries, but these activities were sold to Royal Haskoning in 2002. Financial settlements are easy and transparent: only the salary costs for some expats and a management fee are invoiced by Royal Haskoning to the joint venture. Dividends are paid out yearly. Usually the costs of local representation are split by the various divisions of Royal Haskoning that profit from such an entity, with the country manager reporting to multiple divisions. Since the alliance partner has a direct line to the board of directors, the joint venture only reports to one division to simplify internal communications.

Alko Plas: “For Royal Haskoning this is the only country in the world where we have such a continuous joint venture with a local partner. Due to Thai legislation, it is the only way to have a permanent entity here. Of course you have to adapt to your partner and to jointly determine your strategy and operational approach.. We make our investment decisions together and hold budget rounds. What I see is that the Thai partner is more entrepreneurial than Royal Haskoning, which is more cautious in bidding for projects . At the same time the joint venture gains from the long term contributions of Royal Haskoning in items such as a code of conduct and knowledge around sustainability.”

Collaborative offering



In collaborative offering, two or more companies will often want to supply their own part of the solution requested by the customer, but it also requires overall coordination and, in many instances, the customer will want to deal with just one contact point. The latter wish is in order to prevent ending up with a defective solution, should the separate supplies fail to integrate seamlessly.

In formulating a collaborative offering, there are a number of pricing aspects to consider. The first question is what margin the businesses apply in their pricing of their own contribution to the solution. Not all suppliers are willing to fully disclose their cost price calculations, and the extent to which overhead, capacity utilisation and possible inefficiencies are incorporated varies among companies. Prices can sometimes be compared to

those of previous assignments, or with reference to competitors in the market. But often it will just be a matter of trust that partners do not add an extra margin.

The second aspect concerns the legal form chosen for the offering. Does one partner act as chief contracting party, with a purchasing relationship towards the other partner or partners? This means a bigger risk for this partner; a risk that can be reduced by:

- arranging that the partners are only paid after the client has paid and no further claims can be expected (back-to-back construction);
- requesting a bank guarantee that can be claimed in the event of delivery problems;
- requesting guarantees from a holding company or shareholder to prevent the partner from going bankrupt as a result of setbacks during the project or of liabilities afterwards.

Any reduction of this risk should be reflected in a smaller compensation premium for the chief contracting party. However, percentages of 10 to 30% are not unusual.

Alternatively, the offer can be made as a legal partnership in which both partners have an equal position. If this implies limited liability for the partners/shareholders, this means restricted claim options for the client, who thus will have to consent to that.

Equal collaborations without limited liability for the participating parties can have the consequence that liabilities arise for both parties, instead of for just one. One reason to opt for this may relate to fiscal facilities. In multinationals, the national organisations may choose this option because share transactions, where liabilities can be limited, require the head office's permission.

Finally, the actual alignment of interfaces and tasks should be considered. The most important compatibilities can often be identified, such as hardware requirements for a software system, or the maximum weight of a component for an aircraft. But who is responsible for making sure two software systems can be operated on a single hardware system simultaneously, or for the weight distribution of an aircraft and the implications for its construction? One party shall have to act as system integrator or quality safeguard. This, too, justifies a price premium.

However, each contract provision that assigns part of the risk elsewhere requires a corresponding reduction of this premium.

Parties engaging in collaborative offering will need to confer closely concerning the total sum of risk premiums and margins. The simple fact of collaborating must not cause the partnership to price itself out of the market. On the other hand, having a deficit on the joint budget is as good as a guarantee that tensions will arise in the companies' relationship.

Capgemini

With over 100,000 employees, Capgemini is one of the largest providers of consulting, technology, outsourcing, and local professional services. With the mission statement "Driving Concrete Business Results", the company helps customers transform their organisation and improve performance. The main activity is the implementation of hardware and software solutions.

Capgemini is one of Oracle's most important implementation partners. Balt Leenman, one of Capgemini's alliance managers, has long been involved in this relationship. Back in 2004 he was selling Peoplesoft solutions, before it was taken over by Oracle. He saw the potential of this takeover, wrote an article about it and was invited by Oracle to visit San Francisco. Since then he has been involved in managing this alliance.

"Within Capgemini, the alliance with Oracle is seen as a role model. Oracle was recently declared 'Overall partner of the year' for the second time, beating system integrators like Accenture, Deloitte, IBM, Logica and Ordina", Balt Leenman explains. "But we do not want to focus solely on one or two vendors. We want to be an independent system integrator that

can offer a client impartial advice. In outsourcing we tend to work more with IBM, in enterprise resource planning systems with Oracle and SAP, and in hardware with IBM and HP. Although, since the takeover of Sun, Oracle is a good option as well."

The alliance owes its success to the complementary cultures of the companies. "Oracle is very sales driven, while Capgemini understands the a customer's business challenge. The Oracle sales organisation focuses on quarterly results, Capgemini is more long-term oriented.

For a large client such as KPN, Oracle deploys several salespeople, each pursuing his or her own targets. We wanted to implement Oracle middleware and had organised workshops with the client for that purpose, but that was frowned upon by the Oracle ERP salesman because it could influence his sales cycle. There lies a role for Capgemini and our alliance management."

In his opinion, a collaboration becomes effective if both partners work from a joint value proposition that serves the customer. "We can enhance our success by fully understanding Oracle's solution and its roadmap.

In most cases we cannot build a system from scratch but need to take into account the technologies already in place, and those need not necessarily be Oracle's."

The ideal structure is such that Oracle sells its licenses directly to the client and Capgemini separately bills its implementation effort. Oracle has a system with a referral fee for the first system integrator that registers a sales opportunity in its system, but Capgemini is reluctant to use that to protect its own independence. In the public sector such a reward system is prohibited, and Capgemini has shaped its

bonus system for the sales organisation in such a way that a referral has a negative effect.

What would stimulate Capgemini to sell more Oracle solutions? Changing the reward system would certainly not work with our biggest customers, thinks Balt Leenman. "This would only work in the market for small and medium enterprises, where we have more of a reseller role. It is better to invest more in training and certification and in making joint account plans and discussing opportunities. IBM for example 'sponsors' an alliance manager within Capgemini, and that works as a catalyst. So communication and joint effort is key, not the reward system."

Co-branding

Co-branding is an effective method of using two different brands to sell a product or service. This will often concern one main brand, which is most associated with the product, and a second brand that adds a certain quality or emphasis to a particular aspect of the product or service.

Arranging a satisfactory financial settlement here requires determining the value of the added brand. Does the added brand justify a higher sales price, or does it mainly promote the distribution of the product, yielding benefits on the production side? Benefits can also be obtained by jointly conducting marketing campaigns. These considerations create the following settlement mechanism options:

First, the parties can arrange compensation per sold item. This seems particularly appropriate if the added brand is stronger than the product brand, thus acting as an 'endorser'. The brand value of the stronger brand translates into a higher sales price or greater

sales volume, which is accurately reflected in a certain compensation per sold item. This compensation will then be part of the expected price premium.

Possible variations are:

- If there is any doubt about the combination, the compensation may only become effective once a certain volume is reached, in other words after the introduction proves successful; this reduces the risk of the product launch for the producing brand.
- The compensation may gradually decrease or end once a certain volume is reached, on the assumption that if the product proves a hit, the value of the added brand becomes unnecessary.

Second, the parties can arrange a fixed sum as compensation. This is more appropriate if the aim is to strengthen the producing brand, rather than to boost sales figures. The collaboration between Philips and Swarovski to produce ornament-like memory sticks is a case in point: the goal for Philips was not to sell large numbers, but to add some glamour to its

brand reputation. The collaboration may also be restricted to a small number of highly exclusive products, for instance a Ferrari car with Louis Vuitton upholstery.

Third, parties can arrange a settlement for their marketing efforts. If the producing brand advertises the product, the added brand enjoys the benefit of a greater name recognition. In that case the costs of the campaign can be shared.

A combination of arrangements may mean that the added brand ends up making a net contribution. This could be justified if its brand value is inferior to that of the producing brand, in combination with the right to supply its own product as an ingredient at a favourable price. This may well have been the case in the collaboration between Dr. Pepper cola with NutraSweet sweetener.

Joint R&D

In making arrangements for joint research and development, an important consideration is the extent to which the parties aim to generate shared revenue. It could be that the parties work to produce a single new product and arrange a particular distribution of the revenue, as General Motors and Mercedes Benz have done in the development of a hybrid automobile.

A second scenario is that the parties work to produce complementary products, as did Heineken and Krupps with the Beertender, for which Heineken sells the beer kegs and Krupps sells the home tap. Finally, the parties may engage in joint research but then develop and market their own product, perhaps even in competition with each other.

The modularity of the product also affects the coordination costs and the risks of research and development. This applies particularly during the exploratory phase, during which the product concept is selected based on a large number of ideas and options.

In the commercialisation phase, the product is more or less determined, but then it's a matter of choosing marketing approaches. Here parties often rely on a Stage-Gate model, as described by Cooper. This means that parties must decide in each stage which concepts to pursue, and whether they wish to continue investing. New insights derived from the innovation process can result in changing attitudes towards the alliance, however. This may prompt new arrangements about the income and cost distribution, or even to a different alliance structure³².

The possible variations in contract design pertain both to cost distribution and revenue distribution, as well as the period for which the parties accept obligations.

As regards cost distribution, in many development collaborations the parties will arrange to each bear their own development costs; certainly if both parties largely have their own income. Where the parties work to develop a single product, it will generally be more obvious to define a development budget and arrange cost sharing accordingly. This cost distribution will often be coupled to the revenue distribution.

The period may encompass the entire development process, or it may involve just one or two development stages. In the latter case, the contract may contain a provision that if one of the parties decides to pull out, that party will be liable to pay a penalty as compensation for the possibly wasted efforts of the other partner.

In the event of a successful development, the revenue aspect becomes relevant. This revenue can be shared at two levels. First, intellectual property rights can be awarded to both partners. They are then free to commercialise these rights in whatever way they wish. This may involve arranging a sharing of the rights, or that each of the partners is fully entitled to the rights (see Chapter 5 for a further discussion). But in how far can the rights be reused for a similar kind of collaboration with a different partner?

A second option is to make arrangements about the revenue that ensues from the joint product or service development. This can take the form of a certain percentage, optionally limited by a minimum or maximum for the absolute sum. Here, the underlying intellectual property rights are not settled or awarded separately. Important aspects to consider include:

- The chance of any modifications to or further development of the product, which could mean that precisely the component supplied by one of the partners is no longer distinctive or becomes obsolete.
- For compound products: variations in the proportion of product sales; for instance if Heineken's sale of beer kegs for the Beertender far exceeds expectations, so that it benefits more from the collaboration than Krupps.
- Liability for problems affecting the supply or quality of the products, attributable to one of the partners.

Customers are generally more inclined to accept service models, making these more profitable than sales models in which the customer pays once for a product and then uses this for his own gain. Consider, for example, car leasing as opposed to car sales. In arranging their settlement mechanism, the partners

will need to monetise the value of a service contract across its duration, in order to arrive at a suitable settlement.

For a highly intensive collaboration, a suitable model may be to arrange a partial share swap. Toyota and Subaru are currently collaborating in research and development in order to cut costs. Toyota has been Subaru's largest shareholder since 2005. At that time, the Japanese giant took over a share package from General Motors, giving Toyota an 8.7% ownership of Subaru. Toyota now wishes to increase that package to 17%, but it does not want to hold more than 20%. That way, there is no need for Toyota supervisors to sit on the Subaru board, and Subaru retains its independence.

The unpredictability of joint development is a reason to formulate a broad objective in the collaboration agreement. A packaging manufacturer and a printer once concluded an agreement for the joint development of new commercial packaging materials. Both parties felt there was a market and each decided to dedicate 200,000 dollars' worth of people and resources to the project. As part of the agreement, the formulated objective was that both parties should benefit from the collaboration in similar measure.

When the development resulted not so much in new packaging materials but in a patentable method to reconfigure printing presses for a different format (as this was a cost-determinant factor), this gave rise to discussion: of what good was this innovation to the packaging manufacturer? Given the objective that both parties were to benefit in similar measure, it was agreed to license the new reconfiguration method to other printing companies as well, and to share the resulting revenue.

Raet

With 800 employees and 6000 customers, Raet is the number one IT services provider in the field of human resources and payroll services in the Netherlands. Aside from HR and payroll processing, Raet is active in HR process outsourcing and HR consultancy services. Alliances are used to add extra functionalities to the portfolio.

John Cöhrs, Alliance manager at Raet, describes the selection criteria for new partners. "First of all the partner's knowledge or product should have added value for the customer. Our product portfolios should be complementary, from both parties' point of view. We accept that there might be an overlap, and we can make arrangements for that. And we want to focus on a measurable result of the collaboration."

One of the examples of a joint development is the alliance with Stepstone Solutions. One of the most successful companies in e-recruitment.

Raet had initiated this alliance in order to support customers with their recruitment process. If Raet were to create such a solution themselves, the time-to-market could be longer. A merger or takeover was not feasible at the time, and the procurement of such a solution would not provide exclusivity. Therefore an alliance was the best option.

Three parties were shortlisted and compared in terms of the potential for technical integration and the alignment of their business model with Raet. Raet believes that HR software will evolve completely into a software-as-a-service model. The solution of a partner should fit into this vision and should support all roles in the recruitment process.

Stepstone had a development roadmap that meshed well with Raet. It served only a limited client base in the Netherlands, where Raet has the majority of its footprint. With the other candidates there were doubts about the technical standards and the readiness to invest. Stepstone was selected as partner and retained exclusivity for its own customers.

Raet was granted the exclusive distributorship of Stepstone's solution. Stepstone's product was then integrated in the Raet system, with similar layout and navigation. Extensive knowledge transfer was needed, as Stepstone had to learn about Raet's product roadmap, and 70 salesmen and 200 Raet consultants had to be trained in the Stepstone solution.

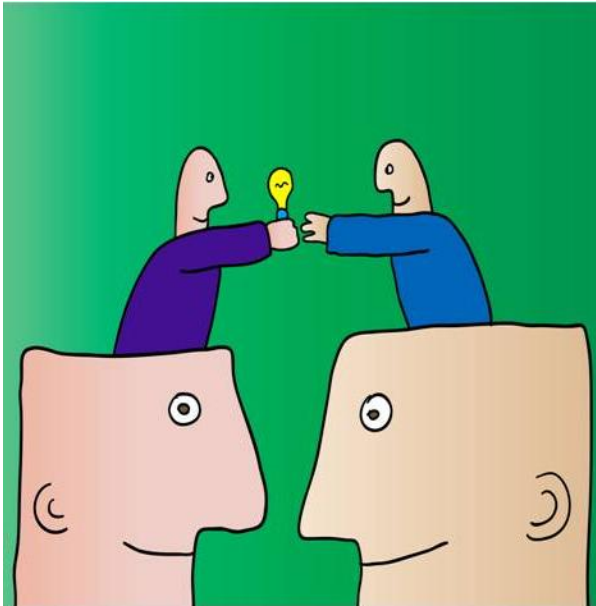
The parties agreed to bear their own development costs. On the revenue side Raet bills the customers based on the number of concurrent users. Raet pays Stepstone a percentage of the fee for the module. When a specific market share is reached, the percentage for Raet increases. This is an extra incentive for Raet to sell the Stepstone solution, and it is perceived as fair since Stepstone on its own would not have been able to achieve such a market share.

For the development of new products, for example specific complex reports, there is an extra incentive for Stepstone to go live as quickly as possible. The revenues for these extra products are split as well. If, for commercial reasons, a discount is offered on the whole package, the discount for Stepstone is the same as for similar solutions in Raet's offering.

John Cöhrs explains the success of the alliance: "Both parties have been extremely open to each other about their own interests, and therefore we could work out the right solutions. Stepstone has other

products that compete with Raet, and in some cases we have the same customers. Even then we can agree on the right course of action."

Technology licensing



Licensing in general means to share the right to use a brand, software program, artwork or technology that is protected by intellectual property rights. In most cases, payment is due according to the extent of use, rather than as a one-off transaction.

Technology licensing, in its simplest form, is more of a purchase-sale transaction with a variable payment model (just as you pay for the mileage of your lease car) than an alliance. However, as soon as the

technology is granted exclusively to one party only, possibly paired with knowledge transfer and further support, it becomes more like a real form of collaboration. Technology licensing occurs particularly in the pharmaceutical industry.

There are basically two settlement methods available:

- A one-off or periodical compensation for making the technology available, enabling unlimited use within a specific context, for instance within one company.
- A compensation according to usage, for instance a fixed sum for each product that incorporates the technology. This compensation may be tied to an absolute minimum, an absolute maximum, may vary with the volume.

If a party provides its own technology exclusively in return for compensation, it will want assurances that the technology will also be marketed. This so-called 'shelf clause' is discussed further in Chapter 5.

It is also important to make arrangement for the transfer of knowledge and further development support. This generally pertains to the deployment of personnel, which can be settled on the basis of working time.

Shared investment

For a shared investment, in most cases the cost estimate should be known in advance with a fair degree of accuracy. Parties must in particular agree to a cost distribution key, coupled to a user right or a procedure to share the capacity of an investment, for instance when four road construction companies jointly operate an asphalt plant.

A distinction can be made here between payment according to availability and payment according to

use. This will often be coupled to the cost structure. A warehouse will generally be calculated on the basis of availability, since this involves various fixed costs. A transportation vehicle, on the other hand, will more often be calculated based on use as being the primary source of costs.

One option is to lease the shared investment to third parties, whenever it is not utilised by the partners. This will of course require additional agreements to regulate the associated leasing efforts, but it can help reduce the effective costs for both partners.

Shell

Shell has worldwide around 1500 joint ventures for various purposes. Luc Meesters is as joint venture manager and board director involved in a number of the downstream partnerships. He explains about the financial arrangements with regard to shared investments.

“An example is the joint development of an oil pipeline from a port city inland. The refineries of various owners can benefit from such a pipeline and it makes sense to combine the demand and to build one pipeline that serves all involved. Cost of transportation are just one part of the total product cost.

In such cases a mechanism needs to be devised to split the investments and the costs associated with the operation of the pipeline. The investment costs can be divided between the participants according to the expected use of the pipeline or interest holdings. Each will receive an equivalent share in the joint venture that will own and operate the pipeline.”

Each year the actual capacity demand of each partner is added up, and a price per unit of oil transported is calculated. This price could be based on the operational costs with a mark-up for the investments and possibly a profit element. In most cases, if 50 to 100% of the maximum capacity is used, this method will benefit all partners because of the relatively low transportation costs.

If a company is an overshipper (volumes transported are higher than interest) than it contributes more than it proportionally would compared to its shareholding. In such a case, if profits would be a result of the companies' operations, an overshipper would receive only dividends in proportion to its shareholding.

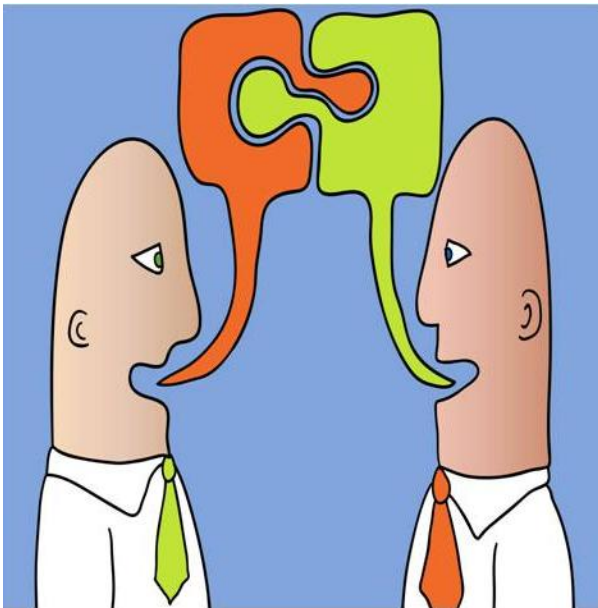
On the other hand, if only a small part of the capacity is used, the price per unit of oil transported can increase dramatically. Eventually partners may prefer another mode of transportation, e.g. by barge or by truck, leaving the pipeline unused. In that case operational costs may be cut, but there is no payback from the investment, which are sunk costs.

Alternatively, depending on the region, type of pipeline and specific requirements, the capacity could be offered to others, or not.

Luc Meesters: "In case of a shared investment in an oil pipeline, the risk of having too little demand is slight. Refineries are built for periods of more than 30

years, and up to the present the demand for fuel has only continued to grow. In other industries, however, this may be different. The obligation to purchase a minimum capacity or paying a penalty if not meeting the nominated volumes, could then be a solution to keep the costs for each partner below a specified level."

Reciprocal hiring agreement



A reciprocal hiring agreement will mainly entail agreeing to tariffs for the deployment of personnel. These tariffs can vary from a cost-plus tariff (specific salary and equipment costs, plus a bit of overhead) to regular market-level tariffs.

The costs for the coordination of the planning processes is generally borne by the party that incurs the costs.

A good example is offered by code sharing in the airline industry. This is an agreement by which two or more airlines include the same flight in their schedule. A seat can be purchased from one airline, though the route is actually operated by a partner airline under a different flight number or code. This offers greater access to cities through a given airline's network without having to operate extra flights, and makes connections simpler by allowing single bookings across multiple airlines.

In most cases, the booking systems of the participating airlines are linked to ensure the availability of seats and to provide the right price information from the operating carrier to the marketing or selling carrier. There can be various mechanisms to determine the price for the seat that has to be paid to the operating carrier. At one end this can be part of the price for the total journey, equivalent to the number of miles travelled with each airline, or it can be a fixed amount. In most cases the conditions are reciprocal. IATA, the International Air Transport Association, has a clearing house to execute the billing and financial settlement of all these inter-airline sales transactions.

Unusual supplier risk

In most cases, this form of alliance has the features of a purchase-sales transaction, but with a greater emphasis on joint management on account of the mutual dependencies. In financial terms this is mainly a matter of framing and pricing the risks, as is common in any sales transaction.

Where risks can be affected significantly by the contracting-out party, it is advisable to arrange a bonus/malus construction to ensure the parties' interests remain aligned, and to improve the consultation structure. In turn, the contracting-out party will want to incorporate some incentives to motivate the supplying party, for instance with respect to the quality of services, which has now become harder for him to control.

Various models have been constructed for this in the construction industry, such as 'Design, Construct, Build, Operate, Finance' and more joint venture-oriented approaches. Here, the 'smartness' of the design has a significant impact on the production costs. That is why a different cost allocation model may be used in certain instances, in which the total construction costs are estimated in advance, and the client and contractor jointly strive to limit the costs as much as possible, starting from the design phase (Figure 26). Cost savings and excesses are shared within certain limits.

The extent to which commissioning companies are open to the tendering of work in the form of alliances differs per country. When we look at the construction of infrastructure (roads, gas pipes, water purification facilities), this appears to be quite common in the United Kingdom. In the Netherlands, the Ministry of Finance has set up a knowledge centre about public-private partnerships, and this approach is gradually

becoming more familiar. In Germany the commissioning party tends to divide the work into small functional parcels, in order to contract these out at the lowest possible cost.

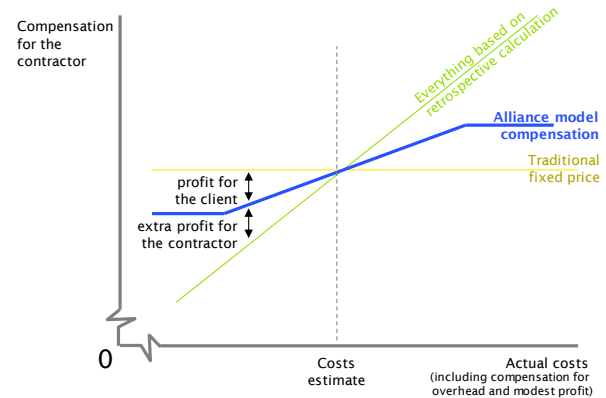
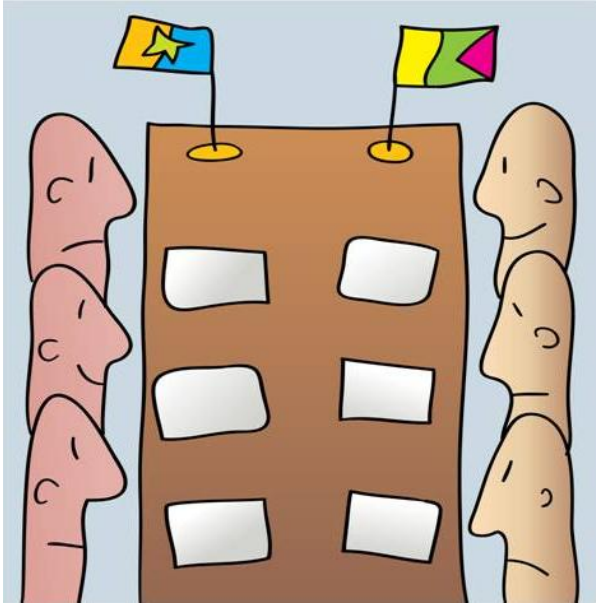


Figure 26. Cost allocation model used in the construction industry, which encourages the contractor to also consider design and environmental factors.

It is good to consider that there may be more ways to structure each of the forms of alliances, described in this chapter. In principle, the possibilities are countless. However, one might do well to strive for a simple structure that can be explained easily to all involved in the alliance. A simple structure will limit the effort necessary to draw up a contract as well. The next chapter will cover some aspects of the formal agreement

5. The formal agreement



In the previous chapters we focused on the creation and distribution of value. A collaboration between two or more parties will eventually be laid down in an agreement. The purpose of the collaboration and the distribution of revenues and costs are important inputs for the contract. This chapter will delve deeper into some general aspects that can apply to various forms of alliances.

Process

Even before engaging your partner in dialogue, it is important to consider the possible legal aspects. As indicated in Figure 27, there are three important

occasions in which the advice of a legal expert or contract specialist is important:

- When formulating one's own strengths, competences or resources: in how far have knowledge, brands or documents been established and protected? Has the confidentiality of knowledge that cannot be protected been arranged well?
- When entering talks with the other party: will a declaration of confidentiality be signed? What would this declaration reasonably cover, and what not? And in how far are the agreements in such a declaration enforceable?
- When fleshing out the collaboration in a contract: which legal form do you choose? What will you formally arrange, and what not? In how far do you take account of new possibilities and patents?

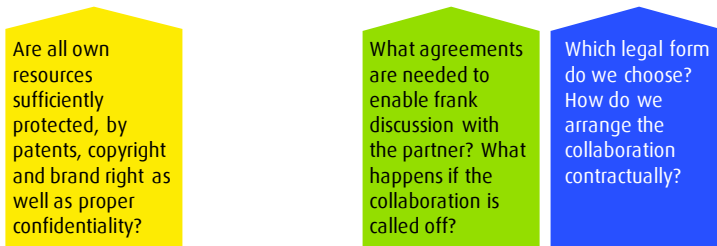
This chapter focuses on third point in particular.

In any collaborative process, it is important to keep legal aspects in mind from the outset. However, this is not to suggest that you should bring along a lawyer to your first meeting, certainly not in an equivalent situation within the same country. If the situation involves a partner abroad, then it does make sense to formulate a protocol in advance to create equivalence, by agreeing which company staff will engage in consultation, and by choosing a negotiating language that both parties can use with equal ease. The same applies for the law to which the agreement will be made subject.

Process



Legal aspects



agreement to lengthy documents. In most cases these agreements are very general, without any sanctions. Drafting an NDA with a clear sanction, for example a fine of 10,000 dollars in case of a confidentiality breach, shows distrust at a moment where parties trust each other just enough to start negotiations. It is important to balance an NDA and to find the right tone of voice, because an aggressively put agreement can damage the collaboration.

Figure 27. Contractual aspects in the process of arriving at a partnership

It makes more sense to first let the discussion be conducted by those that actually stand to benefit from the returns, meaning an executive board member, the business development manager, or the marketing manager. They can then work toward what is known as a 'deal sheet', which lays out in everyday (non-legal) language all the important arrangements such as contribution, authority, distribution of costs and revenue, and so on.

As soon as the deal sheet has been finalised and approved by both sides, the parties' legal staff can convert it into a contract that also arranges matters such as liability, dissolution following bankruptcy, and applicable law.

A remark on the confidentiality agreement or Non-Disclosure Agreement (NDA): There are various models available, ranging from a one-page reciprocal

Contract or joint venture

An important choice to make when fleshing out an alliance is whether it will take the form of a contractual agreement, or of a shares transaction (which includes a joint venture). Both options come in several varieties (Figure 28).

For a contract between parties, without forming a new legal entity, we can distinguish between:

- a unilateral agreement with a clearly defined use of the other party's resources, such as a licensing agreement, an R&D agreement or distribution agreement; and
- a bilateral agreement, in which both partners contribute resources to the collaboration, such as a marketing alliance, production alliance or an optimised customer-supplier relationship.

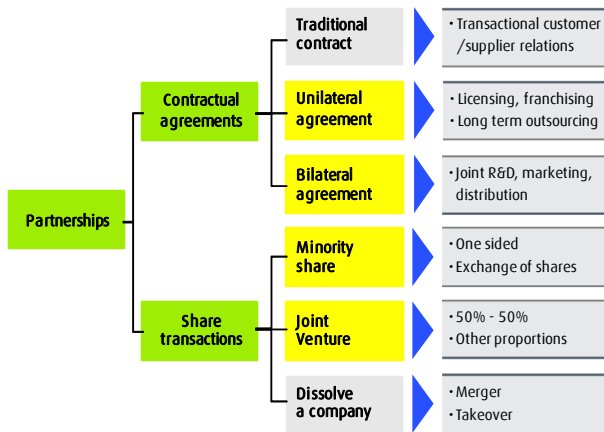


Figure 28, Different legal forms of collaboration

For a shares transaction we can distinguish between:

- a minority stake taken by one the partners in the collaborative partner, or a share swap in which the parties exchange shares;
- a separate new legal person in which the collaborating partners are shareholder, commonly known as a joint venture.

Depicted in this way, an alliance resembles a half-way house between two independent parties engaged in a traditional contract or a merger or takeover, but research has shows that alliances between companies rarely result in such a merger or takeover³³.

The term Joint Venture is frequently used to describe a collaborative business. However, the term does not have a legal status in all countries. It can be a regular company with shareholders and limited liability, where the shares are distributed among the partners. This is the way it is used in this book. In other countries it can be an entity without the possibility to hold assets, where the partners are both liable for

losses incurred by the alliance. The structure then resembles a contractual arrangement.

In all four cases (unilateral and bilateral contract, minority stake and joint venture), the point is for the companies to find a way to gain access to the partner's valuable resources without losing control over its own.

The scholars Das and Teng contend that the preference for the type of collaboration depends on the type of resources contributed by the two parties³⁴. Are these:

- material resources that cannot be copied, such as money, production means, personnel, distribution channels and patented knowledge; or
- knowledge-based resources that can be copied, such as work methods, market information and databases?

The most likely preference depends on the combination of resources contributed by parties A and B, as represented in Figure 29.

		Company B	
		Material resources	Knowledge based resources
Company A	Material resources	Preference by A and B for unilateral agreement, in which use of resources is compensated	Preference by A for a joint venture: here knowledge is shared most quickly
	Knowledge based resources	Preference by A for a minority share in B to retain control over own knowledge	Preference by A and B for bilateral agreement: detailed arrangements can be made about knowledge sharing

Figure 29, Most likely preferences regarding type of alliance, from company A's point of view

If both parties contribute their resources to a joint venture, then that's where knowledge exchange occurs immediately. After all, the parties involved share one primary goal: to make sure the joint venture is successful. This is to the advantage of the partner that contributes the least amount of knowledge-based resources, in this case company A.

Since 2008, the British beverage company Diageo is the exclusive market supplier of the vodka brand Ketel One, especially in the United States. For this it paid 900 million dollars to the Nolet family, who remain owner of the brand name Ketel One. Diageo and the Nolet family transfer the sales rights into a joint venture in which both parties hold a 50% stake.

The agreement is set up based on the interest of Ketel One: this company owns most material resources, namely the sales rights, which give exclusive access to the underlying production company. Diageo owns most knowledge-based resources: namely, relevant market knowledge. The sum paid by Diageo should mainly be seen as compensation for 50% of the sales rights, meaning 50% of the profit.

If, on the other hand, company A contributes the most amount of knowledge-based resources and partner B more material resources, then A will have a preference for a minority share in the collaboration partner. This is the best assurance that the partner will not misuse the knowledge acquired in the course of the collaboration. Should this nevertheless occur to any substantial degree, then the share will anyway be worth more.

In 2010, General Electric Oil & Gas obtained a minority share in Shenyang, China's leading compressor manufacturer. For General Electric this gave further access to the Chinese market, a hard-to-obtain resource that Shenyang could provide. For Shenyang

the technology of General Electric was important, which is less easy to protect in a collaboration. Through its minority share General Electric receives at least part of the extra value that the collaboration generates.

If both parties contribute mainly knowledge-based resources, then the effect of the alliance will decrease following a first learning period. Both parties will want to arrange the best possible protection for their own knowledge, and that they can use newly developed knowledge. A bilateral agreement is the most obvious option here.

CMS law firm has concluded an agreement with The Levant Lawyers, the largest lawyers' office in Lebanon. "There are important opportunities for the further development of our activities in the Middle East", says CMS's Bob Palmer, partner for Energy and projects. Emile Kanaan, chairman of The Levant Lawyers, comments on the initiative: "We are very pleased with the collaboration with CMS. Thanks to this, we can offer our clients access to some 2500 lawyers and the most extensive network of law firms in Europe".

CMS and The Levant Lawyers each offer the other access to clients in their own region. The parties can also acquire knowledge about doing business between the regions. All relevant aspects can be arranged in a bilateral agreement, in which the two parties have an equal position.

If both parties mainly contribute material resources, then unilateral agreements seem most appropriate. Such agreements will arrange, for example, the use of distribution channels, patents or other scarce resources in return for money or services.

At the end of 2010, 3M Drug Delivery Systems signed an exclusive licensing agreement with Spirig Pharma

AG, a Swiss manufacturer of dermatological and dermocosmetic products. Spirig Pharma AG will utilise one of 3M's immune response modifier (IRM) molecules to further its development of treatment for sun damaged skin. In this case just a unilateral licensing agreement is sufficient.

The choice of organisation form has a direct influence on the behaviour of both parties. If it is both parties' objective to develop a large amount of new shared knowledge, for example, then a joint venture would be the obvious choice, despite the fact that a joint venture implies greater overhead costs (notary, accountant, and so on) and will demand more time in terms of reporting and governance.

KLM-Northwest

The KLM-Northwest alliance dates back to 1989 and was one of the first alliances in the airline industry. Although KLM has since merged with Air France and Northwest with Delta Airlines, the alliance still exists and remains successful. Henk de Graauw, until 2010 Director Alliances for KLM, clarifies the different types of alliances and their benefits.

"KLM actually has four types of alliances. With suppliers such as General Electric, for the maintenance of aircraft engines, even to serve other airlines; with retail partners such as American Express, for the combined credit and frequent flyer card; with providers of other modes of transportation, such as our 10% stake in the high speed train to Brussels, which we incorporate into our product as an alternative to a flight; and most important of all, horizontal alliances with our competitors."

The horizontal alliances vary in intensity. First there is the more tactical collaboration on a route between two airlines that need not even be in the same alliance. The main objective is code sharing: one airline sells a flight and buys the transport capacity from the other airline.

The international association of airlines, IATA, has rules for this inter-airline billing and provides clearing services. In general, if a ticket is sold for a flight

involving more than one leg, the revenue will be split according to the miles per leg, with a certain minimum price per mile for the partner that is delivering the half-product.

The collaboration is extended to other aspects in the case of the three large airline alliances: Skyteam, OneWorld and Star Alliance. Within these alliances there are special inter-airline billing agreements which have a larger extent of revenue sharing. In addition, airlines jointly invest in lounges, align frequent flyer programmes, and collaborate in marketing and sales.

The three alliances differ with respect to their exclusivity policy. Members of the Star alliance are prohibited from code sharing with airlines from outside the alliance. The Skyteam members are relatively free to do so, as long as it does not harm the interests of other Skyteam members. OneWorld is a very open alliance and has the most code sharing with airlines outside the alliance.

As collaboration with a partner on a certain route intensifies, new problems tend to arise; for example the question of who should invest in extra capacity? Or in adverse times, who should be the one to keep its airplanes grounded?

One solution is to create a virtual joint venture. This means that both parties bring in the costs of their aircraft, personnel and support operations, which are split along with the revenues. The assets themselves remain with the partner companies.

KLM – Northwest was the first transatlantic alliance, followed by Lufthansa partnering with United and then British Airways with American Airlines. These kinds of alliances are closely monitored by the competition authorities. It is not permitted to have more than 80 to 90% of the business between two cities; there should always be reasonable alternatives. Most alliances are therefore created for long-haul routes. It helps if it is clear that the customer benefits as well, for example from a better choice of flights spread throughout the day.

These joint ventures may incorporate incentives to sell connecting flights for the partner. These are always combined with the revenue management systems of both airlines to ensure a suitable mix between early bookings against a lower price and high-priced last-minute bookings.

In the case of the KLM – Northwest alliance, both partners have closed down their own sales offices in the other party's home market. The joint venture has its own revenue management system.

Henk de Graauw: "It is important to have a 50%-50% joint venture. This makes it easier to settle costs and revenues, and it is more motivating for the personnel. Such alliances are generally for the long term, and a great deal of investment goes into making processes work. The structure should be reflected in the governance of the partnership: it's not a good situation if one party has more influence than the other."

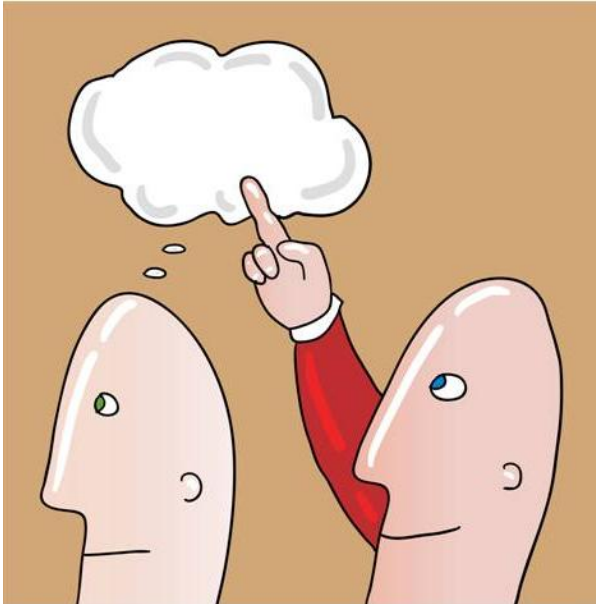
De Graauw does not believe the new airlines in the Middle East will join one of the three alliances soon. "First of all their benefit is not that clear: they hardly have a home market, in contrast to the airlines that founded the three big alliances. Their set of destinations is more competitive than complementary with those of the three big alliances. And second, these state-owned airlines have a different business model and investment pace."

In 2009 Skyteam changed its organisational structure, making the decision-making process more centralised. Up until then there were a lot of working committees with rotating chairmen. When Leo van Wijk left KLM he was asked to remain chairman of Skyteam, and an office near Amsterdam Schiphol Airport was created with a managing director and four vice-presidents, to safeguard the continuity of the working committees. The managing director reports to the Skyteam Supervisory Board, with all the vice-presidents for alliances of the airlines.

Star Alliance has had such a centralised structure for a longer time. There is an office in Frankfurt with more than 120 staff members and an ex-SAS CEO as chairman. OneWorld recently established a support office in Vancouver.

What does Henk de Graauw anticipate for the future? "The structure with the three large alliances will remain. There might be potential for a fourth alliance in Asia, but I think the changes in membership will be driven by mergers and bankruptcies. I predict those mergers to first take place on a national scale, and then within an alliance. Airlines within an alliance are already better aligned at an operational level."

Intellectual property



Patents that can be filed as a result of collaborative knowledge development form a special category of returns. A patent is a set of exclusive ownership rights that a public authority awards to an individual or company in exchange for the publication of the details of the discovery or invention. This publication is mandatory with a view to advancing the state of technology. A patent gives the right to prevent others from making, using, selling, offering to sell or importing the discovery, in the country where the patent applies. Most patents are effective from the moment of publication and for a maximum duration of 20 years after the patent application.

In most countries, patent rights are awarded to the party that first files the patent application, provided the discovery or invention has not already become public knowledge (through use, sale, or any form of

publication). Regarding a discovery or invention made in employment, the ownership depends on the employment conditions and whether the making of the discovery or invention is part of the employer's tasks. Thus, the inventor does not necessarily become the owner of the patent.

If the collaboration between two parties results in the development of new knowledge (for instance in an R&D alliance) for which a patent application is filed, then it is important to have determined beforehand how to go about it. If the patent is filed under both companies' names, they will jointly have to decide about its use or licensing.

It is wise, in this respect, to distinguish between the ownership of the patent and the right of use. It can be arranged contractually that the ownership remains with one of the partners or with the joint venture, and that both partners (and possible merger partners and group companies) have the right to use the invention, but that it requires the consent of the other party to resell the invention or to license it to a third party.

Moreover, some patents build on earlier patents; for example a medicine that is dependent on a patented production method. This is also known as background knowledge. If this is relevant to the collaboration, then it has to be arranged how to deal with such background knowledge, if this knowledge was developed previous to or outside the partnership. It could be that this knowledge derives from a third party, which means that its use needs to be arranged carefully to avoid being held liable for breaching patent rights.

Finally, one should consider how to deal with patents that have been developed as part of the collaboration, but that do not support the goal of the

collaboration, and for patents that are filed after the collaboration has been terminated.

Most parties that regularly file patent applications will have their trusted specialists to conduct the negotiations. For collaborations in which patent applications are less a matter of course, the ‘Intellectual property needs matrix’ by Slowinski and Sagal can offer some basic guidance³⁵. This matrix is elaborated for a joint venture in Figure 30.

	Patents developed previous to partnership (background knowledge)	Patents developed during partnership (foreground knowledge)
Within the context of collaboration	Patents remain with A and B, free use within the joint venture	Patent becomes property of joint venture, free use for A and B for the designated goal
Outside the context of collaboration	Use right for the partner if the developed patent builds on former patent	Patent becomes property of joint venture or of the partner to whose business the patent applies, but free use for the other
After termination of collaboration	Previously awarded use rights remain in place	New patents owned by A or B, free use of patents developed in the joint venture

Figure 30, Possible arrangements for patent rights in a joint venture

Figure 31 outlines the arrangements for a contractually arranged collaboration. The main difference is that, in this case, there is no shared company to which the patent rights can be allocated.

	Patents developed previous to partnership (background knowledge)	Patents developed during partnership (foreground knowledge)
Within the context of collaboration	Patents remain with A and B, free use for the partner if a patent developed in collaboration builds on a previous patent	The patent ownership remains with the one that actually discovered it, but free use right for the partner
Outside the context of collaboration	In principle no use right, but paid licence is possible	Ownership with A or B, no use right for the partner
After termination of collaboration	Previously awarded use rights remain in place	Previously awarded use rights remain in place

Figure 31, Possible arrangements for patent rights in a contractually arranged collaboration

Four complicating factors

A number of complicating factors may crop up while forming an alliance. Four such factors, which are irrespective of the type of alliance or its legal form, are discussed below.

Difference in size



Whenever a smaller company collaborates with a larger company, chances are that the collaboration carries much more significance for the smaller one. This places it at risk of being neglected or overshadowed by the larger company. A change of management in the larger company can even mean a loss of all interest in the collaboration.

The larger company, meanwhile, faces a different risk: it is likely that the knowledge and commitment of the smaller company strongly depends on just a

handful of people. If any of these should leave the company or lose interest, this may jeopardise the collaboration. The smaller company may also lack the strength or scope to go along with new developments or market changes, which can also devalue the collaboration.

These issues generally play a role if the difference between the companies, in terms of turnover, staffing and size, exceeds a factor of 10. This is not an absolute figure. Doing business with an autonomous business unit of a large multinational can be very like doing business with a small company. And a high-tech company with 20 people on the payroll will often be a much stronger partner than a production company with 20 employees.

As a 'standard' example, consider smaller technology firms that may have just one or a few products, but with which they truly contribute something new to the market. Such companies often consist of the founders plus a few others, and they lack the size and skills to commercially exploit their product. Here, collaborating with a multinational is an obvious option: it gives the larger company access to technology, and gives the smaller company access to the market.

However, the companies' interests may differ. For the technology firm, the product for which the alliance is set up may yield the lion's share of their turnover. For the multinational, the added revenue may basically be negligible. Certainly if the manager (at the multinational) who made the deal leaves or makes an internal career move, the technology company may wind up in an impasse: the exploitation rights have been sold but are not generating any income, due to the larger company's lack of interest.

From the smaller company's perspective, the best solution would be to make clear arrangements about

interim payments and the use of the provided expertise. Every bit of knowledge transfer should be met with immediate reward, at least partly. This reward can be payment for a patent or an hourly tariff for the deployment of experts. In addition, a success fee may be arranged for every successful market introduction.

The smaller company cannot force its partner to market a product containing its expertise. For that reason it makes sense to couple any exclusive agreement to a 'shelf clause'. This means that, if the product development does not result in a market introduction within a predetermined period (that is, is shelved) or does not achieve a certain sales volume, then the smaller party is free to offer its patents and experience to another party.

That this is something to take seriously was a lesson learnt by the British smartphone company Sendo, that entered into an alliance with Microsoft in 2000. Sendo had advanced quite a way in developing a telephone suitable for Internet applications, the Z100, and Microsoft was developing software for it. The agreement stated that the Z100 would be developed further jointly, and that Microsoft would receive part of the profit.

In 2001 Microsoft invested 12 million dollars in development, and was entitled to appoint a supervisor to the Sendo board. From that moment on, the development of the Z100 started to lag behind. Sendo claimed that Microsoft was secretly scheming to rob the company of its technology, market knowledge and customers. In 2002 Microsoft entered into an alliance with another company to develop a product comparable to the Z100. Sendo and Microsoft wound up in a drawn-out court case, and the Z100 disappeared from the market.

For the larger company, it is important to have assurances with regard to the efforts and availability

of the smaller company's key staff. This can be arranged, for instance by coupling this to a bonus or by making the payment of compensation conditional on their contribution.

More than two parties

Working with three or more parties introduces a new sort of dynamic in an alliance, certainly if these parties decide to collaborate in a new legal entity. In the latter case, it may happen that the majority makes a decision that is unfavourable for the minority. This is comparable to an association that decides to raise the contribution fee to finance new investments. Members not interested in those new investments will have to contribute regardless, or else must relinquish their membership.

There are two mechanisms that can reduce the chance of such decisions being made:

- First, the statutes of the new legal entity or a separate agreement can stipulate that certain decisions require a larger majority or unanimous consent; for instance, decisions that will change the scope of the collaboration.
- Second, there will always have to be some sort of equilibrium between the partners. If a decision clearly disadvantages one of the participants, he may decide to quit the collaboration or may start exhibiting opportunistic behaviour.

Working with three or more partners often bears features similar to working in a network (see Chapter 3). A collaboration between competitors will generally have a very formal and transparent structure. If it concerns complementary parties, it is customary for one of the parties to shoulder the coordination.

Small companies

Increasing numbers of knowledge workers are offering their services as an independent one-person company, or with just one or two co-workers. It is particularly attractive for this category of companies to collaborate as it will enhance their profile on the market and enable them to bid on large assignments.

However, the downside is that formalising a partnership is a comparatively larger burden for a small company than a large one. They will often lack experience with such contracts, let alone have a lawyer in employment. Fiscal aspects will need to be examined, regardless of how big the deals are. Furthermore, in smaller companies this kind of investigative work is prone to getting snowed under by the day-to-day operational activities.

It is therefore important for small companies to use a standard organisation form to arrange governance, finances and liability. Practical aspects of the collaboration such as consultancy structures, marketing, household regulations and administration will often be taken care of as part of the group dynamics.

In the Netherlands, Alliance experts has set up a collaborative structure for solo entrepreneurs in the form of a cooperative. This legal form is used infrequently, but it does offer a means of letting members enter and exit the collaboration without requiring a notary. Every member has an equal say in governance and receives a share of the profit proportionate to the amount of work that he or she performed through the cooperative. The cooperative concludes the contract with the client and arranges the execution of the assignment with one or more members. More than 25 cooperatives have been set up in this way within the span of one year.

Public-private partnerships



So far we have examined collaborations between two or more private organisations. But what if the opposite partner is a government agency or public institution, a school or a hospital, or a research institute? It may well be that businesses view such organisations as inward-looking, bureaucratic and difficult to work with. Conversely, the public sector may see collaborating with the business sector as something akin to selling your soul to the devil.

A great deal of knowledge, influence and customer contact is contained within public organisations. A window cleaning firm with a recommendation letter from the municipal authority will more easily find customers within that municipality. Furthermore, public organisations also have their markets and objectives, except that their primary objectives are often of a non-financial nature. Citizens' satisfaction, safety, quality of life and ensuring an attractive neighbourhood are typical examples. Finances form a necessary condition here, and this is where opportunities for collaboration may be found.

Whoever is able to arrange a collaboration in such a way that it helps the public organisation fulfil its goals more successfully, or can ensure that extra funds remain to devote to quality improvement, has a good chance of engaging a public entity in such collaboration. The point is thus to pursue parallel objectives.

The organisation form for a public-private partnership can be a new legal entity, but in many cases the public organisation assumes a facilitating role while the business performs the activities. A public authority may, for example, sell land to a project developer and set certain parameters for the development of a new housing estate. Or, a group of primary schools may refer parents seeking after-school care to a specific commercial child care centre. In such instances, an arrangement concerning financial settlement may suffice.

Hago

Hago is a contract cleaner with approximately 9000 employees. It is part of the Vebego concern, active in facility services and cleaning, and employing some 35,000 people worldwide. As contract cleaning is a competitive industry, most of the Hago business units have an operational excellence strategy. Everything is focussed on reducing the time required to clean an office, classroom or shopping mall.

There are exceptions: Hago Healthcare, with around 1000 employees in the Netherlands, strives for customer intimacy. Carola Put – de Vreugd, manager of the Vebego/Hago-St. Jacob joint venture JacobSchoon, explains why: “In healthcare the cleaner does more than just clean the room of a patient or elderly person. Making beds, supporting the care process, flexibility in planning and interacting with the people is part of the job as well. The difference between cleaners and nurses is limited from the point of view of the clients. The only challenge with this strategy is to recruit and train the right people for these low-paid jobs.”

Carola used to be facility manager at St. Jacob, a nursing organisation with 1500 clients and 1500 employees across 8 locations. St. Jacob aims to provide experience-oriented and demand-driven care, under the motto ‘remarkably close’. The strategy is to focus on the core business, which is the care, and to arrange all other aspects in partnerships. The joint venture with Vebego/Hago is the first result of this strategy.

As facility manager, Carola Put – de Vreugd was one of the members of the outsourcing team, and she became enthusiastic about Hago. When the agreement with Hago was finalised, she applied for the job of joint venture manager, which was to be fulfilled by Hago in close consultation with St. Jacob.

The joint venture, as well as her job, started in June 2010.

The alliance is structured as a Limited Liability Company where Hago holds 49% and St. Jacob 51% of the shares. Employees from both Hago and St. Jacob are seconded to the new company but remain on the payroll of the respective organisations. The necessary assets, such as cleaning machines, are transferred to JacobSchoon

One of the reasons for the alliance was that a tax advantage could be obtained. As a public institution, St. Jacob could not reclaim the Value Added Tax that it paid, but the JacobSchoon could. However, while the negotiations were ongoing, the government lowered the VAT percentage on cleaning services from 19% to 6%, which somewhat undermined the original purpose and hampered the decision process.

The other reason was to professionalise the cleaning activities with the techniques that Hago brought in, such as cleaning with a microfiber cloth instead of with water and soap. Hago personnel were better trained in terms of speed than the St. Jacob cleaners, but would still have time to spend a few minutes on social interaction.

The target setting for a more efficient work method was to achieve a 2.2 million euro savings. This was one of the major items during the negotiation process, along with the tariffs for extra work. Hago and St. Jacob arranged to both invoice the activities of their workers to JacobSchoon, the only difference being that St. Jacob invoices the actual hours worked and Hago the scheduled hours. This allows Hago to make a better profit by working more efficiently. The parties also considered transferring the St. Jacob employees to the payroll of the joint venture.

However, this turned out to be a complex operation with relatively large salary increases. It was agreed that over time the percentage of St. Jacob workers will decrease. The division of shares in JacobSchoon will remain unchanged, on account of the fact that St. Jacob wants to retain control.

So far, the results of the alliance are good. There is hardly any issue between the employees about the difference in salary between Hago and St. Jacob cleaners, the sickness absenteeism rate is falling, and everyone concerned is satisfied.

The challenge for Carola Put – de Vreugd is to optimise the financial results of the alliance: Hago was already used to charging all the costs it incurs,

and now St. Jacob is getting used to this process as well. At some locations the cleaners help with the care process while the nurses share in some cleaning activities. This needs to be worked out better. Activities that were not considered during the negotiations, such as floor maintenance, are opportunities for extra work.

Carola explains: “There was already a strong measure of trust between St. Jacob and Hago. That made it possible to forge the alliance in a short time. No other parties were considered, except for another division of Vebego that could perform some extra care tasks, but this did not suit the philosophy of St. Jacob. The mutual trust provided a perfect start for the joint venture JacobSchoon.”

Termination of the alliance



In some cases a collaboration will end upon the completion of a project. Apart from possible shared guarantee obligations, the bond between the partners is dissolved. In most cases, however, it cannot be envisioned clearly beforehand when a collaboration will cease to exist.

This means that two matters have to be arranged:

- It needs to be clear who can end the partnership: each partner individually, or only by all partners jointly? If no arrangements have been made, then generally the latter case applies.
- If the alliance is terminated, it needs to be clear what happens with the possible reserves, debts, patents, rights and obligations. It could be that one of the partners wishes to continue the activities and wants to buy out the other. Various regulations exist to facilitate this process.

While a partnership involving natural persons runs the risk of one of the partners passing away, in a partnership between businesses there is the risk of one of the partners going bankrupt. Also for that situation, the continuation of activities needs to be arranged properly, for instance by arranging to transfer the patents to the surviving company.

One of the most important aspects to consider is what risks you run that could lead to a termination of the collaboration, and what you can do to guard against that. The product or service that you have developed may fail to generate interest. If you are the one contributing the concept (preferably protected by a patent or copyright), are you in a position to switch to a partner with more marketing power without incurring excessive costs? Or if you're the bigger company considering collaborating with a small inventor, what will happen if you run into a dispute, or if his venture collapses? Does it mean you lose your entire investment, or can you acquire the patent for a small fee? Since there is no legislation on this point in many countries, you are free to make your own arrangements in a contract.

An important tool to help settle disputes and prevent a premature exit is to appoint what is called a 'contractual board'. This board is composed of representatives of both parties, that all have equal voting power. All parties thus need to come to an agreement in this board in order to take a valid decision. In a joint venture this board may coincide with the shareholders meeting. For two small companies it may simply consist of both owners.

The competences of the contractual board should be laid down in the collaboration agreement, and may range from defining the research or marketing budgets to appointing the daily operational management of the partnership. The board members can also address opportunistic behaviour exhibited by one of the partners. If the contractual board fails to reach agreement, the next step would be to call on mediation by a neutral third party, or to dissolve the alliance in accordance with the provisions of the collaboration agreement. The simple fact that this possibility exists without it being necessary for one of the partners to have committed a real breach of contract, with all the ensuing damage to reputation and lost opportunities, is often enough to desist a partner from engaging in opportunistic behaviour³⁶.

Precisely which rights you can negotiate depends primarily on your dependency on the alliance, and the value attached to it by your partner. Many biotechnology firms develop components for medicines and enter alliances with pharmaceutical companies that will market these products. An analysis of a large number of alliances indicates that the distribution of revenue is more favourable for the biotech firms to the extent that their products are more successful, and the medicines have been developed further. Pharmaceutical companies receive a larger share to the extent that their product portfolio is healthier, meaning that they actually have less need for a new medicine.

Conclusions

Alliances can play a significant role in the pursuit of company strategy. The type of strategy through which a company seeks to stand out in the market will generally determine the most suitable form of alliance.

This book took three generic strategies as point of departure. These types are based on work by Porter and Treacy & Wiersema, but have been elaborated further with a view to the changing circumstances over the past decade; primarily the immense increase in the accessibility of information and availability of capital.

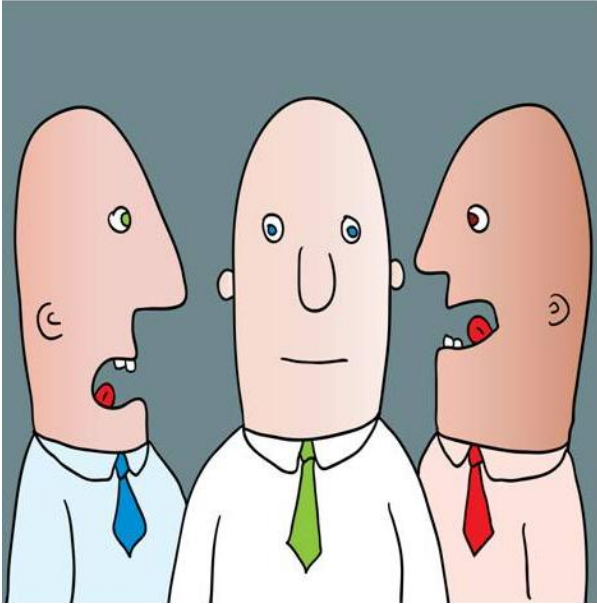
In each case, the principal concern is value creation and the distribution of the added value of collaboration among the participating partners. Alliances that seek to enhance the relevance of a business for its customers often apply a profit-sharing mechanism based on the additional sales or extra margin. For alliances devoted to developing unique products, the cost distribution is generally quite clear, the principal issue being the ownership of intellectual

property rights. For alliances geared to achieving cost advantages, splitting those advantages is often a simple matter.

The various cases demonstrate that an alliance often comprises several areas in which the partners collaborate. By analysing collaborative ventures in terms of several basic types, it becomes easier to establish cost and profit allocation mechanisms. This helps standardise the process of forging an alliance, which contributes to the main aim of this book: to facilitate companies wishing to enter into alliances.

Clarifying the goal of an alliance and elaborating a mechanism for the distribution of costs and revenue is the first step in drawing up a contract. Chapter 5 explores a number of other important aspects. Though each alliance is unique, the underlying contractual provisions are often much less so. Here lies a subsequent challenge towards the standardisation of processes, which would make the use of alliances as a competitive instrument even more accessible.

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