KPMG

TRANSACTION SERVICES

Alliances and Joint Ventures

Fit, Focus, and Follow-Through

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Introduction

Strategic Alliance Definition

A *strategic alliance* is a cooperative arrangement between two or more organizations designed to achieve a shared strategic goal.

There are two general types of alliances: Equity-based and non-equity based.

Equity-based alliances include minority stock investments, joint ventures, and at the extreme end, majority investments.

Non-equity based alliances tend to be governed primarily by a contractual arrangement that specifies the responsibilities of each party, the mode of operation of the alliance, and the considerations involved in expansion or termination.

Source: Professor Harbir Singh, the Edward H. Bowman Professor of Management, Wharton School, University of Pennsylvania

At a time in the global marketplace when business alliances are a popular engine for growth, executives are faced with a challenge: whether or not to invest in sharpening their alliance management capabilities. Whether these collaborations are the more rigid and longer-term joint ventures or the often shorter-term and less rigid strategic alliances, they can be an effective and powerful tool to leverage stronger or complementary capabilities with other organizations. This paper is focused on the factors that matter for success. The goal of this paper is to present a current research-backed view to stimulate dialogue about when and how to use the alliance option.

Recent interviews for this paper, continuing literature research, and our member firms' experiences suggest that the importance of collaboration in today's global economy is increasing. Many large corporations are involved, at any given time, in dozens of alliances. In fact, today it is the norm rather than the exception. Looking ahead, all indications are that strategic alliances and joint ventures will become an increasingly important strategy for profitable growth.

Expansion of scale and scope by competitors is forcing a response and driving more expansion and alliances. An Association for Corporate Growth survey reported that 97 percent of corporate development executives saw the use of alliances increasing in their corporations, and 82 percent of the executives said alliances are an effective means to accelerate growth.[1] In the past 20 years the amount of revenue produced as a result of alliances has increased at least tenfold.

Studies have shown that the increase may be due in part to the view that return on investment (ROI) for alliances has been higher than the ROI of the individual corporations involved in the alliances. Another reason may be that many mergers and acquisitions deals can be very costly, and when they fail, the acquiring company alone bears the brunt of loss.

There may also be a growing realization in certain sectors that there is not a sufficient stock of good acquisition targets to satisfy growth expectations. Alliances offer an alternative way to grow and to obtain specific knowledge that would be very costly or time consuming to achieve alone. The nature of an alliance demands cooperation and trust. And, it is often designed to share risk. We expect that world economies will continue to be highly uncertain, and in this environment, alliances should have a special appeal to executives across the globe.

Expanding pressure to grow, strong competition, continued opening of world markets, and the increased popularity of outsourcing all suggest a need to collaborate at high speeds and at high rates of success. As we enter the next period of global growth, there is the opportunity, or maybe even necessity, to ask a critical question: "Is collaboration through alliances or joint ventures an organizational capability essential to your growth strategy?" If the answer is yes, then it is essential that businesses determine if they possess the skills and the discipline to choose which kind of alliance makes sense for them.

The reality is that many alliances fail to live up to expectation. Over the years, studies frequently find that nearly 40 percent—perhaps even more—of alliances fail to meet expectations.

In preparing this paper, KPMG International combined research from three sources: (1) interviews with corporate managers responsible for alliance/joint venture (JV) management; (2) secondary research on business literature, and; (3) and KPMG member firms' professionals who work with clients directly on their alliances, JVs, and acquisitions.

Listening to and analyzing research input presented three major themes, which reflect the essence of what matters most to success with alliances and joint ventures: Fit, Focus and Follow-Through. The paper will explore each in turn.

- **Fit** – picking the right approach to match your strategies and capabilities
- **Focus** – creating clear and shared priority, purpose, and ownership
- **Follow-Through** – monitoring the right drivers and adapting successfully

Fit – The Right Strategy

The key is having a good process to take all variables and alternatives into consideration when making strategically important choices to partner.

Fit is all about alignment—aligning the right partnering approach to meet strategic needs and aligning the right organizational capabilities to execute effectively. Our research consistently pointed to two factors to get right up front. First, pick the right approach—when to buy, when to joint venture, and when to ally. Second, ensure that organizational strengths and capabilities are aligned with the approach. If the strategic focus shifts from operational excellence to innovation-based growth, the skills, mindsets, and processes will also need to change with it.

A critical aspect to the "right partnering approach" is choosing the right growth or improvement mechanisms—be they acquisitions, alliances, or joint ventures—and maintaining a balanced mix that best intersects with a company's strategy and capability.

In our member firms' experience, and in the research literature in this area, we see that most companies don't properly compare alternative forms of structure and ownership in executing a growth strategy. Many companies "take over firms they should have collaborated with and ally with those they should have bought, making a mess of both acquisitions and alliances."[2] That same study found that 86 percent of 200 companies surveyed reported not having developed any specific guidelines or criteria for choosing between forming an alliance with and acquiring a potential partner.

The process of choosing the best alternative has become more complex in the last year. There are recent regulatory factors that now must be considered in choosing the alternatives. Accounting changes in the treatment of goodwill from an acquisition, and the Sarbanes-Oxley reforms and regulatory requirements, both place pressure on organizations to make the right choice between ownership forms. However, the fundamental strategic purpose for the chosen alternative should be the starting point. If your business wants control, then an alliance would probably lead to friction. If there is a high degree of risk involved, it may be strategically preferable to ally.

Apollo Metals in the United Kingdom uses joint ventures and strategic alliances as tools to create flexible teams to rapidly take advantage of opportunities, according to Will Clare, development director. "You do not have to actually expend any cost or energy other than jointly trying to pursue the opportunity. Whereas if you go the acquisition route and you don't actually achieve what you're attempting, then you end up with some significant acquisition costs and risks."[3] The major appeal of alliances for Apollo is in "the flexibility and the ability to make quick decisions and grab opportunities when they arise."

Each industry and each company will have a different strategic intent and set of competitive conditions. The key is having a good process to take all variables and alternatives into consideration when making strategically important choices to partner. Deciding on whether to form a strategic alliance or a joint venture is only a start to the decision process. It is critical for organizations to focus on increasing their competitive capabilities so they may collaborate effectively beyond their own four walls. A business looking for a partner must be able to honestly assess whether it has the requisite competencies and structures, both internally and within its partner, to successfully implement its chosen strategic approach. These factors do require effort and extra discipline to touch the bases to choose a strategy that will bring success.

Focus – The Right Partner, Purpose, and Priority

Due Diligence and Potential Partners

When selecting a partner, due diligence ought to focus on:

- Reputation and financial stability of your potential partner
- Capability/compatibility of top managers
- Quality of assets/liabilities contributed to the venture/alliance and working capital management
- Quality of the related revenue and earning streams and cost drivers (historical and prospective)
- Quality of financial, accounting, management, and production controls and systems
- Organization fit (integration risk assessment)
- Customer analysis and market assessment/strategy
- Tax and accounting implications

Source: KPMG LLP (U.S.), 2005

In the 1980s, focus became a highly popular strategic imperative. It is an attribute that remains a key ingredient to success today. Our research surfaced three related areas of focus which are most important to successful alliances: nurturing and picking the right partner relationships; setting a clear and shared purpose; and ensuring the appropriate level of priority and commitment among senior management.

Choosing Partner Relationships

In choosing the right partner, a corporation must focus on a candidate with proven competency, commercial stability, and credibility in the marketplace. The most suitable candidates will complement the corporation and fit the objective of the intended alliance. Choosing goes well beyond a review of a potential ally's financials. Identifying strategic and cultural similarities is as important as understanding such aspects as the target's financial fitness, its information technology capabilities, or its R&D track record. Cultural mismatches, for example, are a prime factor in failure, even when the businesses seem to fit on a financial and operational level. Culture may include factors such as a partner's corporate values, how it structures its organization, its reward systems, its leadership styles and decision-making processes, its human resources practices, and its history of alliances.

The foundation is trust. Virtually all the executives interviewed emphasized the need to take time to develop a trust-based relationship before entering into a partnership relationship. If trust is the foundation, the building blocks include competency, credibility, and stability.

Relationships with customers, suppliers, and the community are leading indicators of a potential partner's credibility and its ability to offer a corporation commercial advantage. The alliance must be flexible, able to add brand strength, and create demand. A key factor in deciding whether to form the alliance is knowledge or a strong belief that the market will demand a solution or product created by the alliance.

An organization that is assessing a potential partner must be comfortable on a number of fronts. For example, an organization may consider the following questions:

- Does the partner have the capabilities and the technology that can make the venture work?
- Does the partner have the management skills that are required for a successful collaboration?
- Does the partner have the financial resources as well as the physical assets that are needed?
- Is there an organizational fit? Do the parties see eye to eye from a management perspective?

A recipe for alliance disaster is created when the alliance runs out of resources and one partner has to contribute more than planned in order to keep the alliance operational. All partners start out with a common understanding of the strategy and each other's contribution. Ensuring that a potential partner possesses the required resources is a simple, but often problematic, step in securing a partner. Not knowing whether adequate financial, human capital, and technological resources exist is a signal for an alliance to be put on hold until those questions are answered.

Setting a Clear and Shared Purpose

A good alliance has clarity on its long-term and short-term goals. Successful alliances can be focused on the immediate or long-term needs of the businesses, but partners do not let ambiguity exist about why they are in partnership.

Meeting priorities and building trust are illusive if proper groundwork is not done up front. "Alliances are easy to form but tough to manage.[4]" "Deal making is glamorous; due diligence is not.[5]" Both views are squarely on target when one considers that so many strategic alliances or joint ventures either do not live up to expectations or fail outright. Very often, due diligence and performance metrics are focused too heavily on the financial information, when dimensions such as management philosophy, management decision-making processes, and shared goals are equally important. When partners view alliances as strategic relationships rather than financial deals they only increase their chances of success.

When partners view alliances as strategic relationships rather than financial deals they only increase their chances of success.

There is much truth in a passage contained in "When to Walk Away From a Deal," an article published in the April 2004 *Harvard Business Review*. "Due diligence all too often becomes an exercise in verifying the target's financial statements rather than conducting a fair analysis of the deal's strategic logic," and the ability to realize value from it.

Executives interviewed for this paper stress that due diligence relating to financial data is critical. However, the rationale for going forward with a joint venture or strategic alliance is just as importantly verified by a disciplined and objective approach to diverse matters, such as those relating to intellectual capital, availability and sophistication of information technology, the target's brand strength, its patents, and the culture of the organization.

"You try avoiding alliances with cultures that don't work or fit together. You have to have your eyes open about that when you go into an alliance because if the decision-making process or the management processes are too different—you are going to create conflict…You have to work with people you can get along with and if you can't do that you shouldn't get into it,"[6] said Robert Duffy, general manager of global business development at General Electric. When considering culture, executives and the players in the alliance may also look at the culture of the venture in addition to the culture of the overall organization.

Making Focus a Management Priority

In interviews with executives from across industry lines and around the world, the definition of the project and buy-in of clear objectives by senior management was a commonly cited key to success.

"When we look at our planning and priorities and what we want to accomplish with the partner, we go all the way to the top and we usually deal with C-level executives to set the direction for the partnership. That is where the approval comes from and where the general support comes from," said Ron Lenore, former general manager, strategic partnerships, Delta Air Lines, Inc.[7]

Those corporations that often succeed at alliances stress that buy-in and consistent monitoring by senior executives is essential. When senior management accepts alliances as a means to drive growth, the resources required to make them work will be committed. Don McLellan, corporate vice president and director of business development at Motorola, emphasized how Motorola senior sponsorship and leadership, even in the smallest of alliances, is important in order for all parties to understand that buy-in "is really coming from the top from a generation of leaders who were cognizant of their own businesses, their own customers and, importantly, their need to maintain and develop a network of alliances."

A Changing Environment for Alliances in China

Some country regulations have historically required a joint venture approach to ensure local participation in the market—China is an example where this thinking is changing as its economy matures. This sidebar is a brief KPMG International perspective of the environment for alliances and joint ventures in China and how the environment is changing.

In the early years of China's market reforms, strict regulations on foreign investment generally limited multinationals to invest via joint ventures—either equity joint ventures or contractual joint ventures. Now China's World Trade Organization accession and continued market liberalization are relaxing regulatory restrictions industry by industry, and a switch has become evident toward "greenfield" investments or controlling-stake acquisitions. The trend is a reflection of increased confidence among foreign investors in China and an outcome of lessons learned—choosing the wrong partner, inadequately controlling intellectual property, and strategic conflicts.

Despite the trend to wholly owned investments, alliances and joint ventures are still attractive options in China, as they are in developed economies. Alliances and joint ventures are often the choice of investors with limited experience in China. They provide quick access to distribution channels, customers, supplier networks, local management expertise, and government contacts, and allow investors access to restricted industries such as telecommunications, automotive, and financial services. Alliances and joint venture opportunities are also more abundant—more Chinese enterprises are looking for strategic partners than are looking for outright sales.

Fit, focus, and follow-through: the global themes for success with alliances and JVs still hold true in China, albeit with local flavor.

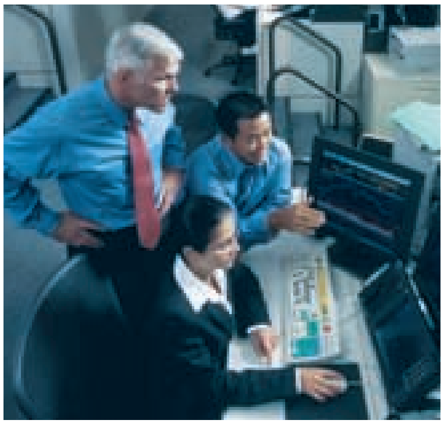
Fit. Picking the right approach is often complicated in China because many investors simply do not understand the market sufficiently. Without a proper understanding, investors leave too much to chance. Even seasoned investors can let the "China hype" override sound strategic thinking and enter into the wrong deal at the wrong price.

Focus. Finding the right partner in China can be complicated as it is often difficult for foreign investors to understand the Chinese partners' mindset. Negotiating the terms of an alliance or joint venture can also prove to be anything but straightforward—it is not uncommon for foreign investors to overlook key decision makers (such as local government officials and regulators) in the negotiations.

Follow-Through. Monitoring investments in emerging economies like China is critical, especially if the organization has limited experience or resources on the ground. Foreign investors should learn from the most successful multinationals: Send your best people to manage the business and rigorously evaluate the performance of your investment—the "strategic promise" of China is no excuse for years of recurring losses.

Source: KPMG LLP (U.S.), 2005

Follow-Through – Monitor, Measure, and Plan an Exit



Indicators of Good Monitoring Activity

- Partners agree on alliance corporate governance matters.
- Partners have, and employ, a common set of performance measurements.
- Partners agree on how and when performance will be measured.
- Communications are constant and meaningful.
- Senior executives accept the responsibility for, and actively oversee, alliances or joint ventures.
- Executives seek out and capitalize on performance patterns among their portfolio of alliances.
- Constant effort is employed to match alliance goals to overall corporate strategy.
- Alliance partners share a common view on the benefits and costs of the alliance.
- Partners institute knowledge-transfer activities.

Source: KPMG LLP (U.S.), 2005

The final theme is about execution—in particular the important roles that discipline, rigorous monitoring, and the willingness and ability to adapt play in success. The key process focus here is monitoring what is happening as the alliance or venture evolves.

Monitoring the Alliance

Failure or lost opportunities associated with a strategic alliance or joint venture, in many cases, is linked to an inability to quickly recognize and react to changing conditions, economic or otherwise. Data suggests that at least 40 percent of alliances break down and financially damage both parties. Researchers recently reported in the *Harvard Business Review* that 48 percent of nearly 1,600 alliances formed by 200 companies ended in failure in less than two years' time.[8]

Since it is essential to take a balanced view of alliance performance, monitoring must be done with an "integrated picture" that shows financial, strategic, operational, and relationship dimensions. This integrated picture provides perspective on whether the alliance is meeting goals and reveals the causes of any trouble.[9] Such value is important to seek if statistics on failure of alliances are to improve.

Responsibilities need to be defined in detail up front to eliminate ambiguities. The success and clarity of understanding and alignment needs to be regularly evaluated. And, planners need to stay with the project, keeping an ear to the ground to monitor the health of the project as it moves ahead.

Two aspects involving the monitoring of a joint venture or an alliance appear to be especially important: the types of metrics to be employed (and how the organizations are structured to adjust to change) and exit planning (including contingencies).

Measuring Performance

Although performance measurement is a well-developed management discipline, research, interviews, and anecdotal information suggest that metrics involving alliances tend to be dominated by financial measures. While financial measures have obvious benefits in terms of understanding short-term results, they are lagging indicators. It is also important to consider applying leading indicators, which can provide a view of the alliance's underlying performance drivers. Leading indicators help create visibility on areas where adjustments can be made before events end up having a negative impact on the downstream financial picture.

Research and experience show that some executives believe in using the same metrics for alliances that are used for their core business. Others tailor metrics to the alliance objectives. While there are clear pros and cons to each approach, metrics that promote the best alignment with the strategy and objectives of the alliance provide a good chance to succeed. Applying the same metrics that are used to run an operating entity to the venture or alliance may provide comfort, but the metrics for alliances should not always be the same as those for fully developed businesses.

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FORD AND DAIMLERCHRYSLER: A VENTURE AMONG COMPETITORS FOR A POWER SOURCE

During an October 2004 seminar at the University of Chicago, Kevin Cramton, Ford Motor Company's director of corporate business development, told several dozen mergers and acquisitions professionals from a cross-section of industries about a potential, 50-50 joint venture between Ford and DaimlerChrysler, relating to the acquisition of the fuel-cell system division of Ballard Power Systems Inc. At the time of the conference a tentative deal had been announced, but not closed.

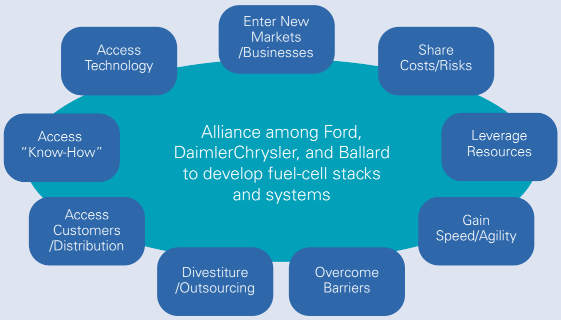
Cramton made his comments at a seminar jointly sponsored by KPMG LLP (U.S.) and the University of Chicago's Graduate School of Business. He described Ford's and Daimler's interest in Ballard, which makes vehicular fuel-cell systems, and he laid out the process by which Ford came to the decision to enter into the venture.

Ford manages about 100 joint ventures and strategic alliances, and has relationships with competitors to produce such products as hydrogen fuel-cell vehicles, diesel engines, and transmissions. The reason for these competitor alliances, Cramton said, is "because of practical economics and the ability to leverage resources."

The fuel-cell alliance, Cramton said, was formed "to develop a new technology through shared efforts." Automakers are exploring fuel-cell technology because it offers an alternative to gasoline-powered engines. Automobiles powered by fuel-cell systems are currently being tested in several cities around the world. Developing this type of technology is an expensive and high-risk proposition that may be best approached through a partnership—in which costs and risks are shared.

Cramton said that when Ford looks at alliances, "we look for key benefits, and we look at them up front, overtly." The Ballard alliance with Daimler, he said, leverages nine-key benefits:

Fuel-Cell Alliance – Key Benefits



Source: Ford Motor Company

- Enter new markets/businesses
- Share costs/risks
- Leverage resources
- Gain speed/agility
- Overcome barriers
- Divestiture/outsourcing
- Access to customers/distribution
- Access to know-how
- Access to technology

The Ford-Daimler-Ballard joint venture "is one of the rare examples where all of the boxes, in terms of benefits, get touched on," he told the group.

Cramton provided his insight on some of the benefits relating to the joint venture:

Enter New Markets and Businesses
"When you are entering a new technology, something that hasn't been invented yet, this is an area where an alliance or a joint venture comes into play and has a huge benefit."

Share Costs and Risks
"In new and evolving technologies, there are major risks and high costs. So, sharing risks and sharing costs, in terms of us and DaimlerChrysler and Ballard, becomes a really key driver in why you want to do an alliance."

Leverage Resources
"We are all better at different things. We (Ford) bring certain technical capabilities. Ballard and Daimler bring others."

Gain Speed and Agility
"This deals with the ability to work together by leveraging those various resources and addressing issues as a group. We have found the ability to be much quicker than if we were lumbering by ourselves in things that we don't fully understand."

Overcome Barriers
"A lot of barriers are regulatory barriers. A lot of them are setting standards. One of the key issues for those in the technology business is that when standards are not in place, there is quite a bit of waste, and there often is a lack of clarity. That is true not only for the developer, but also for the consumer. Being able to overcome those barriers through an alliance is critical."

Divestiture and Outsourcing
"An alliance can allow us to outsource to people who are better at doing these elements than ourselves."

Access to Customers/Distribution
"We hope to access new customers with the fuel cell in the same way we have seen with the new Ford hybrid vehicle, the first hybrid SUV. The reception for this new product has been amazing. Also, the kind of customers who signed up to buy it are very different from the F-series customer. So the ability to access new customers in these potential growth areas is very important to us."

"The distribution element in this case is the infrastructure. This is where BP has been playing a role with Daimler and Ford. You can have a fuel-cell vehicle, but if you can't fuel it up you are in trouble, nobody will buy it."

Access to Know-How
"Know-how is more than technology. It is more of an integration issue. And one of the key elements of what we are doing is: How do you integrate this new technology into an automobile?"

Access to Technology
"This is a brand new technology that we are trying to use. Relying on each other is important.

The key message emerging from the proposed Ford-Daimler-Ballard venture, Cramton said, is that it "allows us to deal with and get benefits from many of these nine areas. In most alliances, you only see two or three or four benefits. You rarely see an across-the-board benefit."

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But putting new and different behavior and measuring devices in place is hard work, which can be impeded by organization inertia. If people employ only the measures that are tried and true, they may be headed for difficulties. Some short-term alliances, which are actually not much more than sales or marketing contract agreements, are not new or complex, and existing measures will most likely work just fine. But if the alliance spans traditional financial reporting cycles or is more than a revenue-driving initiative, the best scorecard will include non-financial dimensions as well. And sometimes these dimensions are hard to measure—but no less important to understand.

While many large companies have dozens of alliances, questions have been raised about whether there is adequate systematic measurement of performance. Fewer than one in four alliances have adequate measures or recognize performance patterns across alliance portfolios, and few executives know whether the alliance portfolio as a whole supports corporate strategy. Consequently, as alliances become more widely used and more important to the overall strategy of the company, not measuring them effectively is an unrealistic option.[10]

At Ford Motor Company, metrics are "established up front to get alignment and enable us to measure our progress toward achieving the strategic objectives for the alliance or joint venture," says Kevin Cramton, the automaker's director of corporate development. "For example, if we wanted to advance technology and share development costs through an alliance in transmissions, engines, or fuel cells, we would jointly define key milestones in terms of costs, investment, quality, and time to market. All of those metrics are defined up front, monitored, and revised, as required, during the course of the relationship. These metrics are specifically designed to assist in meeting operating business objectives. Therefore, the metrics and the milestones and those kinds of measurement systems are what we use to evaluate success or failure. Did we achieve the program objective transmission on time with the quality and the cost that we said we could—and does that compare if we would have done this by ourselves or with other parties? If the answer to all of those is affirmative, then it confirms the alliance or joint venture is working well in achieving its strategic intent."[11]

Planning the Exit

The need to unwind alliances points to another key success factor—exit strategies. The exit shows itself during this follow-through stage, but the probabilities of successful exits are established throughout the alliance process. As discussed, failures happen and, at times, not due to fault, but rather a natural evolution in the market. Sometimes, conditions just change. The key is to be able to adapt. Having a clear exit provision and open communication with your partners during critical reviews can help mitigate the realities of periodic failures to meet expectations.

Like the art of choosing the best strategic approach, developing good adaptive capabilities is an art in which good process can help. It takes effort and discipline to continuously engage in dialogue about what is going on and what could go wrong in the alliance's ecosystem. Motorola, McLellan said, "looks for best practices; we learn from our mistakes, we continually feed back into a process of whether we are governing and structuring our alliances under the right terms. We strive to stay attuned to how relationships work."[12]

Conclusion

We see alliances, ventures, and any forms of collaboration as absolutely essential to future growth, innovation, and sustainability.

Collaboration requires both competency and skill—and excellence demands practice. Many of the same basic blocking and tackling management skills that serve companies well in process management and strategic decision making are critical to good collaborators. Ventures or alliances often fail because executives are not successful with these core skills, such as fact-based decision making, defining clear goals, creating and using effective metrics, and ensuring consistent and open communication.

Alliances, ventures, and any forms of collaboration are absolutely essential to future growth, innovation, and sustainability. When forming an alliance, what matters most for success is making sure that there is a proper strategic fit, steady focus on priorities, and commitment to following through with discipline and rigor.

In interviews with executives at a variety of businesses across industry lines in North America, Asia, and Europe, the following keys to successful strategic alliances and joint ventures—aligned by our three major themes of fit, focus, and follow-through—were identified:

Fit

- Alliance or venture is core to each partners' business
- Shared decision-making process
- Comfort in having brands associated with each other

Focus

- Clearly defined goals, objectives, and expectations for the agreement
- Participants' roles and responsibilities established at the outset
- Recognition of need for possible modification of the agreement recognized
- Shared recognition for flexibility and responsiveness to changing conditions after alliance is launched
- Partners are comfortable with their financial and other resources

Follow-Through

- Clear and defined exit-strategy provisions are negotiated
- Agreement is made to routinely review goals and policies of the deal
- Measurements are both non-financial and financial in nature
- The alliance is providing progress toward each partner's overall goals

Source: KPMG LLP (U.S.), 2005

Appendix: KPMG Interview with Don McLellan, Corporate Vice President and Director of Business Development, Motorola, Inc.

KPMG asked Don McLellan, Motorola, Inc.'s corporate vice president and director of business development, to share some of his thoughts on strategic alliances and joint ventures. Following are some of his edited responses.

KPMG:
Data shows that activity in strategic alliances and joint ventures is picking up around the world. Can you identify the driver or drivers of the increase in these activities?

Don McLellan:
Drivers, fundamentally, are customer needs for complete integrated solutions, elements of which are offered by many different vendors. Take, for example, our wireless carrier customers. Generally, they are all looking to find compelling ways for mobile communication users to have a very rich experience when it comes to data, video, pictures, games, sounds, music, and the like. The need to bring different sources of content and applications together in one device drives our need to align with the best partners in each category, in each region, and for each target product. We try to anticipate our customers' needs, listen to them, respond to them, and ensure that we have the best solutions available. This, by necessity, requires us to increase our network of alliances to ensure these solutions come together seamlessly in our product offerings.

KPMG:
Our research leads us to believe that alliances tend to be the preferred alternative to acquisitions in many organizations. Do you find validity to that observation in your experience at Motorola and in the overall marketplace?

DM:
It is hard to make a generalization on alliances versus acquisitions. It really depends on the business model involved. Our personal communications division is a fast-moving, quick-cycle business that must be nimble, bringing products to market with features developed by many different vendors. In this environment partnerships may be as short lived as a product cycle or two. You could sum it up to say if things move quickly in an industry and no one partner has all the answers for you, then, by definition, you are going to need to maintain alliances with many. For example, we do not need to acquire a mobile game application provider to include mobile games on our wireless devices. However, we definitely need to have alliances with game-content providers to make sure that our devices are optimized for the carriers seeking to market such applications to their customers. In six months, passions and preferences of customers may have evolved, requiring alliances with different content providers. Using our handset business as an example, there is no question that alliances are preferable to acquisition due to the fast pace of changing technology and preferences.

Contrast that with technology gaps that we need to fill—where we want to influence the road map and control the future destiny of a particular technology. In these cases alliances are not the most efficient structure since we might want to take the technology in one direction and our partner wants to take it in a different direction. For example, we might want to integrate a technology into our products to create a unique offering in the marketplace. If that technology were part of a stand-alone business the business owners may want to broadly license that technology to all parties—not creating differentiation but rather a wide base of royalties.

A recent development in transaction accounting arguably creates a bias against acquiring emerging technology start-ups. By recording goodwill now as an asset, not expensing goodwill, acquirers must be vigilant. Newer, disruptive technologies may trigger sudden, unexpected write-downs of goodwill associated with prior acquisitions. If the technology is untested it may be better to seek a license/alliance and not acquire the business to avoid creating an asset whose value may erode without warning upon the introduction of a newer technology.

Similarly, Sarbanes-Oxley reform has increased the scrutiny given to smaller start-ups whose financial and other systems may not be readily suitable for public company compliance. At the margin this may increase the cost of small company acquisitions and may encourage alliance structures instead of acquisitions.

All this said, while stakes have risen in acquisitions, the fundamental strategic rationale for acquisitions has not changed. If you want to control the road map, alliances are going to lead to friction and acquisitions would be the preferable structure. If you do not need to control the road map and you are looking at a time-bound relationship, alliances are more flexible relationship structures.

KPMG:
So, at that point in the strategy process where you have identified gaps, do you then look at the options of how those gaps may be better filled by an alliance, a joint venture, an acquisition, or building it on our own?

DM:
Absolutely. Our strategy process is holistic and includes healthy dialogue among business intelligence, our economic modeling team, our venture investment arm, and corporate development, who are all part of our larger corporate strategy team. While deals do not drive strategy, input from deal teams and others helps frame the art of the possible and, frankly, the art of the "available." With a healthy, practical dialogue about how we can seek to fill gaps in a make/buy/align sense, we can use appropriate tools to gain access to new technology, new talent, or new products.

Early alliances may lead to later acquisitions as well. Two recent acquisitions evolved from an earlier venture capital investment we had made with a robust commercial/intellectual property alliance. By having an alliance coupled with an investment, our management and engineering teams had an opportunity to work closely with one another far in advance of an acquisition, facilitating later integration and road-map alignment.

With respect to joint ventures, some of our JV experience stems from customers encouraging us to get together with another partner, governments requiring us to use a venture model in order to do business in their countries, and the like. We have had customers come to us, particularly in the automotive industry, and say, "I don't want to buy from two different suppliers making parts that combine to form a subsystem; you guys are both good suppliers, but I want one point of contact and one product, so form a venture." So, we take the input from the external world and their cues as to when we approach aligning versus buying versus JVs, along with the input from our own rule book. A lot of it is what the customer wants to see, what the marketplace wants to see, what the local government wants to see or requires.

KPMG:
How would you define the reasons for, or the keys to, success in alliance and joint venture situations?

DM:
We put a lot of time and resources into making sure that we are extracting the value that we promised the corporation when engaging in development transactions; particularly if we have deployed capital by way of an investment or venture. Sometimes alliances could be quite short-lived where the outcome is measured by winning a customer contract. I think it is hard to generalize, but I would say that Motorola is a company that does not take alliances lightly. We are very much conscientious about making sure we are entering into a wide range of relationships that ensure our customers have the products they need and continuing to cull through those relationships to ensure they are still meeting their objectives. If we are not about continuing to prune that, enhance that, or work that network and ecosystem, we're not doing what we need to do for our customers. Therefore, we approach it as a very large priority because it is what gives us the ability to go to the marketplace with winning solutions.

KPMG:
Are there any other reasons or keys for success? Or has Motorola been able to realize those as a company?

DM:
Certainly the first and foremost key to success is really defining what you want out of the relationship and not going into a relationship with just a headline that Motorola plus Company X will collaborate in an unspecified way. To be successful we have to have very clear deliverables—both very important to us and our customers so that it isn't an amorphous alignment. The worst thing that you can do is send confusion into the marketplace with respect to your alignment strategy—creating expectations that a joint solution will be marketed when in fact there isn't one. Clarity of purpose, interpersonal relationship, and commitment at all levels is key. It is important to Motorola that everyone throughout the company is behind our alliance activity. It doesn't mean that everyone knows every CEO of every venture company, but what we do know is that we are intentional about the relationships we enter into and take steps to maintain those relationships.

Another key is senior sponsorship and leadership, even in the smallest of alliances, so that the commitment is coming from the top, setting a tone that not only does Motorola care about its customers, but also its partners—who may be one and the same. I say this not because Motorola or any company has succeeded in each and every alliance relationship, but rather because we know when we have not been successful, and we spend time considering how to improve our alliance management skills for continuing relationships.

Our history and culture help. In the early days of two-way radio Motorola chose to align with local distributors across the United States rather than buying many independent companies to form a distribution network. Cost was an issue certainly, but there was also an intentional strategy to keep the dealer network independent—local, trusted radio dealers who had loyalty to Motorola and Motorola had loyalty to them. This developed a generation of leaders who were cognizant of their own businesses, their own customers, and, importantly, their need to maintain and develop a network of alliances with local distributors with whom we entrusted the sale and service of our products.

KPMG:
If you think about your company's capabilities in terms of structure, roles, knowledge, and the process you use, what is your view of your company's capabilities? Is there a readiness in terms of meeting strategic expectations for alliances and joint ventures for the remaining decade?

DM:
Our teams really want to make sure we have the best products in the market, and they know that it means we may not have created every element in that product offering or solution ourselves, but we need to search for others in the marketplace that have pieces of the solution we do not have. There's just no question that our team is serious about cultivating relationships and finding partners in the marketplace to work with. It is very rare that you find one company with a complete offering, needing no other relationships, commercial, technology, or otherwise. In large respects companies like Motorola are successful when active ecosystems of companies thrive all around us and we maintain capabilities and techniques to foster those ecosystems. Examples include forums to maintain alliances among software developers who write applications for our networks, phones, or other devices. Another example is standard-setting teams that cultivate alliances with fellow equipment makers to promote communications standards. A further example is an extensive alliance management database actually developed in our personal communications business but used throughout the company to track our various alliances. These capabilities and techniques allow us to keep current with and foster our alliance relationships.

In terms of strength of our capabilities we are probably no different than other companies in our industry. We look for best practices, we learn from our mistakes, we continually feed back into a process of whether we are governing and structuring our alliances under the right terms. We strive to stay attuned to how our relationships work, when they're successful, and when they're not by our own mistakes, of which we've had a number and by mistakes of others, and look for ways to improve that.

KPMG:
How would you define the reasons for unfulfilled expectations when creating joint venture entities?

DM:
Often, failed expectations in joint ventures stem from quickly shifting technologies or shifting requirements or desires of the marketplace. It has been less about the way that we interact with the partner, but more about whether we brought a solution to market on time and if the marketplace still wants and requires the joint solution. I can think of examples where we established formal ventures that were designed to bring products to a marketplace but after a few product cycles the market no longer favored those solutions and the venture had to be unwound. Having clear unwind or exit provisions mitigates the impact of unfulfilled expectations.

KPMG:
One of the tools we think needs to be used well is the ability to change or at least alter the alliance during the course of its life because certain conditions change. What skills are required to be able to recognize what is going on, and what metrics should be in place that would allow an organization to get early indicators of change and be nimble enough to make the adjustment?

DM:
It sort of goes without saying that you can never plan completely for the vagaries of either the market or consumer preference or technology shifts that aren't on your own radar screen. So, our alliances have to move along with that flow, and I think one of the areas that we spend time on, probably more so in the past two years than we may have in the past 10 years, is pruning our portfolio of alliances, particularly equity investments. Those are the easiest to see. We cull through and ask ourselves on a periodic basis, typically annually, sometimes more frequently: 'Do we still need to own equity in this company, and, by definition, do we need to have a relationship with that business in a formal way, or can we dial back to where it is just two interesting market participants, both having complementary offerings? Conversely, should we dial up the relationship and seek to acquire the remaining interest we do not own?'

In the past few years we have appointed a dedicated portfolio manager whose job it is to keep track, certainly on the equity side, of all the equity relationships we have and to flag the respective business owners the opportunities to sell the stock. So, for example, if it looks like there hasn't been a lot of activity within a year's time, or we no longer have a board seat, or we no longer are participating in future funding rounds, our portfolio manager will then do some research with our business units to find out if it is still strategic to maintain that relationship, or if it should change: Should a new business owner take over?

KPMG:
Are there any areas for specific improvement in alliances?

DM:
Communication. I think in a large organization with many converging technologies, the communications of alliances and the awareness is something that needs to be worked on continuously. Areas for improvement will always be to make sure that if we team up with a company and the road map changes or evolves in a very positive way—have we done enough to bring that to the attention of the rest of the company? Does the rest of the organization have a dated view of what our partner is doing with us? Have we done enough to bring interesting developments by our alliance partners to the attention of other business units within our company that might similarly benefit in a converging world of similar technologies? The trick is to make sure that you socialize and raise the awareness of what you are doing in one part of the business with another so that you can leverage that relationship, and not necessarily form new relationships altogether.

KPMG:
We've learned that some organizations need to sharpen their skills involving alliances, because the data shows a fairly high rate of failure in strategic alliances, and especially joint ventures. To what do you attribute Motorola's fairly consistent success in strategic alliances and joint ventures?

DM:
If you were to say that on a long-term basis what has been one feature of Motorola's success over the past 76 years, you could say alliance management has been a critical factor. Alliances have allowed us to team up with partners to develop and expand into other countries and other markets. Alliances have facilitated our efforts in standards setting and telecommunications policy. We see having many alliances as part of our everyday business. So, we are conscientious about what we are doing with alliances. I was surprised at first to see that we track over a thousand relationships in our alliance database. Maintaining these relationships requires committed effort. If we continue to invest in that effort, invest in those relationships, we will continue to be successful.

I do cautiously say we have been successful. Can we be better at it? Absolutely. Are we vigilant about finding out about as many mistakes as we can, and in the next deal capturing some process improvements, some checklists, some new approval mechanisms, some new group that has to get together to improve these things? Yes, that is exactly what we do.

Endnotes

[1] ACG Network, "Six Reasons Alliances Work Better Than Acquisitions," Dorothy Langer, October 2002.

[2] "When to Ally and When to Acquire," *Harvard Business Review*, July – August 2004, Professors Jeffrey H. Dyer, Prashant Kale, and Harbir Singh.

[3] Interview conducted on behalf of KPMG by research firm, Penn, Schoen, and Berland Associates, 2004.

[4] "Strategic Alliances: How to Manage, How to Measure," *Business Finance Magazine*, March 2004.

[5] "When to Walk Away From a Deal," *Harvard Business Review*, April 2004.

[6] Interview conducted on behalf of KPMG by research firm Penn, Schoen, and Berland Associates, 2004.

[7] Interview conducted on behalf of KPMG by research firm Penn, Schoen, and Berland Associates, 2004.

[8] "When to Ally and When to Acquire," *Harvard Business Review*, July – August 2004.

[9] "Managing an Alliance Portfolio," *The McKinsey Quarterly*, 2003, Number 3.

[10] "Managing an Alliance Portfolio," *The McKinsey Quarterly*, 2003, Number 3.

[11] Interview with KPMG, 2004.

[12] Interview with KPMG, 2004.

KPMG's Transaction Services Practice

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