Chapter 4
Strategic Alliances/Knowledge-Intensive Partnerships

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4.1 Introduction

The confluence of important developments in the international economic environment during the past two to three decades has turned inter-firm cooperation into an important mechanism of business interaction and market and technology access (Malerba and Vonortas 2009; Caloghirou et al. 2004; Jankowski et al. 2001; Vonortas 1997). Particularly in high- and medium-tech industries, the private sector has increasingly used various kinds of cooperative agreements such as joint ventures, joint R&D, technology exchange agreements, co-production, direct minority investments, and sourcing relationships to advance core strategic objectives. Called alliances (partnerships) in this chapter, such agreements imply deeper and steadier relationships than arm's-length market exchanges but fall short of complete mergers. They involve mutual dependence and shared decision-making between two or more independent parties. When research and development is a focus of the partnership, universities and other research institutes may also participate.

The proliferation of inter-firm alliances has raised expectations of accelerated long-term growth opportunities for developing countries through faster access to markets and technologies and greater learning possibilities. Available evidence, however, shows that although developing country firms have increased their participation significantly, recorded partnerships are still overwhelmingly concentrated in developed economies. It also shows that a rather small group of newly industrializing

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countries and economies in transition which have significant capabilities and large domestic markets have benefited disproportionately more than others.

Rather than equity-based, the vast majority of partnerships during the past 20 years have been contractual agreements, catering to the pressing need for strategic flexibility in high-tech sectors. Strong arguments can be made that non-equity agreements can favor of developing country firms as they require less commitment and get closer to informal kinds of cooperation. Numerous cases of transnational companies operating in developing countries and emerging economies have shown how cross-border partnering and networking can significantly raise those countries' technological prowess and business competitiveness.

Analysts may have paid too much attention to formal forms of partnering—like those mentioned above, involving explicit contracting among parties—and much less attention to various forms of informal partnering among organizations and individuals. Anecdotal evidence indicates that informal partnering probably accounts for a very large share of partnering activity in industry, involving extensively small and medium-sized enterprises (SMEs) in proximate geographical areas.

Formal and informal partnering should be seen as a continuum, where formal enterprise cooperation, clustering and networking are perceived as alternative, and often complementary, modes of operation. Formal partnership requirements—including strategy formulation and significant partner contribution in tangible and/or intangible resources—may be placing the bar too high for the majority of (mainly small) firms in most developing countries. That, however, leaves a whole lot of other cooperative interactions for these economic agents to pursue. It now seems quite probable that more informal partnering through networks and clusters is a way for many firms in developing countries to increase their sophistication and become stronger and more competitive, thus gradually preparing for more formal partnerships.

For firms that do graduate to formal partnerships, this Chapter expounds a roadmap to harnessing their potential for promoting technological prowess and economic competitiveness. Key lessons for success include a clear understanding of the firm's objectives in the partnership, the negotiation of a suitable agreement with sound dispute resolution and exit clauses, the treatment of the agreement as a "living" document, and the awareness of the importance of knowledge and relative capability distribution among partners. For these firms, policy decision-makers and international organizations have important roles to play in terms of spreading the message of partnership opportunities, on one hand, and in terms of creating a supportive infrastructure, on the other.

4.2 Common Types of Alliances

Three types of alliance are particularly common:

- **Equity shareholding**: Arrangement in which a company becomes a minority shareholder in its partner through an equity investment. This action is often reciprocated by the alliance partner.

  - *Example*: In 1999, Renault and Nissan entered a strategic alliance through a cross-shareholding agreement, whereby each company purchased a minority equity stake in the other. Renault currently holds a 43.4% stake in Nissan while Nissan holds 15% of Renault shares. This arrangement ensures that each company will act in the financial and strategic interests of the other while maintaining its own identity and culture. Activities include joint production of engines, batteries, and other key components.

- **Joint Venture:** Arrangement in which partners agree to contribute resources and equity to develop a new business entity with a specific purpose in mind.
  - *Example*: In order to save money on procurement operations, in 2011 Deutsche Telekom (DT) and France Telecom (FT) created a new 50/50 joint venture firm known as BUYIN. The new company, which is based in Brussels, manages the procurement of terminal devices, mobile communications networks, and fixed network equipment for the two telecom giants. The alliance is expected to save the companies about € 1.3 billion over the first three years of operation. Furthermore, DT and FT have expressed interest in expanding the joint venture to other areas such as IT infrastructure in the future.

- **Contractual (non-equity):** Arrangement that lacks shared ownership or dedicated administrative structures. Cooperation is undertaken through non-equity based means such as licensing deals, technology exchange agreements, sourcing relationships, co-marketing, etc.
  - *Example*: Malaysia's AirAsia and Australia-based Jetstar teamed up in 2010 with a plan to reduce the two budget airlines' operating costs. Through a non-equity alliance, the airlines agreed to explore opportunities to jointly procure aircraft, cooperate in passenger handling in Australia and Asia, pool aircraft components and spare parts, and jointly acquire engineering and maintenance supplies and services. The airlines expect the alliance to reduce costs, pool expertise and result in cheaper fares.

Indus Towers Joint Venture

An example of a successful joint venture in the telecom industry is the Indian tower management company Indus Towers. Indus Towers was established in November 2007 through a joint venture between BhartiAirtel, Vodafone Essar, and Idea Cellular, with the goal of reducing passive infrastructure costs for each company. Over the past decade, the Indian telecom industry has been undergoing extraordinary growth, with some experts forecasting an 80% penetration rate by as early as 2017. Early competition in this industry was intense and marginal revenues were very low compared to other countries, which led to challenges with capital investment in new tower infrastructure. At the beginning of 2007, only 25% of wireless towers in India were shared

between telecom operators. This system was inefficient for operators because firms were building towers in overlapping areas that could easily be serviced by a single tower.

BhatiAirtel and Vodafone Esser, the two largest private telecom-services providers in India, realized they could cooperate on tower development while remaining competitive in their core businesses of providing telecom services. Together, they decided to jointly establish an independent firm to construct and manage towers throughout the two firms' common operating regions. Idea Cellular, the third largest telecom operator in India, was also offered a smaller share in the new firm and eagerly accepted based on the expansion prospects it could provide.

Negotiating and implementing the terms of the joint venture included several challenges that needed to be resolved by the parties involved. Determining how to value the assets that each company contributed was an early area of friction, which was resolved through the establishment of a point system where towers were rated based on attributes such as location and size. The companies then contributed capital for new towers such that the point values were equal among each partner. Other early issues included network downtime, the lack of a standardized data sharing platform, and conflicts between strategic company objectives. In the face of these challenges, Indus Towers was able to find solutions in large part due to equal representation on the management board and a shared understanding of the challenge that needed to be solved.

Over the next 4 years, Indus Towers had grown into an efficient vehicle to operate towers throughout the country and had successfully evolved into an independent tower company. At the beginning of this decade Indus Towers was the largest telecom tower company in the world with a portfolio of over 110,000 towers and plans to add 5000 more each year until 2015.

Source: Gulati et al. 2010

4.3 Context of Strategic Alliances

4.3.1 Definitions

Alliances refer to agreements whereby two or more partners share the commitment to reach a common goal by pooling their resources together and by coordinating their activities. Partnerships denote some degree of strategic and operational coordination and may involve equity investment. They can occur vertically across the value chain, from the provision of raw materials and other factors of production,

through research, design, production and assembly of parts, components and systems, to product/service distribution and servicing. Or, they can occur horizontally, involving competitors at the same level of the value chain. Partners may be based in one or more countries.

A narrower set of partnerships can be characterized as innovation-based, focusing primarily on the generation, exchange, adaptation and exploitation of technical advances. Called strategic technology alliances (STAs) herein, these arrangements are of primary concern to both developed and developing countries as a result of expected direct contribution to national capacity building.

The most basic distinction in partnerships is between formal and informal agreements. Relatively little is known about the latter apart from anecdotal evidence that (a) many firms routinely partner informally on short-term business endeavors, and (b) informal partnerships may account for the vast majority of collaboration. Informal partnerships are unfortunately almost impossible to track down systematically. They fall more in the realm of clusters and networks to which we will return in the last section.

4.3.2 International Context

Since the early 1980s, when the first data were put together to map a sudden burst of inter-firm cooperation, it has been established beyond doubt that alliances have become an important mechanism of business interaction and market and technology access around the world. A proliferating literature in economics, business and policy has tried to identify and interpret the important features of cooperation among firms, universities, and other public and private organizations.[1]

A set of developments in the international economic environment has underlined the explosion of business partnerships since the late 1970s. Four changes, in particular, seem to be key:

- *Globalization.* Transnational companies have pushed into new product and geographical markets relentlessly.
- *Technological change*. The pace of technological advance has accelerated significantly, partly as a result of increasing competition through globalization. In addition to being an outcome of competitive pressures, however, technology is an enabler of globalization. Technological capabilities have diffused around the world more widely than ever before.
- *Notion of* "*core competency*". Increasing international competition and faster pace of technological advance have robbed firms of their ability to be self-sufficient in everything they want to do. The current management mantra is to do internally what a company does best and outsource the rest through partnerships.

[1] For literature reviews see, for example, Caloghirou et al. (2003, 2004), Gomes-Casseres (1996), Gulati (1998), Hagedoorn et al. (2000), Hemphill and Vonortas (2003), Vonortas and Zirulia (2011).

- *Economic liberalization and privatization*. This process has led to unprecedented international flows of capital in the form of both foreign direct investment and portfolio investment. Developing countries have managed to increase their share of the intake (but the distribution among them remains highly skewed).

Such developments have changed the nature of international business interactions that has supported the development of a score of developing countries since the mid-twentieth century. Traditional mechanisms of technology transfer including licensing, the acquisition of capital goods, and the transfer of complete technology packages through foreign investment are being supplemented by many semi-formal and formal new mechanisms for gaining access to technologies and markets. These new mechanisms entail the formation of dense webs of inter-organizational networks that provide the private sector with the necessary flexibility to achieve multiple objectives in the face of intense international competition. The result has been an increasing interdependence on a global scale that few firms interested in long-term survival and growth can escape.

The available literature on formal business partnerships and networking has tended to focus primarily on developed countries: their firms have dominated global partnering records, at least as currently accounted for. OECD member countries have accounted for no less than four-fifths of the activity over the years. More recently the rapidly developing economies of China, India, and Brazil have registered significant international cooperative activity, especially large multinational corporations based in these countries. The same firms also dominate international trade and investment.[2]

The vast majority of the recorded alliances are classified as contractual agreements. Contractual agreements do not involve equity investment across partners or in the collaborative activity (such as in a joint venture). Sectors registering large numbers of partnerships around the globe include pharmaceuticals, chemicals, electronic equipment, computers, telecommunications, and financial and business services. Service sectors took an increasing share of the total in more recent years. The motives of firms to partner differ among sectors. Cost-economizing—e.g., share costs and risks of a technological development—appears to be more significant in capital and R&D intensive sectors such as telecommunication hardware. Strategic considerations become important when firms use partnerships to enter new product areas, especially ones with high technological and market risk. In information and communication industries a major driving force towards international partnerships seems to be the effort to develop new global product and system standards. In pharmaceuticals, cost economizing and speed to market seem to be very important. In the automotive sector, securing resources to develop state-of-the-art technologies for environmental friendly vehicles, achieving economies of

[2] For references to partnering in developing and transition countries see Deloitte (2004), Freeman and Hagedoorn (1994), Ivarsson and Alvstam (2005), Lee and Beamish (1995), Rondinelli and Black (2000), Si and Bruton (1999), and Vonortas (1998). A series of publications by UNCTAD review the literature on partnering and networking for national capacity building (UNCTAD 1999a, 1999b, 2000a, 2000b).

scale in production, and accessing markets appear to be major drivers. Finally, in the airline industry cost savings through investment in common systems of reservations, ticketing, and client services appear to be the main driving force for international partnering activity.

A major development has been the contrasting evolution of equity-based STAs (e.g., traditional joint ventures) and non-equity STAs in the past two decades. From almost 100% in the mid-1960s, the share of equity-based STAs in the total fell to about 70% in the 1970s, 40% in the 1980s, less than 20% in the1990s, and less than 10% more recently. The gap has been filled by non-equity, contractual forms of STAs such as research consortia and joint development agreements that have provided the main mechanism of inter-firm collaboration in more recent years. For instance, all countries with significant public R&D programs fund research consortia these days, with the most prominent example being the Framework Programmes for Research and Technological Development of the European Union.

High-tech manufacturing sectors—information technology, pharmaceuticals, aerospace, defense—have gradually developed a dominant position in STAs since the early 1980s. Medium-tech sectors—instrumentation and medical equipment, automotive, consumer electronics, chemicals—have followed. High-tech sectors have strongly preferred contractual STAs, relative to medium- and low-tech sectors.

4.4 A Practical Guide

Alliances can significantly expand opportunities for companies interested in accessing markets and technologies and for governments interested in indigenous capacity building and economic growth. However, benefits do not flow automatically; nor do partners necessarily gain equally. There is a lot of learning associated with setting up and managing successful partnerships and room for policy decision making to facilitate them. This section distills lessons from past experience to draw a practical generic guide to negotiating and managing successful partnerships. It focuses mostly on STAs.

4.4.1 Partnership Opportunities and Dangers

Consideration of a business partnership must always start with a careful recount of the *strategic challenges* confronting the firm in question. Management must consider:

- Where does the firm want to go in the future? What are its strategic objectives?
- What are the necessary projected steps—organizational, technological, finance, marketing, and so forth—to achieve the strategic objectives?
- To what extent do the required resources and capabilities exist internally?

The more *tactical challenges* for management considering a specific task include:

- What is the exact activity the firm is currently interested in and why can it not be either carried out in-house or bought from an external source?
- How is a partnership expected to assist in accessing the requisite resources and capabilities that the firm does not already possess?
- What kind of partners is the firm interested in? How is it going to identify them?
- How to successfully negotiate the partnership? What are the specific assets that the firm will bring to the negotiating table? How much control can it afford to give away?
- How to manage the partnership and learn from it?
- How to set clear objectives for the partnership?
- How to evaluate partnership performance?
- When and how to dissolve the partnership?

From the point of view of the firm, potential *benefits from partnering* include:

- Access to markets; create new product markets;
- Share costs of large investments;
- Share risk, reduce uncertainty;
- Access complementary resources and skills of partners, such as complementary technologies, people, finance; exploit research and technological synergies;
- Accelerate return on investments through a more rapid diffusion of assets;
- Rationalize the deployment of resources to enhance economies of scale and scope;
- Increase strategic flexibility through the creation of new investment options;
- Unbundle the firm's portfolio of intangible assets, and selectively transfer components of this portfolio;
- Co-opt competition;
- Attain legal and political advantages in host countries.

More broadly, alliances have such virtues as flexibility, speed, and economy. They can be put together in little time and be folded up just as quickly. They can involve little paperwork. An analogy of partnerships *vis-a-vis* market internalization through mergers and acquisitions would be "love affairs" rather than "marriages".

Alliances also entail costs. Regardless of strategic goals, inter-firm collaboration always implies a *trade-off* between greater access (markets, finance, resources, and capabilities) and lesser control of strategic decision making, day-to-day management, technological and other kinds of proprietary knowledge. Partial loss of control over strategic decisions, over technology use, and over market position can invite opportunistic behavior by one or more partners resulting in the involuntary loss of important assets, particularly intangible assets such as technological and other types of knowledge. Other potential *drawbacks from partnering* include:

- Increased transaction costs due to
  - increased management needs,
  - diversion of management attention
  - employee coaching into the agreement

  - decisions and responsibilities that are subject to negotiation.

- Lack of compatibility of the collaborative activity with core firm interests; e.g., locking the firm into a product/service standard that may not be in its best interest.

It should be stressed that partners often join a partnership for different reasons. Reasons for participation can shift over time, implying shifts regarding the perceived benefits and costs of collaboration. The motivation to enter into a joint relationship must, then, be not only strong but regularly reexamined during the lifetime of the partnership.

Petrobrás Subsea Boosting Technology Development

Over the last several decades, Brazil's Petrobrás has evolved successfully into a global leader in deep sea drilling techniques by using strategic alliances to help it absorb external knowledge and generate unique solutions. Particularly, the alliance strategies that it employed during the 1980s and 1990s played a crucial role in its development of subsea boosting technologies.

Subsea boosting refers to technologies that increase the flow rate of wells in deep sea oil fields. This has been an important area of concern for Brazil since most of its recent large oil discoveries have been found under these conditions. Before Petrobrás utilized subsea production, it was limited to using a Floating Production System (FPS) which was subject to problems including limited depth capabilities and setbacks due to poor weather.

Petrobrás' development of Subsea Multiphase-flow Pumping Systems (SBMS) showcases how it navigated these challenges to join the select club of firms that operate subsea production systems. It began with little to no knowledge of the technology, but was able to join an industry project to research SBMS technology, led by Scottish pump manufacturer Weir Pumps. Petrobrás' role in the project was limited due to its lack of experience, but it was able to use this experience to monitor the progress in SBMS technology and understand new developments that occurred. The project ultimately failed, but Petrobrás succeeded in gaining a much deeper knowledge of the hurdles facing the technology and which competing avenues held promise. This knowledge helped Petrobrás take the next step and establish a technological cooperation agreement with German pump manufacturer Borneman, with the goal to develop a prototype system that was suited for utilization in Brazil's offshore fields. It took a much more active role in this project and contributed extensively to a testing campaign that identified and ultimately solved the bottlenecks in the system. By 1997, Petrobrás was ready to put the innovation into production. At this time, Petrobrás ended its relationship with Borneman and entered a new joint industry project in which Westinghouse, Leistritz, and a host of other suppliers would take part in delivering the system to Petrobrás. The decision to shift away from Borneman was purely an economic choice. Petrobrás had already acquired the technological know-

how it needed to implement the system and became more concerned with system costs than technology development.

The experience of Petrobrás in its development of SBMS systems highlights how it used different modes of partnering at different stages of development in order to attain the maximum benefit at each stage. In the first stage, it was mainly concerned with learning about opportunities, and the joint industry project served as an entry point to monitor progress in the sector while minimizing costs to the firm. From here, Petrobrás was able to develop its own technology through a technology cooperation agreement and ultimately mastered this technology. Finally, it commercialized this technology through the use of industry collaboration in order to reduce its costs. Although the Petrobrás experience is special due to the great amounts of capital available to the company, it illustrates how partnering is a fluid endeavor with requirements that change and evolve as a firm progresses towards its objective.

Source: Furtado and Gomes de Freitas 2000

Tata-Fiat Joint Venture

The challenges of developing a successful joint venture are exemplified by the partnership between the Italian automaker Fiat and its Indian partner, Tata Motors. In 2007, the companies created a joint venture firm to produce engines, transmissions, and complete automobiles at plants in India. With a strong relationship previous to the agreement, the JV firm seemed like a natural progression for two companies with similar values and objectives. Fiat already had a presence in India for several decades, and established a wholly-owned subsidiary, Fiat India, in 1995. However, the Indian subsidiary struggled in the following decade, leading company executives to believe the company could not "go it alone" in the Indian market. They felt that Fiat needed a committed partner to identify appropriate products and prices for the Indian market, build an effective distribution network, and commit to a long-term arrangement. Tata Motors, on the other hand, was in a position to benefit from Fiat's technical expertise and global business network.

In 2005, the two companies began a dialogue on how they could mutually benefit from cooperation. Through high-level discussions, Fiat and Tata executives soon realized that the companies had much to gain from one another. The meetings soon led to a Memorandum of Understanding, which solidified their intent to "analyze the feasibility of cooperation, across markets, in the area of passenger cars that would encompass development, manufacturing, sourcing and distribution of products, aggregates and components." A year

later, the two companies signed an agreement for a dealer sharing network in India, with Tata Motors managing the marketing and distribution of two Fiat models, the Palio and Palio Adventure. Soon thereafter, the head of Tata Motors, Ratan Tata, was appointed to the board of directors of Fiat, signaling a new era of cooperation between the firms. This increasing level of integration set the stage for the 50-50 joint venture, which was agreed upon after a long negotiation process involving aspects such as asset values and exit clauses. The agreement seemed at first to be a golden opportunity for both firms.

Four years later, the alliance between Fiat and Tata was still in operation, with a good number of vehicles produced by the joint venture since its inception. However, as of 2011 the partnership had yet to break even and was increasingly on shaky ground. Fiat's product line had struggled to gain ground in India, with many analysts pointing a lack of Fiat model variety, and a poor perception of Fiat in India generally as the source of strains. Still, the challenges associated with the partnership may run deeper than product lineup and marketing failures. Many cultural differences exist not only on a corporate level, but on a national level as well. The future of the Fiat-Tata alliance was still uncertain, but one thing had become clear: executives from both firms should work together to improve Fiat's image and appeal in the Indian marketplace if the venture was to succeed in the long-run.

Sources: Mitchell et al. 2008; Chaudhari 2011

4.5 Partner Choice

The existence of complementary needs, assets, and capabilities among partners is generally considered a prerequisite for maximizing collaboration benefits and minimizing costs. Complementarities may be reflected in:

- Expertise in different, but commercially linked, technologies;
- Strength in different, but commercially linked, markets;
- Specialization in separate parts of the value chain.

The trade-off of linking complementary organizations may be higher transaction costs for running the partnership. The chance for disagreements, for instance, between partners on market strategy, technology designs, and decision-making processes rises. Holding all else constant, like-minded partners with similar management perspectives, goals and will result in fewer conflicts and lower costs of managing collaboration.

Common Alliance Problem: Choosing the Wrong Partner

The risks involved in strategic alliances increase substantially when the alliance is codified in a written contract, and especially when there is uncertainty about the future or a partner's reliability. For example, when Dow Chemicals signed a $ 17.4 billion Joint Venture Formation Agreement with Kuwait's state-run Petrochemical Industries Company (PIC) in 2008, everything seemed to be on track for the creation of a new leading global plastics manufacturing company known as K-Dow. Shortly after the 50-50 joint venture deal was inked, however, PIC's parent company, Kuwait Petroleum Corporation, reneged on the agreement with concerns over the ensuing global recession.

The breakup of the joint venture agreement had severe consequences for Dow, which had expected $ 7.5 billion in revenue from the sale of several chemical plants to PIC. Prior to the debacle, Dow had agreed to acquire a rival firm, Rohm and Haas, with the funds it had planned on receiving from the joint venture deal. Not only did the failure of the venture lead to a drawn out legal battle between Dow and PIC, but Dow was also facing a lawsuit from Rohm and Haas for failing to honor the acquisition deal.

Sources: Sieb 2008; Westervelt 2009

4.6 Partnership Negotiation[3]

Negotiation is one of the most important aspects of partnerships. Depending on the objectives, experience, and complexity of the deal, partnership negotiation can be a difficult process. The length of negotiation is reported to vary from a few weeks up to 2 years. Several issues are extremely important and tend to dominate the negotiation phase:

- Control of the partnership, including its equity structure and veto power over various aspects in managing the partnership (appointment of key personnel, dividend policy, technology use, export markets, quality standards, supply sources, etc.);
- Conditions surrounding technology transfer. This is the most frequently mentioned item in partnership contracts following control;
- Dispute resolution;
- Terms of partnership termination.

Common negotiation problems include:

- Valuation of the assets brought by each partner to the partnership;
- Transparency;
- Conflict resolution procedures—explicit rules and/or trust relationships;

[3] The section draws considerably on Miller et al. (1995).

- Allocation of management responsibility and degree of management independence;
- Changes in ownership shares as partnership matures;
- Exit policy;
- Dividend policy;
- Measurement of performance.

Managing Alliances: Eli Lilly's Corporate Strategy

In 1999, Eli Lilly established the pharmaceutical industry's first "Office of Alliance Management" which was established specifically to implement and guide alliances once agreements are made. Eli Lilly's management recognized that most unsuccessful alliances fail due to implementation issues, personality conflicts and other non-technical factors. The Office of Alliance Management addresses these issues and works closely with partners to ensure strategic, operational, and cultural alignment to optimize resources and meet alliance goals. This office is part of a larger framework of Eli Lilly's alliance building strategy, which also includes offices geared towards identifying opportunities and negotiating agreements with partners.

Source: Stach 2006

Fairly common *relationship problems* include:

- *International strategy-related problems*. A particular type of conflict in cross-border alliances may occur when a multinational corporation (MNC) with a global strategy forms a partnership with a local partner pursuing more narrowly defined goals. Global strategies frequently require the MNC to incur costs in one country in return for profits in another. Local partners may thus be placed at a disadvantage. Given that relationships can shift over time, this may become a problem during the course of the partnership. Such problems can include the following:
  - Export rights. Exporting sometimes represents a fundamental difference between industrial and developing country partners. A MNC may not want the partnership to freely export products to markets already be served from other manufacturing points in its system. The developing country partner will be of a different opinion as it will typically view exports as a natural avenue of expansion.
  - Tax issues. The optimization process undertaken by the MNC will cover its worldwide burden. If the partnership exports products through the TNC system, transfer-pricing strategy will not necessarily be in the interest of the local partner.
  - Dividend, investment policies. The global investment programs of the MNC may affect its preference of dividends over reinvestment in the partnership. Again, the local partner may have diverging views.

  - Partner size. Large size differences may introduce difficulties during rapid expansion periods of the partnership due to their different resource base. Size differences may also have operational implications that can cause problems (e.g., the larger firm not taking the partnership seriously enough).

- *Ownership and control problems*. Long-term, strategic partnerships may need operational management with considerable independence from either partner. Problems may arise from changes during the lifetime of the partnership. A possible change involves the management in one of the partners that may affect this firm's attitude towards the specific partnership. In addition, one needs to consider possible disagreements over time regarding changes in product lines, raw material sourcing, technology transfer and utilization, and so forth.
- *Cultural problems*. These involve both the social cultural backgrounds of companies based in different countries and the corporate culture that characterizes each company. Both types of cultures condition how people view their environment and how they interpret issues. Complaints concerning arrogance, business practice, corruption, and so forth have not been unknown to partnerships.
- *Problems related to dynamic changes in the relationship*. The changing environment within which the partnership operates alters partner relationships and can cause stress.
  - Experience in a partnership results in learning. Learning can modify how one views the contributions of the partner. Learning should happen from all sides and involves better market understanding and improved capabilities. Learning boosts self-confidence and raises expectations for partner contribution. The result sometimes is dissatisfaction. Moreover, dissatisfaction is frequently the result of differential rates of learning that make a firm feel falling behind its partners.
  - Unforeseen changes in circumstances making parts of the agreement obsolete. Introducing the necessary modifications may be difficult, even in cases where all sides agree.

Common Alliance Problem: Differential Rates of Learning

Looking to expand into the Japanese marketplace in the 1970s, General Foods Corporation entered a partnership with Japanese food giant Ajinomoto. Ajinomoto offered its marketing expertise and knowledge of local business practices in Japan, and General Foods agreed to disclose its advanced processing technology for products such as freeze-dried coffee. After several years of successfully partnering together, Ajinomoto's management began to feel that the alliance was unnecessary because Ajinomoto had internalized the advanced processing technology and was no longer learning from its American partner. General Foods, however, was not as successful learning about the Japanese marketplace and still needed Ajinomoto's expertise. When the collaboration deteriorated and eventually disbanded, General Foods was left disappointed.

Source: Barlett et al. 2008

4.7 Conclusion

The proliferation of partnerships during the past three decades has raised expectations of accelerated growth through faster access to markets and technologies and greater learning possibilities. There is evidence that inter-firm partnerships can be an extremely useful tool to assist developing country firms in their efforts to catch up. Partnerships can accordingly assist countries speed up the process of establishing competitive indigenous industries. Partnerships can also play a major role in mobilizing the necessary resources and technological expertise to upgrade lagging infrastructure.

Formal partnerships require strategy formulation and partner contribution, whether in financial resources, intangible assets, market familiarity, market access, etc. Frequently, the required level of strategy sophistication and resource commitment is considerable. It is, thus, possible that these requirements raise the bar too high for the mass of (mainly small and unsophisticated) firms in the majority of developing countries. Still, this leaves many other interactions for these agents to pursue. It seems quite probable that informal partnering through networks and clusters is a way for many relatively disadvantaged developing country firms to become stronger, more competitive, and to meet the minimum capability prerequisites in order to graduate to formal partnerships. Governments may be wise to try addressing most developing country small firm problems related to size and competitive position through networks (often more vertical, supplier-buyer relationships) and clusters (regional, more horizontal, agglomerations).

For firms that do graduate to formal alliances, the following are key lessons for success:

- Clearly understand the strategic objectives of the firm.
- Clearly determine the firm's needs from the partnership.
- Negotiate a suitable agreement.
- Treat the partnership agreement as a "living" document.
- Understand that the comparative advantages of partners at the outset of the agreement may change over time.
- Be aware that technology transfer is one of the most sensitive and contentious issues. Create clear provisions for a framework of technology use in the partnership.
- Partnership agreements must contain sound provisions for dispute resolution and, in the event of irreconcilable differences, the exit mechanism to be employed in terminating the partnership.
- Monitor and review the partnership throughout its lifetime.

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