**The New Emerging Market Multinationals**

**APPENDIX TO Chapter 4 on Acquisitions:**

**Creating Advantage and Growth through Alliances**

**Co-written with Professor Prashant Kale**





Alliances or joint ventures are an ‘alternative’ to doing acquisitions, when it comes to internationalizing through inorganic means. Here we briefly look at some of the issues in managing alliances and offer some suggestions on how to deal with them.

## Alliance Formation

First, when forming an alliance EMNCs need to ensure that they have a good business case and the right alliance partner. It goes without saying that alliances are more likely to succeed if partners bring ‘complementary’ or non-overlapping resources/skills to the relationship – that way, each partner has a reason to be interested and committed in the alliance because each company brings what the other lacks and vice-versa. For example Tata Motors has an alliance with Fiat because Fiat brings its world-class engine technology that Tata can use for its own cars, as well as provide Tata with a channel to distribute its cars in some overseas markets. In return, Tata provides Fiat its own huge distribution channel (that Fiat lacks) to sell cars in India, as well as a large committed volume of engines it will buy from Fiat. The two partners have also set up a joint manufacturing/assembly facility in India – by combining forces, they can become more cost competitive vis-à-vis their other global rivals because of the economies of size and scale they achieve.

However, partner complementary is just a necessary but not sufficient condition to form alliances. It is equally important that potential partners are organizationally compatible – which means some of their core values and style are similar enough for them to be able to work together to achieve expected benefits. This latter aspect is often a challenge in most international alliances. Partners come from different countries (with their own competitive, social and institutional conditions and norms) and hence are not always compatible enough to work harmoniously with each other. Thus we advise EMNC executives not to form alliances with undue haste. Before signing the alliance deal they can assess their compatibility with their potential international partner in some of the following ways:

- Visit the potential partner's facilities and spend enough time talking and interacting with their executives, managers and frontline staff;
- Interact with some of the partner's customers or suppliers to assess the partners style of dealing with these stakeholders;
- Study some of their partner's prior alliances to understand why they might have failed or succeed and how the partner may have behaved in those alliances.

**Alliance Governance**

Finding a good partner is critical for alliance success, but companies also need to have the appropriate design and governance to protect the relationship from any hazards due to possible opportunistic behavior by either partner. EMNC executives can use 'equity ownership' as a means to enable alliance governance – by that we mean, companies can either organize the alliance as an 'equity-based joint venture' wherein each partner holds an equity stake in the new venture they form, or they can form an alliance wherein each partner holds a minority equity stake in the other. Equity-based alliances like joint ventures facilitate better alliance governance because equity ownership creates a 'mutual hostages' situation by aligning the interests of both partners. By owning equity, partners are not only required to make ex-ante commitments toward the alliance but also their concern for their investment reduces the possibility of opportunistic behavior in the future.

Equity ownership gives each partner proportionate representation on the 'Board of Directors' of the joint venture which, in turn, allows them to supervise the alliance, monitor its functioning, and address contingencies as they arise. Equity ownership also creates a 'transparent' basis for each partner to get a share of the returns in proportion to their level of ownership, and therefore creates an incentive for partners to cooperate and work with each other. Numerous academic studies show that in general, alliances which are organized as joint ventures are more likely to succeed than non-equity or pure contractual alliances.



**Alliance Management**

Finally, alliances or joint ventures succeed only when the partners are able to effectively manage the alliance on a day-to-day basis after it is 'up and running'. Two factors are most critical in this regard: coordination and trust. Coordination refers to *aligning actions* between partners, and problems in coordination arise *even when partners' interests are fully aligned* with each other. Many of the companies we have studied have been relatively weak on this front.

To manage coordination successfully, companies should use a variety of mechanisms. First, partners can develop clear guidelines on what specific tasks will be carried out by each partner, who exactly is accountable for them, and a timetable about when that has to be done. Second, partners can also create a formal role or structure with authority and decision-making ability to oversee ongoing interaction between partners and facilitate information and resource sharing between them. For example, each company can have a 'dedicated alliance manager' on its side for this purpose, or they can jointly create a joint alliance review committee that meets regularly to play this a role. A formal mechanism like this is also useful in identifying and resolving potential conflict situations way before they become a 'storm'. Third, partners can also rely on mechanisms such as joint teams and co-location for leveraging synergies, sharing information and best practices with each other, and mobilizing resources for required actions. The exact nature of various coordination mechanisms, and the extent to which they are required, will of course depend upon the nature of interdependence between partners.



Anyone who has been involved in alliances will also tell you that 'trust' is the single most important thing in successfully managing alliances. Trust really means one of two things in the alliance context – first, it is an expectation that one's partner will not act 'opportunistically' for its own personal gain and second, it is the degree of confidence that individual partners have in the each other's reliability and integrity.

If trust is so critical a practical question to ask is: how do managers and companies develop that trust in alliances? There are a few simple ways to do this: A company can build trust by demonstrating to its partner that it trusts the partner (i.e., show that it is trusting) by making a large, unilateral commitment on its side. By voluntarily placing itself in a position of vulnerability, a company invites the alliance partner to reciprocate its actions, and inter-firm trust gradually develops between them.

A second way is to demonstrate that one is trustworthy, rather than trusting; a company must scrupulously honor all its commitments, and make sure to commit to only those actions that are within its power and ability to execute. By doing so, and living up to the expectations and commitments that are made, a firm is able to develop the partner's trust in itself and vice versa. A number of foreign companies we interviewed often mentioned that the Tata Group in India is generally at the forefront in this regard – which is why they are often one of the most sought-after partners in the Indian business environment. The Indian companies we interviewed said the Japanese partners are also generally good in this aspect in comparison to some of their western counterparts.



A third driver of trust is simply inter-personal trust, which develops between those individuals from the two companies that regularly interact with each other at the alliance inter-face. It is based on the social bonds that develop between these individuals as they work regularly with each other, understand each other's working style, and are stable in their respective roles.

**The Dark Side of Alliances - Alliances as a 'Learning Race'**

Thus far, we have focused on the positive aspects of alliances or joint ventures in that they are a means to combine complementary resources and skills of partners to achieve mutually agreeable objectives and we have highlighted some of the factors that increase the likelihood of alliance success. But alliances have a 'dark side' to them too, that can seriously undermine the long-terms interests of the companies involved. The very complementarity of resources/skills that is the raison-de-entre of almost all alliance formation lies at the heart of this tension – some companies see alliances not only as a means 'to access' a partner's complementary skills/resources, but more importantly, as a way 'to learn and internalize' those skills/resources in the long run – and when that happens they are willing to walk-out of the alliance and compete directly with their erstwhile partner. In other words, the 'short-term co-operation' between partners becomes a basis of 'long-term competition' between them. And if both partners think in this fashion, an alliance simply becomes a 'race-to-learn' between partners from the get-go, because each company is keen to learn quicker and more from its counterpart because of the fear of being left behind in this endeavor.



Such a dynamic was particularly seen in the market-entry alliances formed between many foreign multinationals entering emerging markets and their local partners. Joint ventures such as the P&G-Godrej or Kinetic-Honda in India fall within this category and it seems that in those ventures the foreign partner came out ahead. In both cases, the foreign partner was able to use the joint venture as a means to access the local partners' know-how, skills and resources (e.g., knowledge about the Indian consumers and markets, local sales and distribution infrastructure, etc), learn from it quickly, and then go its own way to eventually compete directly with their erstwhile local partner. (Of course, the local partner has the opportunity to learn global best practices and cutting edge processes as well.)

Instances such as these evoke a strong reaction from partners. For example, one Indian executive we interviewed had this to say, “Local companies have simply acted as an escort service for MNCs to help them enter the Indian market.” Such experiences leave a scar among EMNCs to which they respond in one of three ways: (a) they shun doing alliance or joint ventures in future and view them with deep suspicion, (b) they become more careful and ensure that they do not let the alliance partner take undue advantage of them and (c) they strengthen their own learning capabilities in alliances and in future when they do alliances domestically or overseas they try to be ahead in the ‘race-to-learn’ and win it.