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STRATEGIC MARKET PERSPECTIVE

Alliances and M&A in European Business Integration

Business Integration Programme – Europe

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Alliances And M&A In European Business Integration

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Abstract

This report analyses approaches to the establishment, implementation and measurement of the success of strategic alliances in the European Business Integration industry.

It also examines recent M&A activity and assesses the reshaping of the industry which is currently occurring.

The objective of the report is to assist vendors by helping them better understand key aspects of the strategic alliance process, including partner selection, how to foster alliance success, typical alliance problems and measuring alliance success.

Alliances and M&A in European Business Integration will provide improved understanding of the potential problems associated with alliances, as well as areas most likely to provide benefit. This will assist companies that are considering forming alliances by identifying selection criteria, defining methods of ensuring success and indicating ways to avoid failure.

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Alliances And M&A In European Business Integration

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I

Introduction

This report, *Alliances and M&A in European Business Integration,* is produced as part of INPUT's European Business Integration programme which tracks and analyses the Systems Integration, Turnkey and Professional Services industries.

A

Scope, Background and Purpose

In this report, INPUT analyses how best to approach the establishment, implementation and measurement of the success of strategic alliances in the Business Integration industry.

The research on which this report is based was undertaken against the backdrop of a number of partnerships, acquisitions, alliances and mergers recently announced or now under way both in Europe and the United States. U.S. data is included in this report where it is of direct relevance to competition in the European marketplace due to the increasing global nature of supply and demand in large-scale systems development and integration.

Some of the most high profile deals of this nature include:

- *Xerox and the Electronic Data Systems (EDS) division of General Motors.* This started in June 1994 as a $3.2 billion 10-year contract for EDS to assume day-to-day operational responsibility for Xerox's global information management system. In March 1995, EDS in turn awarded the Xerox Business Services division a five-year, $500 million contract to operate and manage some 100 EDS high-volume, networked print centres worldwide.

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- *Andersen Consulting and GE Capital.* This March 1995 alliance to pursue opportunities in the U.S. information technology outsourcing market focuses on mainframe computer operations. It includes the purchase by GE Capital of Andersen Consulting's OM/NI Solutions Centre, thereby substantially expanding GE Capital's Commercial Processing Services business. The two firms anticipate delivering "best of breed" information technology outsourcing solutions by serving customers from their respective core competencies: Andersen Consulting will focus on helping firms to manage and continuously improve their information technology function overall, while GE Capital will provide mainframe services to improve cost effectiveness and efficiency.

- *SHL Systemhouse and AT&T Global Information Solutions (AT&T GIS) now renamed NCR.* As agreed in March 1995, AT&T GIS will license for use within AT&T and will resell the SHL TRANSFORM performance support software environment. AT&T GIS expects to use the SHL client/server education and systems development software environment to combine the knowledge base and services methodologies of a number of AT&T business units, providing a comprehensive information resource to AT&T services professionals worldwide.

- MCI's subsequent acquisition of SHL Systemhouse.

- *GE Capital and CIS Technologies.* In November 1994, these two firms formed an equally owned business entity to provide accounts receivable financing to the health care industry, based on a $2 million investment by GE Capital, which is also providing access to up to an additional $7 million in debt. CIS Technologies is providing technology, research, and transaction processing service and support. Both firms will provide sales support and management.

- *Hewlett-Packard and Oracle.* As announced in December 1994, the two firms will jointly sell and market the deployment, using Hewlett-Packard Odapter software, of large-scale object-oriented software applications on the Oracle7 relational database management system.

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- *Wang Laboratories and Bull (Integris in the U.S.)* exchanged cash, equity investment, and certain operational units to make Bull/Integris the preferred worldwide integrator and reseller of Wang's workflow and imaging software and to make Wang a worldwide distributor of Bull's open systems products. Bull receives an equity position in Wang and cash; Wang receives Bull operational units for U.S. Federal Systems Integration, for U.S. Customer Service, and for workflow and imaging software business worldwide.

- *SHL and various others,* including: *Vanstar* for offering technology deployment services; *Oracle* for jointly marketing Oracle Cooperative Applications and SHL's transformational outsourcing services, and for Oracle/SHL fixed-price migration of customers' financial systems from mainframes to open systems; *Microsoft* for major early NT implementation and joint clients' implementation of Exchange; other agreements with *Sun, TSW, Pyramid, Information Advantage,* and *PowerSoft.*

- *SAP and some 50 other firms* that are Technology Partners, Platform Partners, Implementation Partners, and Logo Partners, including recently announced agreements with *Information Resources Incorporated, DEC,* and *Andersen Consulting.*

The objective of this report is to assist vendors by helping them better understand key aspects of the strategic alliance process, including:

- Different types of partnerships
- Selecting partners
- How to foster alliance success
- Typical alliance problems
- Time factors during the alliance
- Measuring success.

In the report's concluding chapter, INPUT summarises key recommendations for success in strategic alliances, as drawn from findings throughout the report.

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B
Methodology

As listed in Exhibit I-1, INPUT conducted telephone interviews with 22 consulting and technology firms in the US and Europe who are or have been involved in strategic alliances.

Exhibit I-1

Firms Interviewed

- American Management Systems
- Andersen Consulting
- Arthur D. Little
- AT&T
- Boeing
- C3
- CACI
- Cambridge Technology
- Computer Sciences Corp.
- Control Data
- Corporate Software
- DEC
- Electronic Data Systems
- Ernst & Young
- Grumman
- Hewlett-Packard
- PRC
- Price Waterhouse
- The Registry
- SEI
- Tandem
- Wang

Source: INPUT

Structured questionnaires were used to collect this data. Secondary research sources, such as industry journals, periodicals, and other INPUT reports also were studied for preparation of the report.

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C

Report Organisation

The report consists of five additional chapters:

- Chapter II is an Executive Overview highlighting the key findings of the report.

- Chapter III tracks the development and role of collaborative agreements and M&A activity. It also provides details of some of the most high profile recent deals affecting the BI industry including IBM and Lotus, MCI and SHL Systemhouse, and EDS and AT Kearney.

- Chapter IV provides background on setting up alliances, and describes the types of strategic alliances found from the survey and the most important factors in selecting a partner. It also provides advice for firms that want to maximise the success of their strategic alliances.

- Chapter V identifies key problems encountered during alliances, indicates to what extent alliance success varied over time, reviews the measures of success that have been used and concludes the report with a summary of recommendations for vendor success in strategic alliances.

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Related Reports

For additional insight into strategic alliances, readers are encouraged to consult other INPUT reports, such as the following:

- Systems Integration Market — Europe, 1995 – 2000 (1995)
- Business Integration Market, Competitive Analysis (1995)
- Managing Risk in Systems Development Contracts (1994)
- The Role of the Chief Financial Officer in Outsourcing Decisions (1994)
- Pricing and Marketing of Outsourcing Services (1994)
- Procurement Approaches to Systems Integration Projects (1993)

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II

Executive Overview

A
Convergence Drives Industry Reconfiguration

Although, almost inevitably, there has been something of backlash against the concept of *Convergence* over recent months, *Convergence's* underlying technological foundation is indubitable, is finally becoming a reality, is increasingly influencing the individual development of both areas, and is making it no longer feasible to think about IT and communication technologies in isolation.

The commercial ramifications of these technological developments are driving a period of creating, what, even in late 1994, would have appeared a number of unusual new alliances and interest blocks.

Organisations from many different backgrounds and heritages in computing and communication industries are engaged in a process of frenzied merger, acquisition and alliance activity that is currently altering the shape of the large project service market; new and different value chains are emerging through the convergence of different companies, markets, and sectors. Service vendors, aware of the implications of these developments on their access to both traditional and new marketplaces, are attempting to ensure that fundamental shifts in the nature of demand do not leave their services offering isolated in legacy markets.

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However, the very nature of this profound period of change, offers enormous challenges as well as opportunity.

The IT industry is littered with examples of failed collaborations, alliances, and partnerships; it is clear that in the current flux many organisations will make either poor strategic decisions, or execute these potentially correct decisions badly. Of course, some may do both.

Vendors of Business Integration services, engaged in alliances, M&A's, or partnerships face the requirement to rigorously examine both the strategic and operational implications of undertaking major business alliances, and in particular:

- Explicitly agree an understanding of a common set of *business*-related objectives
- Examine, at the earliest stages of the deal, potential reasons for the failure of the relationship, and identify appropriate and mutually acceptable exit strategies
- Be cogniscent of the primacy of organisational "cultural fit".

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B

Agreeing Common Sets of *Business*-Related Objectives

As shown in Exhibit II-1, two categories of advice stand out in the feedback from the firms interviewed for this report in terms of making alliances or any form of strategic business relationship work.

Exhibit II-1

Vendor's Most Common Advice

- Alliances succeed only if there are shared corporate commitments, objectives and goals and understandings — Advice offered by 86% of the firms interviewed
- Nurturing of both communications and the working relationship is key to alliance success — Advice offered by 41% of the firms interviewed

Source :INPUT

The most common advice is to ensure that corporate commitments are shared between the alliance partners, keep objectives and goals in alignment, and ensure that the partners' understanding of the terms of the alliance are not in conflict.

The second most common category of advice focuses on the need for nurturing communications — person-to-person and organisational — and the alliance's working relationships, to encourage a high degree of alliance success.

Firms entering an alliance are urged to be sure that the partners' understanding of objectives and benefits is clear to both parties. This includes the specific advice to be sure that both the partner's objectives and the firm's own objectives are understood clearly. Also, be sure these are communicated accurately. In addition, look for mutual benefits within those objectives. One form of mutual benefit is profit sharing; 41% of the firms interviewed report that profit sharing is a partnership objective with which they have experience.

Roles and responsibilities of each partner must be agreed upon prior to the start of the alliance. Who will undertake what roles — separately or

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jointly? Which responsibilities will be shared, and which will be assigned to only one of the partners?

To help clarify these roles and responsibilities, it is recommended that shared measurements be clearly agreed to, and that each partner understand what metrics are used internally by the other to judge performance.

One specific understanding that is critical to the success of the partnership is just what resources and investments are being committed to the alliance by each party; a mentality of "investing in the alliance" on both sides will help to ensure success of the partnership. Without this either side may at any stage become suspicious of the commitment of the other.

Corporate commitment includes both financial commitments made by each side as well as being sure that the alliance fits each firm's long-term corporate strategy. Both corporate and executive commitments should be matched from the outset.

In order to best implement this advice about commitment issues, INPUT recommends that as many of these as possible be dealt with before the partnership agreement is finalised. Explicitly state both shared and separate corporate objectives and benefits expected, for mutual sign-off as part of the agreement.

The other, closely related category of advice cited here is the need to nurture communications among all individuals in the partnership in order to continually strengthen the working relationship.

What this means above all is consciously caring for the "health" of the working relationship. Interviewees in this report said repeatedly that the key to generating this health is effective communication.

Regarding these communication issues, INPUT recommends that a firm's care for the alliance's working relationship should start even before the agreement is signed.

Successful alliances look for opportunities to bring in other individuals or points of connection and communication to improve the effectiveness of the working relationship. Look carefully to see if trust and win/win deals are the prevailing tone of the relationship, and implement corrective actions if they are not.

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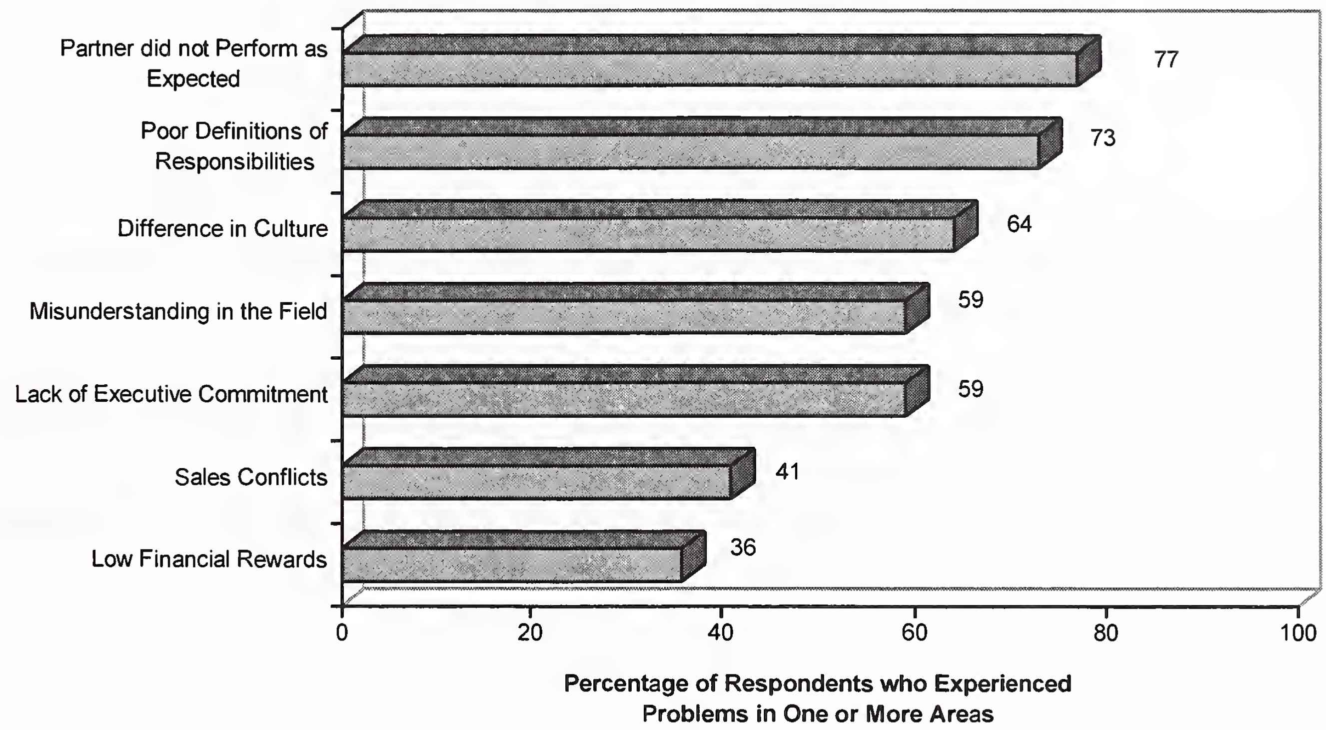
C

Understanding Reasons for Failure

Firms surveyed replied to questions on the top problems they have encountered with strategic alliances, providing the overall ranking of problems shown in Exhibit II-2.

Exhibit II-2

Reported Problems with Alliances



Source: INPUT

Two problems stand out at the top of the list:

- Failure to perform as expected during the course of the alliance
- Responsibilities that were not clearly defined.

It comes as little surprise that there is a strong correlation between these two factors. Note that in three-quarters of the instances where a firm reports problems with a partner not performing up to expectations, it also mentions problems with poor definition of responsibilities.

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This fits directly, of course, with earlier-reported feedback about setting and communicating clear roles and responsibilities.

Clustered together as moderately important are three other problem factors. First among these is a difference in cultures between the partnering firms. It is interesting to note that two-thirds of those reporting culture differences also report international alliance experience, which may have been a contributing factor; on the other hand, some with international experience report no culture-clash problem, and some without international alliances still report culture problems, presumably of the "corporate culture" type.

Second in this group of moderate problems are situations of field-based misunderstandings within the alliance. These are mainly due to lack of, or poor, communications regarding the implementation aspects of the alliance. Third are problems that stem from lack of executive commitment, which once again is a key point of advice cited earlier in this report.

Significantly lower among alliance problems reported are sales conflicts between the partners and financial rewards that fall below expectations. This indicates that most firms are realistic with regard to their expectations of financial rewards from alliances, and they are effectively managing the sales activities related to their alliances.

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D

The Primacy of "Cultural Fit"

Vendors actively involved in alliances or M&A activity in this current period of significant change in the IT and communications industry, hoping to benefit from "value-chain mutation" by staking out new, potentially explosive market opportunities, face major challenges in making these collaborations work.

Integrating disparate IT systems following in the wake in M&A activity is clearly one of the key offerings Business Integration (BI) vendors offer to their client organisations. In making BI-related alliances, acquisitions and partnerships successful vendors are faced with the challenge of applying these skill sets to their own internal organisations.

How to merge IT systems is often one of the major issues for executive management boards pushing through a merger or acquisition. BI vendor's independent, external skills are often key in undertaking this type of project. One of the key problems for BI vendors in making this happen for their external organisations is the lack of this external, impartial role.

There are a number of high profile examples of mergers being scrapped through a failure to agree on which technology should be kept, which abandoned and what are the best environments for future development.

There is a body of academic research which argues that technology is becoming one of the key stumbling blocks in the transitions organisations face in the process of acquisition, merger, or alliance. IT is coming to occupy a central role in the integration of business operations.

BI vendors face serious challenges in attempting to manage these potential problems without the use of external consultancy or services-led IT assistance.

Perhaps the most important challenge vendors face though is the one of integrating the diverse cultures organisations with different backgrounds invariably have.

Change in any sphere, be it operational or strategic, is a long-term exercise which brings dislocation, pain and self-doubt. Changing *culture* or attempting to forge a completely new culture increases these experiences by a factor of ten.

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Many of the large management consultancies have themselves undergone much of the pain of cultural change, driven by the pre-recessionary drive for market share, which led to the merger that formed KPMG Peat Marwick, and the mega-merger between Coopers & Lybrand and Deloitte Haskins & Sells. KPMG's experience and that at the now renamed Coopers & Lybrand (after a brief time as Coopers & Lybrand Deloitte) shows that there are many casualties of often bitter and intense restructuring attempts to derive a new culture from two existing ones.

Whether the recent moves made by EDS, Unisys, MCI, Microsoft and AT&T are successful remains to be seen. EDS will for some time be a melting pot of management consultancy cultures. Either a hybrid EDS culture, distinct, robust, and marketable, will emerge or the differences will lead to a difficult period of internal struggle in which focus on the marketplace will be undermined and the very advantages of the exercise will be lost.

However, success in this period will offer BI vendors a clear differentiation opportunity in the marketplace.

Technical based BI vendors, with enhanced and revamped business consulting skills, especially in the *soft* areas of change management will be well positioned to help their clients introduce and manage new emerging technologies and management approaches.

The market proposition of business enabling technology will be a powerful message in the increasingly business conscious environment, but an environment that is still technology driven.

The other key gain vendors will achieve is the ability to leverage, from reference through to delivery, their own experience of undergoing and benefiting from change.

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Exhibit II-3 summarises the eight areas of INPUT's key recommendations for alliance success.

Exhibit II-3

Key Areas of INPUT Recommendations

1. Objectives and understandings
2. Communications
3. International considerations
4. Choosing a partner
5. Types of alliances
6. Definition of responsibilities
7. Impact of time
8. Measuring success

Source: INPUT

The first two recommendations relate directly to the most common categories of alliance advice provided by firms, as listed in the previous exhibit.

INPUT recommends that a firm entering into a partnership looks for close alignment in the commitments that each partner is willing to make and the primary objectives that each has for the alliance. Included in this is the alignment of each partner's understanding of the terms of the alliance, both initially and over time. Each partner in an alliance must work carefully at nurturing the alliance's communications channels, in part to foster a shared mutual understanding of the alliance's terms over time. Closely related, the alliance's working relationship itself must be consciously examined, and enhanced wherever and whenever possible, if the partnership is to succeed.

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III

The Role of Collaborative Agreements and Mergers and Acquisitions

A "Cooperation" Becomes of Key Importance

As the information services industry undergoes continuing and increasingly more rapid change over the next decade so will the role of collaborative agreements and mergers and acquisitions expand. These will be two of the major mechanisms by which the industry will be re-engineered to adjust to the dynamics of the market.

Any company facing the challenge of expanding into new markets, whether defined geographically or by service product has a number of strategic options available to them:

- Start-up a new operation
- Employ an agency
- Establish a strategic partnership
- Acquire or merge with another company.

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Each of these options present certain advantages and disadvantages as summarised in Exhibit III-1. In this section we are concerned with the rationale for undertaking collaborative agreements (strategic partnerships) and M&A activity from the perspective of information services vendors.

Exhibit III-1

Strategic Options for Information Services Vendors

Strategic Option	For	Against
New Start Up	Full Control	Too Slow And Costly To Achieve Full Market Position
Select An Agency		Lack Of Control
Establish Strategic Partnership	Access To Markets And Expertise	High Potential For Conflict
Merger Or Acquisition	Achieve Synergy	Financial Commitment High – Management Challenge

Source: INPUT

1. M&A — Principal Motivators

The motivating factors that drive M&A activity are complex and will often be particular to the companies and senior executives involved. Some of the principal factors are likely to relate to:

- The desire to operate on a larger scale for economy and profitability
- The desire to expand market share and thus increase pressure on competitors
- The need to diversify into new markets and effect restructuring
- The need to enter a new geographic market
- The desire to inject new management into an unsuccessful company, for example rescuing a company in distress.

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In addition to these positive motivators there may well be negative motivators in operation. Mergers between companies can be motivated by defensive reasons. For example, two companies might see themselves as being vulnerable to competition or indeed to being acquired in a hostile situation.

In the information services industry M&A activity can largely be attributed to the need to achieve a critical strategic size, to handle larger contracts for example, gain access to a critical technology or market base of customers. Achieving critical size was clearly one of the prime motivators behind Olivetti's recent failed attempt to merge its services division OIS with Finsiel in Italy. It is this need to obtain critical size that is discussed in more detail below.

To obtain a better understanding for the vendor's rationale in approach to M&A activity it is instructive to look at the structure of the European information services industry, analysed by the principal revenue size categories.

Exhibit III-2 illustrates the vendor analysis categorised by annual revenue bands. Those companies with revenues of over $100 million per annum can typically be described as operating on a global basis, or at least aspiring to operate globally. This group contains all the major system vendors.

The next category (annual revenues falling in the $10 million to $100 million) can be described as regional vendors. They operate in more than one country or concentrate on specific regions. For example, a number of large French information services vendors (e.g. Sligos) have expanded into Italy and Spain; the largest German vendors target the German speaking parts of Europe, whilst UK based vendors have targeted the English speaking markets.

Those vendors with revenues falling in the range of $1 million to $10 million per annum are almost exclusively national companies. They have some exports but these are likely to make only a marginal contribution.

Companies with revenues under $1 million are likely to serve only either a very specialised or localised customer base and are very unlikely to export products or services.

In total INPUT estimates that there are some 10,000 vendors operating in the European Information Services industry. There are also probably

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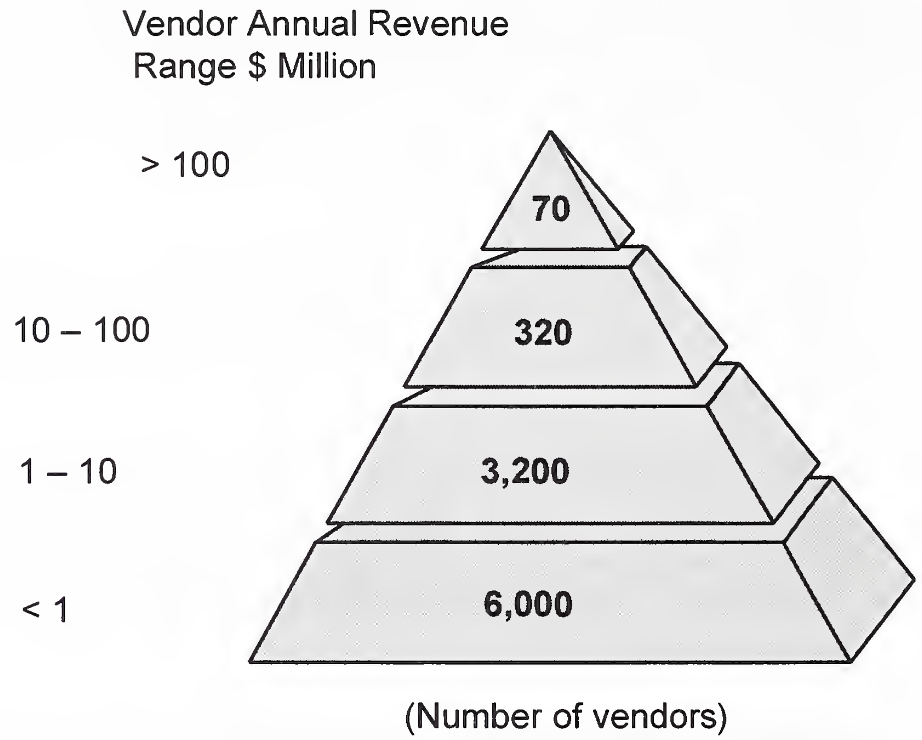
another 20,000 organisations generating some information services revenues that does not exceed $250,000 per annum, the minimum level at which **INPUT** would recognise the organisation as a vendor firm.

Exhibit III-2

Industry Structure European Information Services Industry (1995)



Source: INPUT

The major vendors, those in the top tier of the industry, are clearly motivated by the ambition to develop critical market size and geographic coverage to support a global position.

The need for global market positioning follows the general movement towards international corporate activity and the emergence of larger, regional trading blocks. The EC initiative to create a single European market during the 1990's was one of the important manifestation of that trend. Increasingly strong national companies have sought to establish a wider European base. Making an acquisition one of the few realistic strategies that can be used to escape the 'middle size' dilemma. However, although it may be a necessary condition for achieving critical size, it is certainly not a sufficient one.

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The need for critical market size is determined by other factors, in principle the capability to offer a genuine breadth and depth of skills, services and management experience and expertise. This is particularly critical for systems integration contracting where a vendor required the customisation tools, experience and capital structure to serve as the prime contractor. These are the key attributes of the large firms which will impose significant demands on management attempting to create them for the potentially diverse cultures for acquired firms.

We can summarise relevant dilemmas for information services vendors in the following way:

- **LARGE** firms compete on the scale and depth of their expertise and can achieve strength through diversity
- **MEDIUM** sized firms are just not big enough to offer the same depth of skills across a broad range of services as are the large firms but they tend to have similar overheads and cost structures
- **SMALLER** firms can compete on cost
- **NICHE** firms compete on high competence in a narrow sector.

Thus, there exists a tendency for concentration at the top and fragmentation at the low end of the industry (see Exhibit III-2) with medium sized firms being squeezed in the middle. This is one of the key motivations for M&A activity. However, the appropriate size of an organisation will be a function of the particular objectives chosen or forced upon the company by competitors and market conditions.

An alternative to an M&A strategy in this situation is to seek some form of collaboration and this is discussed in the next sub-section.

2. Collaboration — Principal Motivators

The need to establish a critical market position, discussed in the previous section as one of the principal motivating forces for M&A activity, is also a powerful motivator for collaborative ventures. The gaining of that critical market position can imply the need for:

- Meeting specific marketing goals
- Meeting financial objectives
- Gaining access to specific skill capabilities.

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Alliances will often have clear marketing goals. An alliance can assist in gaining access to markets that would otherwise be out of reach or require unrealistic levels of finance. An alliance can bring the key contacts and local or specialist market knowledge required for successful market penetration or development.

The financial aspect, is clearly a major factor, few companies can afford the costs of developing all of the marketing opportunities available to them. Additionally an alliance may represent a means of controlling operating costs where an alliance can be formed with an organisation having a lower cost structure to fulfil some vital part of the overall client contract. This could be of particular importance in situations where the vendor needs to provide an international service.

Another key factor that may motivate the need for an alliance is access to specific capabilities. An alliance may just serve to augment internal capabilities. Possible capability areas that vendors might seek to just supplement through an alliance could include:

- Network management
- Equipment maintenance
- Disaster recovery services
- Applications maintenance
- Applications development
- Consultancy.

System vendors have been one of the most active groups adopting collaboration strategies. IBM in particular has created numerous alliances and relationships to assist its drive into system services. Groupe Bull has adopted a partnership approach to the SI market, developing relationships in Europe with amongst others, Andersen Consulting, Cap Gemini Sogeti, Logica and British Telecom.

Services vendors still need access to the powerful marketing leverage that system vendors wield. However, the need exists for system vendors to extend or maintain their sphere of influence in an increasingly open world.

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Systems Integration and Outsourcing services represent a potential threat to account control. System vendors seeking partners to assist them in protecting their existing sources of business.

In many situations the client, aware of the lock-in to a particular equipment vendor, is anxious to have the guidance of a full service independent firm that can, in effect, act as an umpire for strategic platform and system architecture decisions.

The emergence of this new buying approach will present a channel control problem to equipment vendors, potentially cutting off the direct interface to the client in some situations. The general move in the industry towards emphasis on applications (services) rather than equipment (products) is increasingly forcing equipment vendors into commodity markets as channel control is lost. Commodity markets are dominated by the lowest cost producers or those vendors with an excellent or unique product strategy.

Some examples of vendor alliance strategy objectives are identified in Exhibit III-3 and discussed below.

System vendors have developed strong alliances, to augment dedicated in-house staff, and to add software products and professional services (including business consulting). These moves allow them to offer a full range of support services. IBM and Digital are involved in many such alliances. Vendors have also added systems operations resources. Systems operations firms recognise systems integration contracting as a vehicle for building systems for clients that they can later convert into long-term systems operations contracts. Communications firms are adding both software and professional services to expand network services into full-scale systems integration capabilities.

It is not clear how successful these actions will be in expanding market share. For some vendors, the addition of new capabilities and entry into new markets represents a real challenge to traditional cultures. Some vendors have already recognised that they are better serviced by leveraging their internal skills and products rather than attempting to provide a large number of services and products that are not synergistic with their core businesses.

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Exhibit III-3

Emerging Alliance Strategies

Core Business Category	Required Additional Capabilities	Strategic Objectives
Computer Equipment	Software Development Software Products Systems Operations	Full Range Services
Telecommunications Equipment Vendors	Software Development	Network SI
Professional Services - Management Consultancy	Software Products Software Products Network Services Systems Operations	Full Range Services
Professional Services - Software Development	Software Products Management Consultancy Systems Operations Network Services	Full Range Services
Systems Operations	Professional Services	Systems Operations
Engineering Products Companies	Professional Services	Support Core Business
Network Services Vendors	Professional Services	Support Core Business
Network Services	Professional Services	Network Services
Telecommunications Service Operators	Software Development	Network SI

Source: INPUT

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B

Vendor Collaboration Strategies

The emergence over the last few years of vendor alliances, distribution agreements, collaborative research and equity partnerships, has rapidly become one of the most significant features of the information systems and services business.

The selection of partners and the management of collaborative ventures are likely to be increasingly important challenges for vendors during the late 1990's. This chapter addresses these issues through an examination of:

- The various modes of collaboration possible
- The potential benefits and pitfalls associated with strategic partnering
- A review of some significant examples of vendor collaborative initiatives.

1. Strategic Partnering Options

The concept of strategic partnerships and alliances involves separate, legal entities (and in some cases even competitors) assigning roles within their overall strategic plans to other vendors' products or services in an attempt to include areas of business that are outside their current capabilities and resources.

Strategic partnering represents a fairly new concept of cooperation among companies. Although it has recently found particular favour in the information services industry, legal and structural precedents for strategic partnering have come from other major industries in recent years, such as in the automobile, steel, petrochemical and pharmaceutical industries. Much of the initial strategic partnering in these other industries has been with foreign companies, particularly the Japanese, who have long been practitioners of strategic partnering, which is related in part to the policies of their governments.

Strategic partnering is not an "all or nothing" proposition; it can be used as a limited support option at every level of the corporation, e.g., capital requirements, marketing sales, service, and R&D, as depicted in Exhibit III-4.

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Exhibit III-4

Strategic Partnering with the Outside World

FINANCE	Venture capital, "big brother" sponsor
MARKETING	Packaging, pricing, positioning
SALES	Distribution channels, manpower, wholesale/retail outlets
SERVICES	Post sales support
R&D	Partnerships

Source: INPUT

There are several types of alliance mechanisms that can be used to achieve these various support options and these are shown in Exhibit III-5. The partnering relationships explained below are ranked in the order of highest strategic involvement and thus of decreasing commitment or expenditure.

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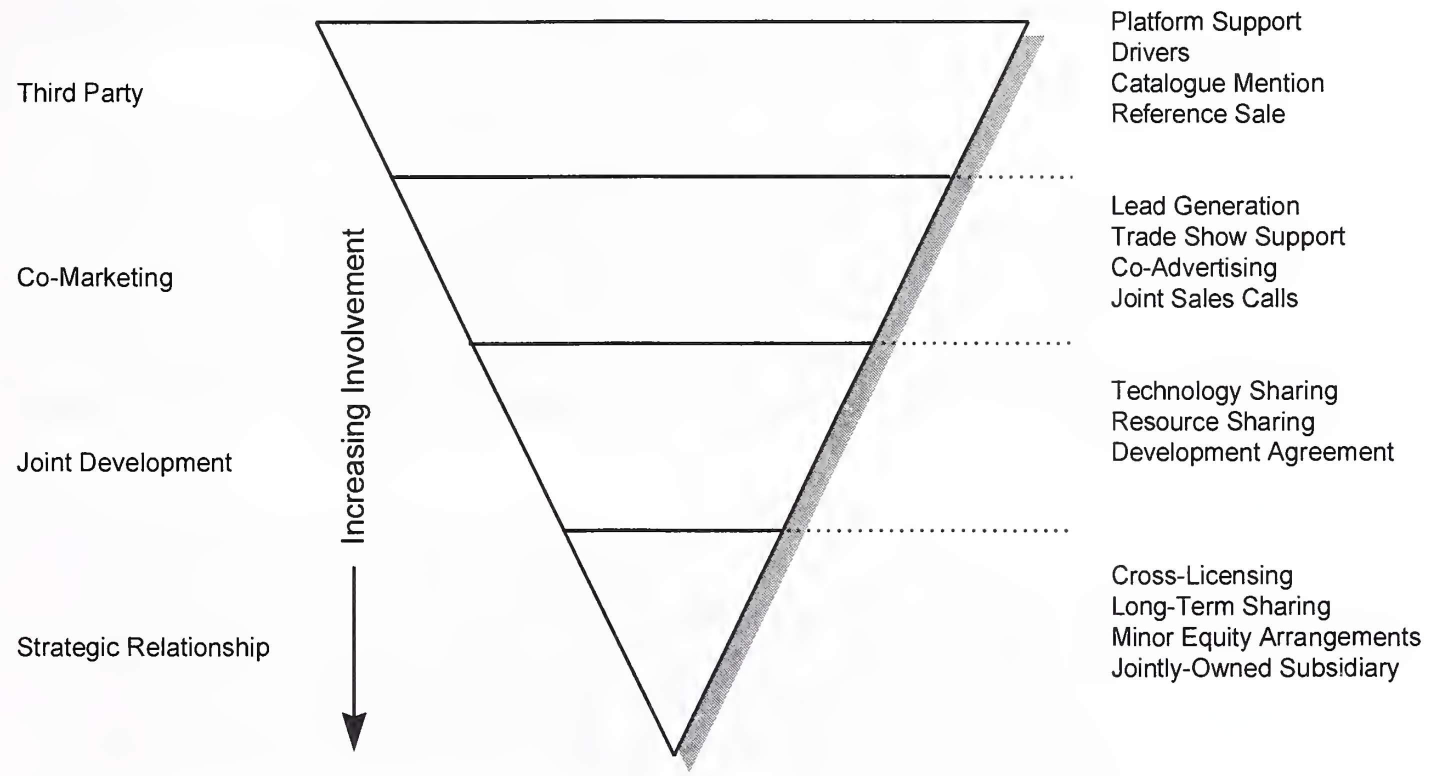
Exhibit III-5

Alliance Mechanisms



Source: INPUT

2. Strategic Relationships, Joint Ventures

There are occasions when companies agree that it is in their best interests to work together over a long period of time, generally years. Resources are expended and the results of the efforts are shared and agreed upon up front. A jointly-owned subsidiary or equity sharing arrangement using cross licensing is the technique that is generally employed.

The creation of strategic relationships has become over the last several years, one of the key features of the information technology industry. System vendors, notably IBM, have been particularly active in establishing strategic relationships with other firms, the recent IBM/Apple accord being one of the most interesting, given the competitive history of the two firms. Further examples of strategic relationships for IBM and other vendors are given below.

Some industry participants have preferred to describe such relationships as *tactical alliances* implying that the goals envisaged are relatively

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short-term and that the motivation for them is probably more defensive than offensive.

Venture capital financing for a start-up company can also be considered as a type of strategic partnering.

Still another type of strategic alliance activity is that between the information service vendor and a third-party maintenance provider, particularly one that can provide cheaper maintenance rates than the original product manufacturer. Such relationships can help the information services vendor establish tighter account control over the maintenance and support revenues coming from its user base as well provide for the continuing of relationships that help foster add-on product sales.

One of the most significant trends in the information services industry, which is promoting the need for strategic alliances, is the strong demand developing for integrated, networked solutions often delivered by means of systems integration contracts. The ability to provide multivendor connectivity and a broad array of product offerings, and the necessity to customise many such project offerings, are requiring alliances among vendors.

This requirement is particularly strong in the government and particularly the defence sector. The scale of projects (several hundred million dollars) is so great that a team of suppliers is required to absorb the project management and financial risk involved. For example in the CHOTS contract for the UK Ministry of Defence, the winning prime contractor ICL estimated its bidding costs at nearly $40 M and the unsuccessful consortium, led by BT and including Bull and SNI pulled out after investing in the region of $35M to bid.

In all of these areas of opportunity, the key to a successful relationship is finding a partner that can perceive the mutual benefits the alliance can/may bring, while preserving the independence of each. This entails a substantial element of risk and mutual trust, not only in the abilities of the respective partners but also in the ultimate goal that each is pursuing. An arm's length relationship is best, where possible, since it preserves the identity, freedom of choice, and image of the partners. However, many will find it necessary to conclude a closer agreement involving mutual monitored shareholdings representing commitment and interest in the growth and profitability of the partner.

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3. Joint Development

Joint development is used as a mechanism to create a capability using both participants' technology. This means that finance and other resources are budgeted and the budget to be created is mutually advantageous and probably available more quickly than if it were attempted by either party on a separate basis.

The joint development relationship is frequently part of or can be developed into a longer term relationship, which INPUT defines as a strategic relationship. Thus IBM and Apple's joint development pre the 1995 acquisition was refered to as a strategic alliance. The relationship established between ICL and Fujitsu eventually led to an 80% stake being taken in ICL by Fujitsu.

4. Co-Marketing

This arrangement strengthens the third-party relationship (described below) by the amount of additional resource that each company expends to proactively help market each other's products.

The type of activities used in this mode of partnering are:

- Lead generation
- Trade show support
- Joint sales calls.

This type of relationship can also be characterised as more of a software publisher's role for the computer systems vendors. Computer systems companies more recently have been very aggressively pursuing cooperative marketing partnerships.

An example of this kind of activity is that between Hewlett-Packard and Software AG. In this arrangement, the two companies jointly market UNIX versions of Adabas, Natural and Network for HP9000 computer systems.

ICL has a similar type of agreement with D&B Software for the provision of applications products on ICL Series 39 systems.

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5. Third Party

In this relationship, the software vendor develops the application to work on a specific system platform or with a specific software module. This may entail the need of a small amount of software to customise the application to the particular environment. When this occurs, the two parties place the relationship in a catalogue of such relationships. It is this which differentiates the relationship from that of co-marketing where the marketing is pro-active from both parties.

This is a popular alliance mechanism today, with each of the larger computer systems vendors, in particular, having developed hundreds of such relationships in an attempt to stretch the potential appeal of their systems as far as possible.

Value-added reseller (VAR) agreements and agency agreements between computer system vendors and independent software developers have become an extremely important distribution channel. VAR relationships can move into the co-marketing classification where the system vendor becomes increasingly active in marketing particular applications software products. This direction is impelled by increasing competition amongst system vendors for the higher-quality VAR's or VAR's with the most significant application products.

Companies such as Digital Equipment are placing a major emphasis on third parties for application software solutions, with Digital providing the application development tools to facilitate the integration of the application software with its network architecture and systems software products.

In contrast IBM has placed more emphasis on equity participation, for example with PAXUS in insurance systems, with QSP (Quality Software Products) in accounting systems, in order to attempt to gain more control over the development and marketing process.

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C

Advantages and Disadvantages of Strategic Partnering

The adoption of strategic partnering as an integral part of a vendor's market thrust has a number of paired advantages and disadvantages. Whether this approach will be a positive or negative step for a given vendor will be largely determined in large part by management strength. Strategic partnering is not a prop for weak management or a panacea for internal structural weaknesses. Strongly managed companies, can thrive on this approach because it extends their sphere of influence. It can expand their technological market and product and managerial horizons while increasing the pace of growth and access to new markets.

Vendors can emerge from strategic partnering either strengthened and invigorated or in disarray; learning about the company's strengths is productive — learning about the company's weaknesses in excruciating detail can be destructive and debilitating.

Some of the principal reasons that contribute to the difficulties inherent in managing strategic partnerships are:

- The intended benefits are asymmetric and expectations are overextended, particularly in respect of financial goals
- They can involve a loss of autonomy and control for one or other of the partners
- The circumstances of the business unit may change
- They are inherently more unstable than acquisitions and thus require significant investment of time by senior executives
- There are no established guidelines on how to handle the intercompany relationship
- Each relationship is unique, and the parameters governing it are constantly changing
- Strategic planning relies on companies doing an excellent job at something some companies have difficulty with, strategic planning
- Strategic partnering has such a profound effect on a company that it may alter the organisational structure on an ongoing basis, as the partnership develops.

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The difficulty inherent in managing collaborative ventures has led to considerable pessimism amongst managers as to the success rate for strategic partnering. However, research undertaken by Mckinsey and published during 1991 provides a more optimistic picture. The study, which covered acquisitions as well as alliances, found that over half of the initiatives were successful on the basis of financial criteria. Alliances, in distinction from acquisitions, can be used to develop both the core and non-core activities of a company, acquisitions work best when used to strengthen core activities. Alliances can also be used effectively to fill functional holes in an organisation and to share finance.

Strategic partnering has proven to be successful among Japanese companies, and as such the Japanese model for partnering/collaboration is now being studied in more detail. Guidance is needed on how to maximise the advantages of partnerships while guarding against negatives, such as the unwanted transfer of competitive advantages to the partner.

One observation that has been made concerning Japanese international alliances is that they enter into them with a clear expectation that they will last for less than 10 years and that they will end by the buy-out of their partner.

Some of the factors to consider for achieving success in strategic partnering include the following.

For the smaller partner:

- Avoid an overdependence on the partner that could substantially weaken the smaller partner if the alliance is cancelled.
  - Don't look to the bigger partner as "the" solution for a particular problem, or don't let the bigger partner become the largest customer.
  - Don't let the bigger partner have exclusive marketing rights to the product.
- Encourage a substantial equity participation to discourage sudden dissolutions of partnerships and to increase level of interest in the success of the alliance.

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For partners of all sizes:

- Ensure the full development and evolution of the business logic of the proposed alliance before entering into financial negotiation which may inhibit a frank exchange of information — you need to know your partner. View the alliance as a learning experience covering not only the products and services involved in the exchange, but also other facts of the other company's operations. However, avoid being a loser in a strategic partnership by closely monitoring the information that is exchanged.

- Evaluate your own strengths and weaknesses as well as those of your partners prior to the negotiation of the alliance.

- Full commitment from both parties is most likely to be achieved by a 50/50 ownership arrangement, but management responsibility has ultimately to rest with one partner. Joint ventures should aim to have strong executives that protect them from potential conflicts between the owners

- View the alliance from the standpoint of longer-term strategic goals, especially the particular goals to be achieved from the partnership. Alliances can be viewed as a way of buying time

- Evaluate on a regular basis the benefits/disadvantages of the partnership including the amount of resource being devoted to the relationship. Clear motivation and measurement schemes must be devised together with effective mechanisms for problem resolution involving senior executives.

- Recognise that difficulties are likely to rise very early in the relationship as lower levels of the respective organisations become involved. Some of the hardest management effort must come after the initial plunge has been taken to set up the relationship.

Clearly, the development of collaborative agreements requires great self-confidence, managerial strength and flexibility, which are not easily found. But the greater degree of sharing, the greater the potential for benefits to both parties. The final success of the strategic partnership, however, lies in the accuracy of the evaluation of the marketplace and the strategic plan that is developed.

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Some of the key advantages and disadvantages of strategic partnering are summarised below:

Advantages:

- Provides an evaluation period for a longer-term company and product fit
- Combines complementary strengths
- Minimises risk of a more permanent relationship
- Expands marketing/product capabilities
- Facilitates bidding on complicated deals
- Accelerates time-to-market of individual products
- Substitute for venture capital financing.

Disadvantages:

- Today's partner can become tomorrow's competitor
- Some loss of control for individual companies
- Relatively high failure rate of strategic alliances
- Can accentuate inherent management weaknesses.

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D

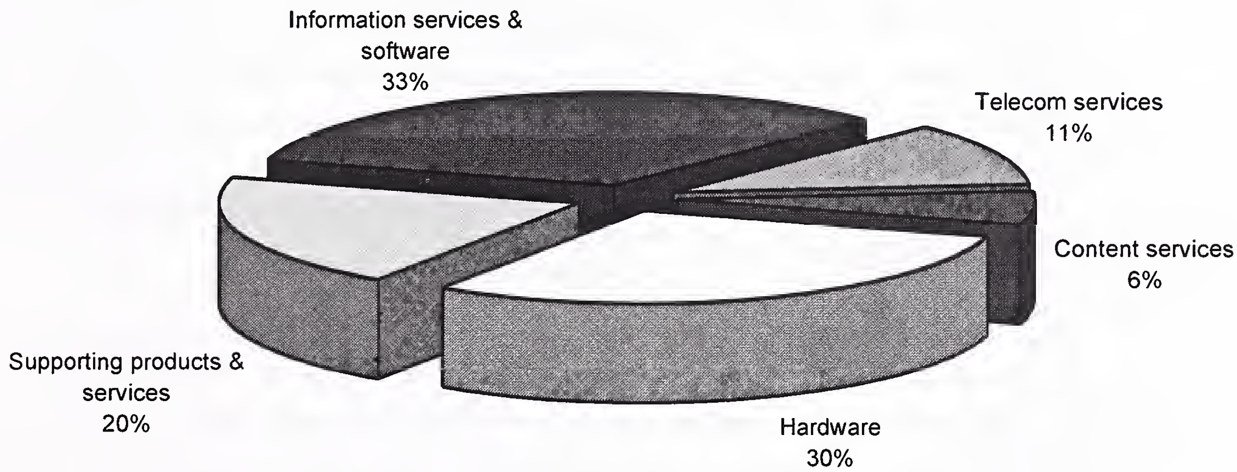
Merger and Acquisition Activity

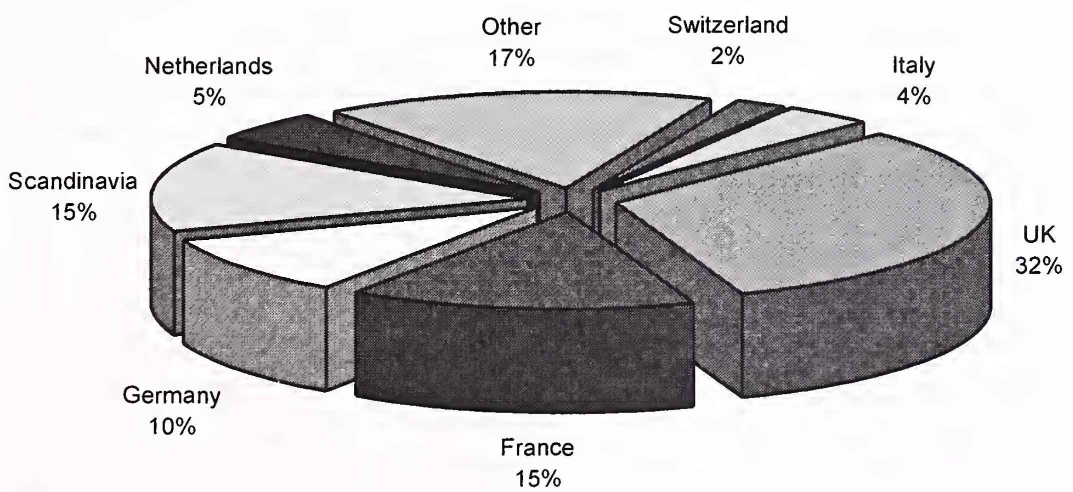
Activity in the IT services market has been exceptionally busy over the last six months, even when compared with a hectic period last year. The number of acquisitions within the European IT industry in the first half of 1994 was 413 as compared with 547 for the first half of 1995 – an increase of 32%. The values of such transactions increased even more. The value of deals during the first half of 1994 was $7.4 billion; in the first half of 1995 it was worth $17.5 billion – almost 140% up year on year.

The breakdown by business type and nationality of the seller is given in Exhibit III-6.

Exhibit III-6

European Acquisition by Type of Business and Nationality of Seller (first half of 1995)





Source: INPUT

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This percentage growth is not surprising given the desire for growth by acquisition which is characterising U.S. vendor activity, particularly CSC and EDS. This strategy is, in turn, caused by customer demand for global support and service. Not only are such companies growing faster than the worldwide average but their acquisitions are proving to be good purchases. Recent research suggests that most large deals do not deliver significant returns. In fact, in a recent study which covered 150 acquisitions worth more than $500 million over the last five years the following results emerged.

- 30% of deals substantially eroded shareholder returns
- 33% only created marginal returns
- 17% gave substantial returns.

Of companies that closed six or more deals 72% had returns above the industry average — this group accounted for just under a quarter of the total group (24%). Of companies which closed five or fewer deals 54% had above average returns — this accounted for over three quarters of the group (76%). Significantly, among non-acquirers produced superior returns. Specific examples of deals with poor returns includes Novell's purchase of Wordperfect in June 1994 (which it is now trying to sell as part of its business applications division) and the AT&T acquisition of NCR in 1991.

The inexorable drive to grow by acquisition inevitably places stress on such companies to continue at the same rate each year. Good targets become scarcer and higher prices can be paid for mediocre organisations. The American vendors who are regularly acquiring European companies will experience above average returns but there will be limits as to the number of major acquisitions which are available each year. At the time of this report going to print there were a number of unconfirmed rumours that IBM was looking to acquire CSC. Exhibit III-7 overleaf illustrates the key European acquisitions during 1995.

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Exhibit III-7

Key European BI Acquisitions During 1995

Date	Buyer	Seller	Seller Activity	Value
January	CSC (US)	Ourourmoff International (France)	IT management consultancy	n/a
	debis Systemhaus (Germany)	Cap Volmac CAP debis VFC unit (France)	Systems Integrator	n/a
	EDS (US)	Database (Italy)	Facilities Management	n/a
	SNI (Germany)	Pyramid Technology Corp (US)	Servers	n/a
	Wang Laboratories (US)	Various Bull Businesses (France)	Computer Services, Systems Integration	n/a
	Computer Sciences Corp	Ouroumoff International	IT mgmt consultancy (France)	
	debis Systemhaus GmbH	Cap Volmac CAP debis VFC unit	Systems integrator (France)	
	Electronic Data Systems Corp	Database SpA	Facilities management (Italy)	
	Wang Laboratories Inc	Bull workflow/imaging business	Doc imaging systems (France)	
	Wang Laboratories Inc	Bull US gov'ment sys business	Systems integration (France)	
	Wang Laboratories Inc	Bull US cust services div	Computer services (France)	
	Wang Laboratories Inc	Bull sales /services sub (Can)	Computer services (France)	
	Wang Laboratories Inc	Bull sales/services sub (Mex)	Computer services (France)	
	Wang Laboratories Inc	Bull sales/svs sub (Australia)	Computer services (France)	
	Wang Laboratories Inc	Bull sales/svs sub (NZ)	Computer services (France)	
February	Misys (UK)	ACT Group (UK)	Software & Services	$336mn
	Unisys (US)	TopSystems Int'L (Netherlands)	Client/server software	n/a
	Unisys Corp	TopSystems International	Client/server s/w (Holland)	
March	CMG (UK)	Pecom (Germany)	Computer Services	n/a
April	EDS (US)	Banco Banesto (Spain)	Computer Services	n/a
	EDS Corp	Banco Banesto (Comp services sub)	Computer services (Spain)	
May	ICL (UK)	Dataserv (US)	Retail Applications	n/a
	Admiral Computing Plc	Delphy Consultants NV	Training & Services (Belgium)	£5.4mn
	IBM Corp	Lotus Development Corp	Systems & apps software (US)	$3,300mn
	ICL Plc	Dataserv Inc	Retail applications (US)	
June	CSC (US)	Lucas Engineering & Management Systems	Consultancy & Project Management	$500mn
	EDS (US)	AT Kearney (US)	Consultancy	$600mn
	Computer Sciences Corp	Lucas Engineering & Sys	Management consultany (UK)	
	Computer Sciences Corp	Lucas Management Systems	Project mgmt s/w (UK)	
	Control Data Systems Inc	Binary Systems Ltd	Messaging services & s/w (UK)	
	Electronic Data Systems Corp	AT Kearney Inc	Consultancy (US)	$600mn
July	CSC (US)	Oxford Consortium (UK)	Healthcare Computer Services	n/a
	Philips (Netherlands	BSO-Origin (Netherlands)	IT consultancy	n/a
	Computer Sciences Corp	Oxford Consortium	Healthcare comp servs (UK)	
August	Cambridge Technology Inc +	Systems Consulting Group	System integration (US)	n/a
	Ceridian Corp	Comdata Holdings Corp	Transaction processing/svs (US)	$900mn
September	Getronics/Roccade (Netherlands)	Raet (Netherlands)	Computer Services	n/a
	SHL Systemhouse (Canada)	Planning Consultancy (UK)	Computer services	n/a
	Getronics/Roccade NV#	Raet NV	Computer services (Holland)	
	SHL Systemhouse Inc	Planning Consultancy Ltd	Computer services (UK)	£13.5mn
October	Cambridge Technology Ptnrs	Axiom Inc	Management consult (US)	$19mn
	Datamind Dta Info Servs	Sulzer Informatik	Computer services (Switzerland)	
	Lynx Holdings Plc	Vistec Group Plc	Computer services (UK)	£22mn
December	MCI	Systemhouse	Systems Integration	$850mn
	Computer Sciences Corp	Ploenzke AG	System consultancy (Germany)	

Source: INPUT

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E
Recent Major Strategic Deals

1. IBM — Lotus

The IBM-Lotus deal has many implications for both the personal computer and BI industry — topics such as what this means to the future of IBM's OS/2 Warp (vs Microsoft's Windows) and what an IBM-sponsored Lotus Notes product will do to the market for Microsoft's Exchange groupware. As further details of the acquisition are revealed, these considerations will be addressed in greater detail in subsequent INPUT research bulletins.

Exhibit III-8 summarises INPUT's recent forecasts of the worldwide market for Lotus Notes and related services.

Exhibit III-8

Worldwide Market For Lotus Notes and Related Services

	1994 ($M)	1995 ($M)	1996 ($M)	1997 ($M)	1998 ($M)	1999 ($M)	CAGR% 94-99
Software including Notes, Add-ons & 3rd Party Applications	680	890	960	1010	1150	1380	15
Professional Services	180	270	320	360	350	390	17
Systems Integration	440	790	970	1300	1410	1540	29
Network Services	20	160	310	480	690	890	107
Total	1320	2110	2560	3150	3600	4200	26

Source: INPUT

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Exhibit III-9 summarises the comments made by IBM's John Thompson, senior vice president, Steve Mills, vice president of Software, and James Corgel, vice president of Consultant Relations, regarding strategic advantages of the acquisition for IBM.

Exhibit III-9

Strategic Advantages for IBM

- Good channels - IBM will gain strong third party and retail channel management, as well as strong relationships with over 3000 software applications providers
- Robust messaging infrastructure which provides a way to loosely couple applications across enterprises
- More products to go head-to-head with Microsoft
- A Notes-based business culture that is very efficient and productive, as well as thousands of talented Lotus software developers
- Strong brand image and extensive desktop skills

Source: INPUT

IBM has done their homework on Lotus' products and markets. However, the marketplace appears to be concerned and somewhat sceptical of IBM's understanding of Lotus' entrepreneurial culture which has made them successful.

IBM's poor track record working with smaller firms has caused many Notes customers to express concern. Although the deal gave Lotus an independent structure to preserve its corporate culture, INPUT expects that there will be considerable growing pains as Lotus is assimilated by IBM.

The Lotus acquisition, the largest software acquisition in history, is a strong indication of the wave of vertical integration that is growing in the computer industry. INPUT expects the frequency of acquisitions and mergers within the IT industry to continue at a robust pace.
Exhibit III-10 illustrates recent software acquisitions- and offers an indication of the size of the deals being made and the stature of the participants.

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Exhibit III-10

Recent Large Software Deals ($M)

Company	Acquired By	Deal Value	Year
Lotus	IBM	$3,500	1995
Legent	Computer Associates	$1,780	1995
Powersoft	Sybase	$875	1995
Wordperfect	Novell	$855	1994

Source: INPUT

IBM is the largest software company in the world and virtually the only company that can pose a formidable challenge to Microsoft. The battle for the groupware market should turn up a notch as Microsoft prepares to release Exchange.

2. MCI — SHL Systemhouse

Inevitably, there has been something of backlash against the concept of *Convergence* over recent months. AT&T's recent "demerger" has been interpreted by some commentators as evidence that *Convergence* is essentially operationally untenable, and that it supports the demise of the "smaller share of larger markets" argument.

However, *Convergence's* underlying technological foundation is still indubitable, and more sober reflection suggests that AT&T's actions were driven more by the need to face the implications of a particular failed acquisition rather than to re-correct the underlying strategy.

The convergence of information technology and communications, long heralded, is finally becoming a reality, is increasingly influencing the individual development of both areas, and is making it no longer feasible to think about IT and communication technologies in isolation.

The commercial ramifications of these technological developments are creating, what, even six months ago, would have appeared a number of unusual alliances.

One of the most interesting of these new relationships, and the focus of this profile, is the recent acquisition of the systems integrator, SHL Systemhouse, by the second largest US long-distance telecommunications carrier, MCI Communications.

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MCI, with the avowed intent of challenging AT&T and BT in the fight to become the world's premier information services player, has entered a period of aggressive expansion based on both organic and acquisition led growth.

MCI with revenues of $13 billion in 1994 are the second largest long-distance carrier in the USA.

However, CEO Bert Roberts Jr, has recently stated that his objective is to transform MCI into a diversified communications conglomerate, and that MCI's corporate objective is "to get to the future before AT&T".

Roberts believes that MCI can no longer thrive in one area of activity. He estimates that by 2000 half of MCI's revenue will come from products/activities that MCI does not currently offer.

MCI is trying to push a trend towards competing on its "integrated service offerings" rather than on price, aiming to win the loyalty of large multinational customers who are looking to rationalise their complete communications procurement requirements.

Integrated packages MCI offer include customer service call-centres, helping corporations install advanced computer and telephone networks and processing credit card transactions for banks and retailers.

MCI is also counting on integrated services to dominate the global market. Already the fastest growing international carrier for basic voice service, MCI is adding 50% more traffic every year. Concert, its joint venture with BT, is a private network that serves companies with worldwide offices and provides a number of ways for companies to exchange data internally. Most conveniently of all, Concert puts voice and data traffic onto a single bill offering companies the ability to deal with a single customer-services organisation.

To further this end, MCI has over the last year been building a series of alliances which attempt to take the organisation outside of traditional areas of operation.

Primary amongst these have been the offering of 20% of stock to BT for $4.3 billion, and, most controversially, the $2 billion investment in Rupert Murdoch's News Corporation. The development of the relationship between BT and MCI hints at an increasing co-operative role between BT's system integration arm, Syntegra, and SHL. MCI have also announced a deal with Microsoft whereby MCI will market Microsoft

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products, including a customised version of MSN, and provide a new delivery channel for software upgrades. Oracle are also planning to become an active partner in this new, and potentially extremely powerful, trading block. Exhibit III-11 provides a schematic of these relationships.

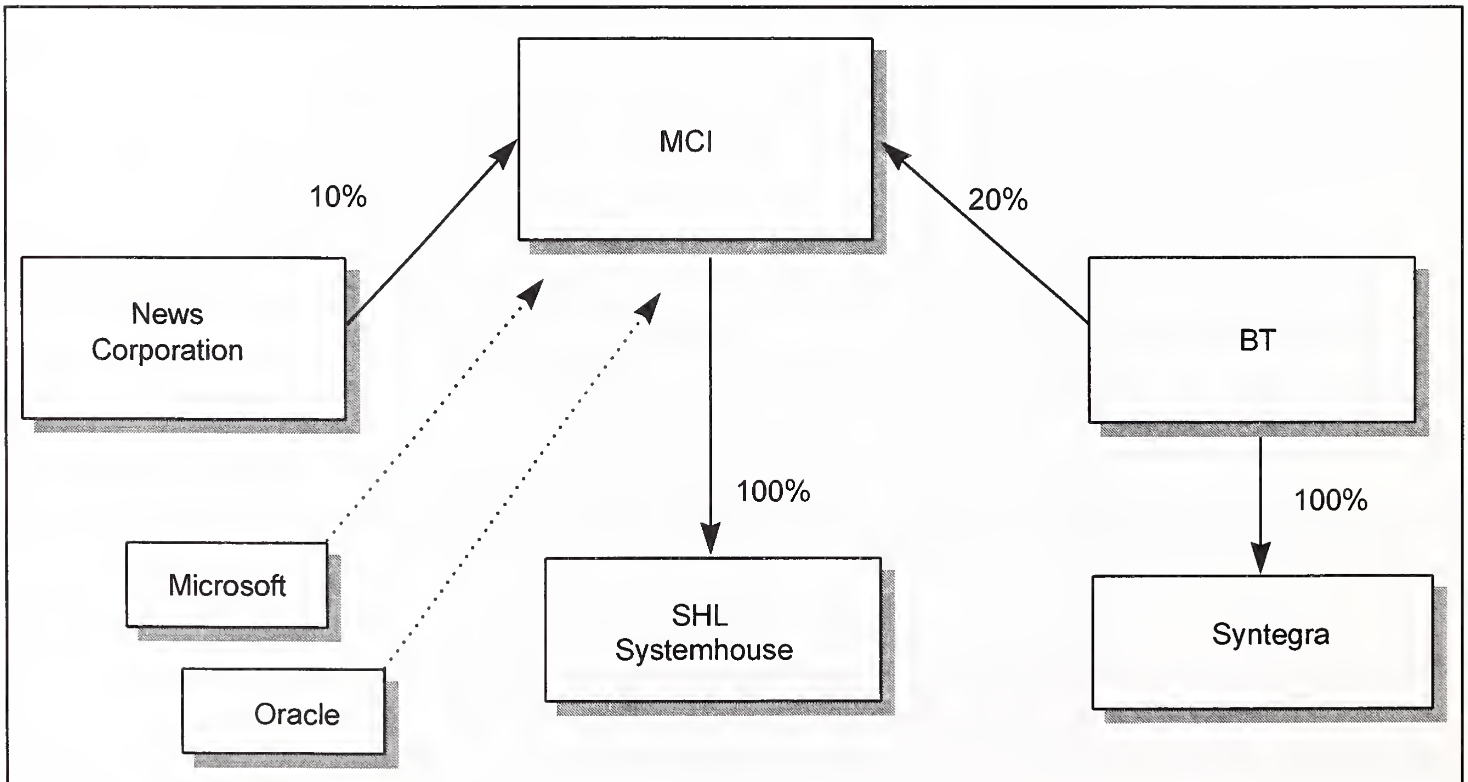
MCI have been extremely active in enhancing service offerings through joint ventures in Mexico and Canada, new businesses in consulting, software, Internet access, paging and cellular communications, and the construction of alternative local telephone networks in 14 US cities.

In August 1994, MCI restructured putting traditional long-distance services into a new division, MCI Telecommunications, which will focus on selling high-margin packages of telephony and consulting services. New businesses and global joint ventures have been placed into another division, MCI Ventures & Alliances.

More recently, MCI has made repeated efforts to enter the fast-growing market for cellular and wireless services, including the acquisition of Nationwide Cellular, the largest US reseller of cellular services for $190 million.

Exhibit III-11

MCI – BT News Corporation Equity Relationship



Source: INPUT

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Since May 1995, MCI has also contracted to resell services from five other cellular providers, including AT&T, which means the company can now offer services to 75% of the US population.

By not investing in a wireless infrastructure MCI has been able to offer significantly lower cost services.

MCImetro is MCI's local service division that has installed fiber optic networks in 14 cities, hooking businesses directly into MCI's long-distance network.

Furthering a strategy aimed at integrating computing and communications offerings, and, by coincidence, on the same day as the AT&T demerger announcement, MCI announced its offer to buy the increasingly high profile Canadian systems integration and outsourcing vendor, SHL Systemhouse.

The deal, worth $1 billion in cash, will leave SHL as a stand-alone operating company within MCI.

SHL Systemhouse has been instrumental in driving the message of transformational systems development, either through outsourcing or project contracting, over the last two years.

Recognising the need to help organisations migrate from legacy platforms to predominately client/server environments, SHL have ridden a wave of marketplace demand which has seen them achieve world-wide revenues of $850m, $100m (12%) of which comes from its 700-strong European operation. Exhibit 2 details SHL's European revenues by delivery mode.

Exhibit III-12

SHL Systemhouse Analysis of European Revenues

Delivery Mode	($m)
Mainframe Systems Management	8
PC & Desktop Systems Development	50
Client/Server Software Development	10
Consultancy (BPR)	17
Training & Education	15

Source: INPUT

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SHL's European, non-outsourcing based, client references include organisations such as the world's leading marketing communications group WPP, the cellular phone unit of Cable & Wireless, Mercury, KLM, and the computer games manufacturer, SEGA.

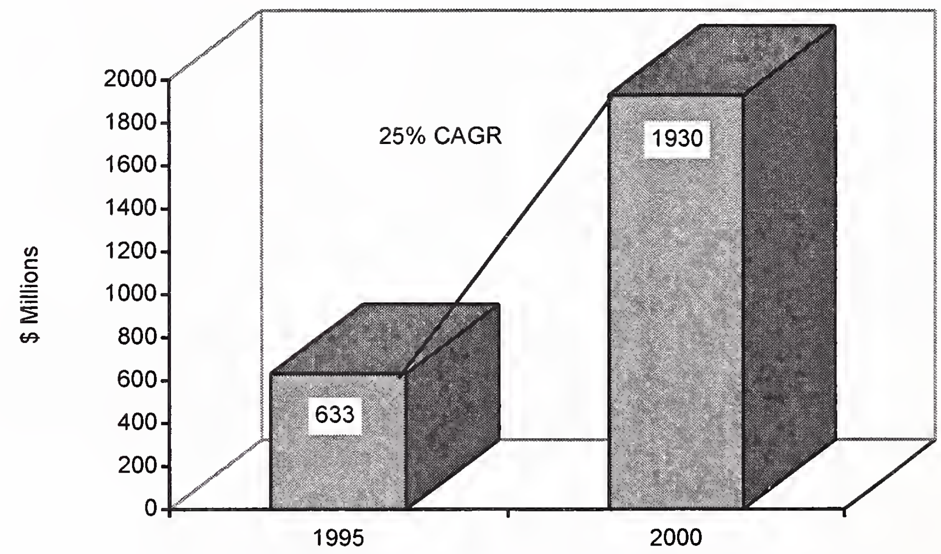
Another prominent organisation which has used *Transform* includes, the now ING owned investment bank, Baring Asset Management. SHL has assisted Barings in designing and implementing client/server architectures utilising Hewlett-Packard servers and with the development of new applications to run on this infrastructure.

The telecommunications sector has replaced the financial services sector as the most dynamic area for the adoption of new technologies and has led some to dub it the "New City"; the "City" of London being the last area to witness such high growth rates of IT related investment.

Exhibit III-13 provides a forecast of SI related growth in the European telecommunications market until 2000.

Exhibit III-13

Systems Integration Services Growth in the Telecommunications Sector, Europe 1995-2000



Source: INPUT

However, this explosive growth is not unsurprisingly attracting growing numbers of vendors into the European telecommunications marketplace.

These include traditional, existing European SI players who are attempting to manoeuvre their services offerings away from low-growth or stagnating vertical markets, as well as players new to the European market or new to the IT services industry altogether. MCI fall into this latter camp.

AT&T have recently announced their intention of competing head to head with BT in the UK market including in the residential services, and aim to generate revenues of $1 Billion in the UK by the end of the century.

Heightened levels of competition in a market which is undergoing, and will continue to undergo for some time, fundamental structural transformation will present major challenges for all interested parties.

Roberts sees MCI's primary strength as an aggressive marketing orientation; a strength they will need as they face threats in their primary market posed by the US Telecommunications Deregulation bill, which would allow the seven regional Bell operating companies to compete with MCI, by offering long-distance services, slimming MCI's already narrow margins.

3. EDS — AT Kearney

One of the major factors which EDS are concentrating on in supporting the current Co-Sourcing and Value-orientated initiative is the building of its consulting capability.

Consulting initiatives began in earnest in July 1993 with the recruitment of Michael Gleason from Coopers & Lybrand. John Pendlebury, another senior C&L partner joined in Europe in October 1994, and has been instrumental in building the practice up to its present size of around 200 people in Europe. Patrick McHugh, responsible for Coopers and Lybrand's reenginnering practice has also recently joined.

EDS's goal is to have 5,000 consultants on staff at a worlwide level within 5 years; there are presently 1,800. The UK practice has grown from 20 to 70 people since the beginning of 1995.

These plans have received a significant boost with the recently announced decision by the U.S. consultancy firm, AT Kearney, that they will be merging with EDS.

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This move which had been under discussion for a considerable period of time, and had appeared in late May to be a signed deal, then days later appeared cancelled, was finally completed in early June 1995.

Kearney will add possibly as much as $350m to EDS's consulting revenues and thereby create one of the world's biggest consulting operations overnight. Senior AT Kearney parttners, have been offered around $4m each through a 10 year annual payment deal which will attempt to stop a possible "brain drain".

EDS's existing consulting interests have now been placed within Kearney which will trade under its existing name as a separate division. The division will be run by Kearney's chief executive officer, Fred Steingraber, Mike Gleason, who had been running EDS management consulting services will report to Steinberger, who in turn will report to EDS board member Gary Fernandez.

The consultancy offering has not been positioned as a form of "loss leader", consultancy day rates are believed to be equivalent to those of the big audit based firms and it will clearly be required to stand alone within a reasonable period of time.

It will be some time before it is clear whether these moves are a success, but its success will be a necessary contributing factor to the success of the overall drive into value and business based metrics.

4. AT&T's "Demerger"

Rapid changes in the telecommunications market have driven AT&T to streamline its opeations into three free-standing companies. This move has brought to an end the existence of the telecom giant, that dominated the service, equipment and other segments in the communications industry. AT&T's rearrangement demonstrates the fast pace of the telecommunications industry where companies are reacting to change and positioning themselves for a more competitive markeplace, through mergers, partnerships, joint ventures and major reorganisations.

On September 20, 1995, AT&T announced a strategic restructuring of its organisation. The old AT&T organisation has now been split into free-standing, independent companies that will operate in major business segments of the information industry communications services, equipment and computing.

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The new services business, operating under the brand name, AT&T corp., will be composed of AT&T's current Communications Services Group, the AT&T Universal Card Services Corporation, AT&T Solutions consulting and systems integration organisation and AT&T Wireless Services. The services business had a revenue of $49 billion in 1994.

The new communications systems and technology company, Communications Systems, will consist of AT&T Network Systems Group, Global Business Communications Systems, Consumer Products, AT&T Paradyne and Microlectronics. The equipment business contributed approximately $20 billion to AT&T's 1994 revenue.

AT&T Global Information Solutions (GIS), the company's computer unit, will be established as an independent company and will continue providing computer platforms, placing special emphasis on the financial, retail and communications industries. GIS has a revenue of $8 billion in 1994.

On 19th January 1996, AT&T GIS changed its name back to NCR Corporation, in anticipation of being spun off to AT&T shareholders by January 1997, as an independent publicly traded company.

AT&T plans to eventually divest its remaining 80% interest in AT&T Capital Corporation—its equipment leasing and financing business. This unit had revenues of $1.4 billion in 1994.

AT&T expects to complete all transactions by the end of 1996.

Permanent executive leadership for the independent business will be named at a later date. However, AT&T has appointed key management that will oversee the transition of each new company. They are summarised overleaf.

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Exhibit III-14

AT&T Key Executives

Name	Title
Robert Allen	Chairman and CEO,AT&T Corp
Alex Mandi	CEO, Communications Services Group
Richard McGinn	CEO, Network Systems Group
Lars Nyberg	CEO, NCR
Thomas Wajnert	CEO, AT&T Capital Corp

Source: INPUT

According to AT&T Chairman Robert E.Allen, the change was needed to focus on the growth opportunities in the individual business segments of the global information industry.

INPUT believes that a financially-driven AT&T is taking drastic steps to maximise shareholder value by splitting the organisation into independent entities. The change has taken place to raise capital and simplify the company culture.

AT&T reflects a complex meeting of corporate cultures:

- The services driven long-distance, cellular and electronics messaging business
- The manufacturing business, most of which used to be an independent subsidiary
- Western Electric
- The computer business, reflecting NCR's solutions-oriented culture.

The mode-oriented solutions business of its computer systems division was at odds with the universal service strategy of its long distance carrier business. Enabling each corporate culture to set its own direction will allow the three independent companies to make decisions more quickly.

AT&T became a vast organisation, as a result of acquisitions such as AT&T Paradyne, and NCR and internal entrepreneurial ventures like the

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successful Universal Card. The new structure combines smaller entities with focused goals, into organisations that can attract the capital and talent needed to remain competitive.

With this new restructuring, AT&T is fragmenting its systems integration business across the three businesses. What happens when a bank wants to develop a nationwide communications network to route check images? Under its new organisation, AT&T GIS will have a reduced level of telecommunications expertise to provide affordable communications services between banks. Would AT&T have been better off with a separate systems integration group that was divided by markets, rather than attaching systems integration groups to each business?

AT&T has the systems integration capabilities to provide solutions, but has promoted it weakly. For example, WalMart makes widespread use of AT&T's TOP END transaction monitor as a competitive weapon to link together multiple internal computers. AT&T needs to promote this capability, if it wants to dominate the retail systems integration business. To date, its lack of market focus has weakened its position, a situation that Lars Nyberg expects to remedy.

AT&T's move to dis-integrate its business, is definitely a counter-trend, and comes at a time when companies are merging and consolidating to position themselves in a more competitive marketplace. The restructuring will give AT&T sharper focus in its individual areas of expertise-service, equipment and computing. However, a challenge faced by the company will be to retain its vertical emphasis. Unlike Unisys' restructuring, which was market-driven, AT&T has chosen to restructure along product/service lines. The split has, however, conveniently positioned AT&T GIS for an aquistion in the future.

A risk for AT&T will be that it will not be able to leverage market opportunities across its businesses. In addition, its SI business will be diffused and the company will face serious competition from big systems integrators.

Some challenges faced by AT&T include:

- Attracting talent to the new organisation
- Understanding how to sell solutions for specific markets
- Promoting SI expertise.

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AT&T is a flexible organisation and has repeatedly demonstrated strength in restructuring and managing change. This financially managed company has undergone many reorganisations over the years and continues to re-invent itself. The positive element in all its reorganisations is that the company manages to rejuvenate its groups to keep the company alive.

All in all, AT&T's reorganisation is a strong financial move which should please investors and AT&T management. However, whether customers will be drawn to AT&T for its SI capabilities, remains to be seen.

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IV

Setting Up Alliances

This chapter gives some background on some of the information technology (IT) industry's most common perceptions about setting up strategic alliances, as derived from secondary sources. It then describes INPUT's findings from this primary research survey about the types of strategic alliances undertaken and the most important factors in selecting a partner.

A Background on Strategic Alliances

1. Reasons for Alliances

One well-accepted and common motivation for entering into strategic alliances is to bring to the firm's customers a new expertise, product, or service that the firm either cannot provide at all or cannot provide by itself as economically, quickly, or effectively as it can in partnership with a leader in that area. This generally takes one of two forms: integrated marketing or sales of certain existing products or services from each firm, or development together of one or more products or services. Often a development or marketing alliance can lead to faster time-to-market and thus a competitive advantage for one or both partners. In certain situations, such a partnership is virtually the only practical way to achieve a market position that is critical to the success of one or both firms.

Such an alliance may also be a means to win customers that are new to one or both of the partners, in part by extending the "value proposition" (i.e., the value provided by the firm's products and services) offered by the firm, and thus attracting new customers. One efficiency that can result is that such a partnership can allow a firm to concentrate on continually

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refining and improving its key core competencies without being distracted by having to provide or enhance other functions that can be better handled by the partner. Alternately, there may be a "learning curve" model that is key to the alliance, whereby one or both partners wish to expand or strengthen their areas of competency by working together over time.

One important subset of this kind of alliance is a partnership between a "large-older" firm and a "small-younger" firm. Often such alliances work for mutual benefit because the large firm gains access to the small firm's new technology that cannot be as easily or quickly developed in house, while the small firm gains access to the capital and/or distribution resources of the large firm. Such partnerships are also less risky to both sides than would be outright acquisition of the small firm by the large one.

Another driver of strategic alliance formation is the desire to market or sell jointly to each other's customers, presumably for the mutually beneficial result of increased sales, revenues, and profits.

Other partnerships may be focused on reducing costs, perhaps by using resources more effectively, by reducing overhead, or by off loading functions to another firm. This might also involve changing ways of doing business with one another in a manner that reduces costs.

Closely related are partnerships that mainly allow a firm to augment internal capabilities and thus perhaps avoid the cost of developing or extending those capabilities itself . Examples might be network management or disaster recovery agreements that transcend mere vendor-buyer relationships, perhaps because of a corresponding product or service provided in the reverse direction under the same agreement.

Some strategic alliances in IT are focused on better management of future contingencies, especially where there may be a high degree of uncertainty. That is one view of the recent acquisition of McCaw Cellular by AT&T. This partnership started out with AT&T taking only a one-third equity stake that provided McCaw with capital and access to AT&T's customer base. As a full acquisition, on the other hand, the partnership provides AT&T with leadership access to the high-growth cellular telephone business and perhaps a re-entry point into local telephone service. This is an ideal way to manage the uncertainties of how these contingencies will impact AT&T in the future. Similarly, McCaw's uncertainties in the face of future competitive, technological, and regulatory contingencies are reduced by acquisition-based full access

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to the AT&T brand name, the larger firm's customer service expertise, and its financial and technological strengths.

2. Critical Success Factors

In terms of partnership success factors, some observers say that it is best to aim for "high-stakes" partnerships: Larger stakes, it is argued, will drive the partners to work harder for success. Others counsel firms to "start small" with limited-scope partnerships.

Also, some say, aim to ensure that both partners are critical to one anothers success in the venture—that it is not a one-sided alliance.

There is general agreement that it is also important to alliance success that the interface between the companies, their communications and working relationship, be very strong. Some argue that the strength of the working relationship can be enhanced by consciously aiming to place the alliance's communications and management structure somewhat outside either firm's existing business practices and rules. This is particularly important when the communications and management structure are culturally very different between the firms. Included in managing the relationship are agreements about expected outcomes, time horizons, and mechanisms for coordination, communication, and conflict resolution.

Finally, some argue that *only* long-term partnerships, those expected to last more than five to seven years, are worth the effort required for a successful strategic alliance.

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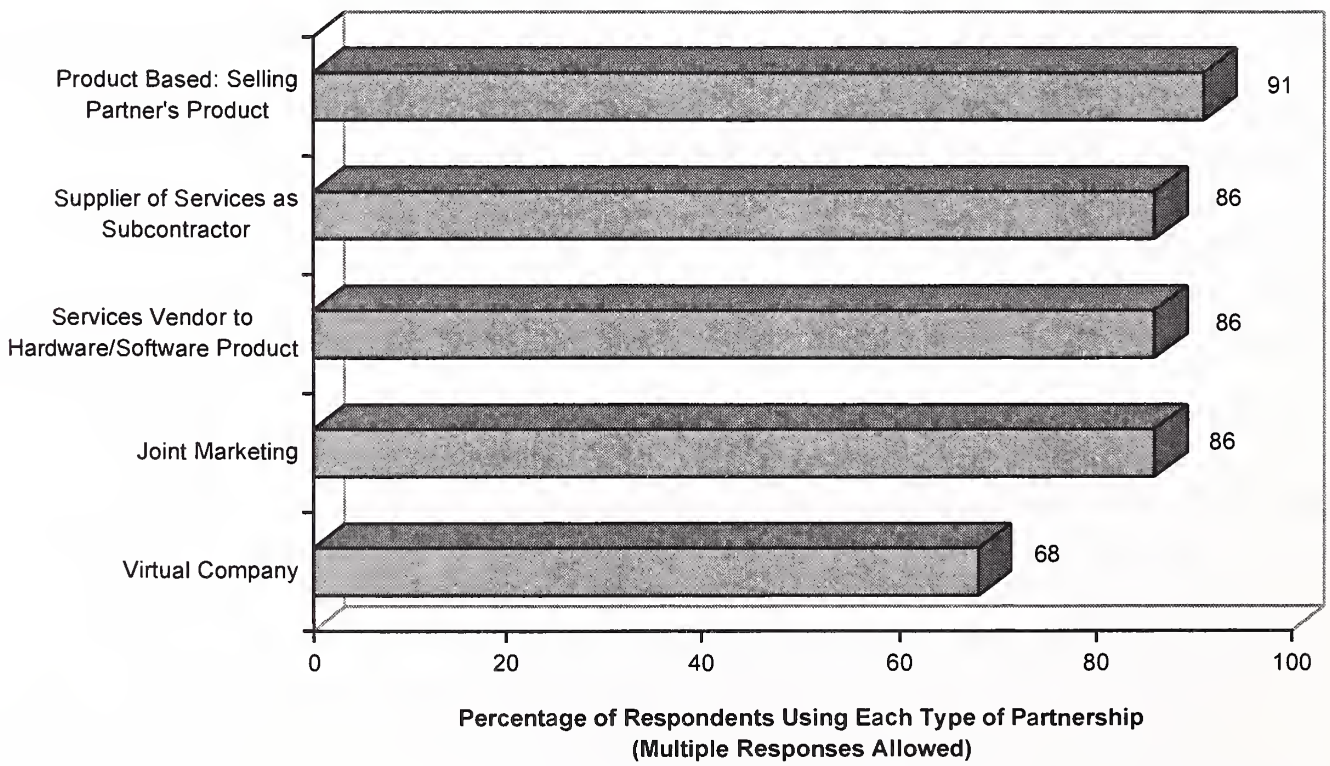
B
Experience with Partnerships

Exhibit IV-1 details the experience of interviewees' firms with different types of partnerships. Almost all of those interviewed have had experience with four key types:

- Product-based partnerships, in which the product or products of one or more partners are sold to customers as part of the alliance agreement
- Subcontractor relationships, in which one partner owns the prime contract with one or more customers and the other functions in the subcontractor role
- A partnership based on providing one or more services to a vendor of hardware or software products
- A joint-marketing relationship.

Exhibit IV-1

Experience: Types of Partnerships



22 Respondents *Source: INPUT*

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Somewhat fewer firms report operating together as part of a "virtual company"—a larger entity that exists mainly to implement an agreement to work together under defined terms, rather than being an actual corporate structure. Note that a virtual company often is formed to support a specific business project, and thus may be disbanded after project completion. Although less important to date than the other forms of partnership reported here, INPUT believes that virtual company alliances will become increasingly common in the future.

The slight majority (55%) of firms interviewed that have had experience with international alliances report that some special factors come into play, as listed in Exhibit IV-2.

Exhibit IV-2

International Alliances—Special Factors

- Cultural differences
- Differences in business practices
- Issues of exporting from the U.S

Source: INPUT

At the top of the list are the differences in culture, presumably including language differences, that often must be bridged to support successful implementation of an international alliance. Closely related, there may be specific differences in how business is practised in non-U.S. locations, whether those are matters of law or custom. Finally, some interviewees note that a working partnership that requires exporting of equipment, materials, hardware, software, or other items from the U.S. will involve special export-related factors, making it different from either a domestic U.S. alliance or an international alliance that can function without such exports.

Based on these findings, INPUT recommends that firms enter alliances having an international aspect with special caution. It will be important to anticipate areas in which cultural differences or differences in national business practices may impact the partnership, and then to staff, plan, or otherwise manage to handle those differences. Similarly, a firm should examine whether export issues will require special procedures or operations not normally part of the firm's business practice.

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C
Choosing a Partner

Exhibit IV-3 lists the factors that the firms interviewed consider most important in choosing an alliance partner.

Exhibit IV-3

Choosing a Partner: Most Important Factors

Rating of Importance	Factor Mentioned by Respondents
Most Important	- Financial stability - Track record - Commitment to long-term relationship - Industry knowledge
Secondary Importance	- Knowledge of specific business processes - Overall technical knowledge - Specialised technical experience
Low Importance	- Management expertise - Sales contacts - Experience with previous alliances

Source: INPUT

Several different factors cluster together as being most often cited by firms as highly important in choosing an alliance partner:

- The partner should be on a stable financial footing
- Before partnering, a firm should look at the track record of a potential partner in businesses or technologies similar to those involved in the alliance. (Note the distinction between this and interviewees' feedback about alliance experience, cited below in the last point for this exhibit.)
- The partner should demonstrate a commitment to fulfilling a long-term working relationship
- The partner's knowledge of the industry should represent a positive contribution to the alliance.

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Although still rated as very important overall, other factors are cited on a somewhat less frequent basis:

- The partner's demonstration that specific business processes are part of its base of knowledge and experience
- Overall technical knowledge of the subject matter to be dealt with by the alliance
- Specialised experience with the technology or technologies that are involved in the partnership.

Three other factors are rated as less important: the expertise of the partnering company's management, the sales contacts that the partner brings to the alliance, and previous alliance experience. Contrasting this last point with the greater importance ascribed to "track record", cited above in this exhibit, interviewees seem to be saying that specific experience of a potential partner in other alliances or partnerships is less important than an overall record of business or technical performance in areas that will be key to this alliance.

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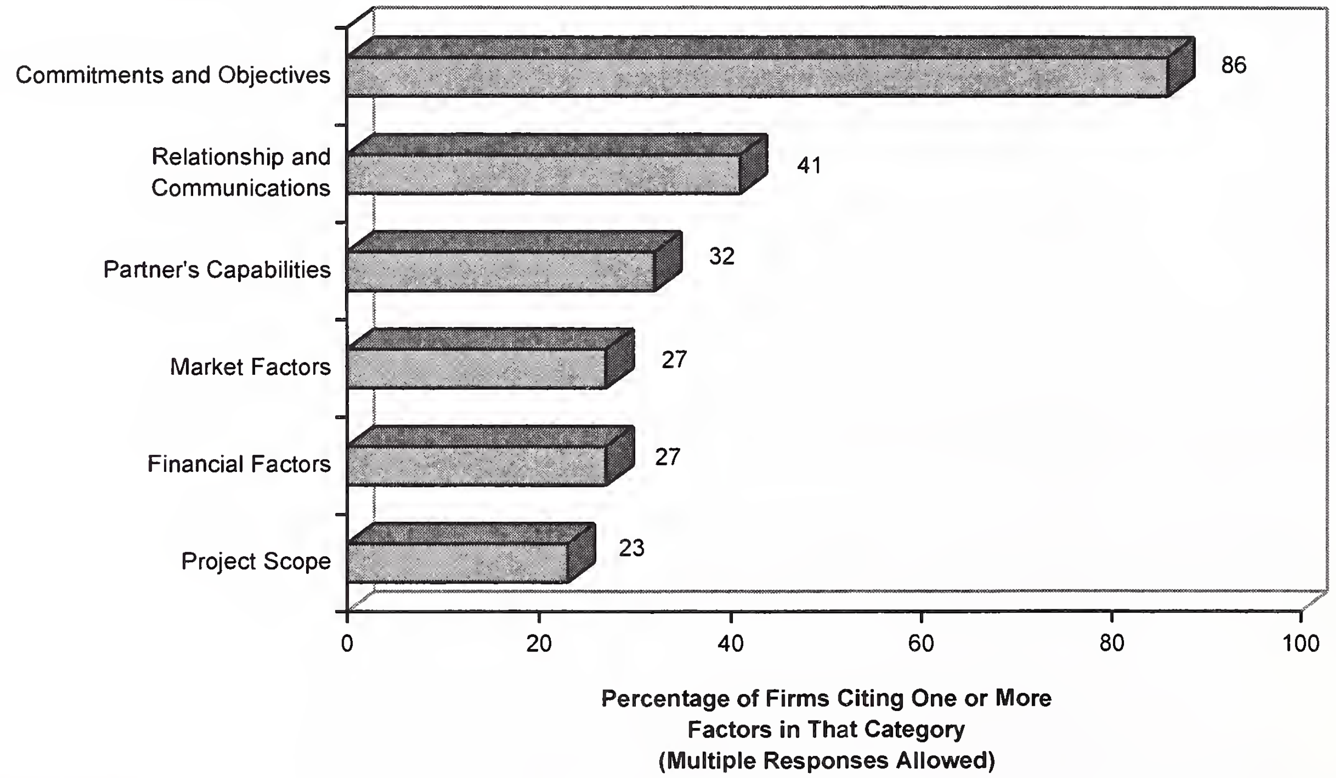
D
Key Advice Overall

As Exhibit IV-4 summarises, interviewees' feedback falls into six main categories. (Note: See Exhibits IV-2 and IV-3 for detailed feedback on each of these categories.) Most important by far is a series of insights about how the partners manage their commitments to and the objectives of the alliance. Second is feedback about the working relationship and how its communications are managed. Less often cited is advice that relates to the partner's capabilities, various factors related to the marketplace, financial factors, or matters dealing with the scope of the project.

Exhibit IV-4

Key Categories of Advice About Successful Strategic Alliances



22 Respondents *Source: INPUT*

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As noted by the title of Exhibit IV-5, below, the first two categories of advice cited above, commitment and communication, are top factors contributing to alliance success.

Exhibit IV-5

Specific Advice on Commitment and Communication

- Be sure of shared corporate commitment, objectives, goals and understanding
  - Achieve clear understanding of objectives and benefits
  - Agree on roles, responsibilities, measures and expectations
  - Know the commitments of each for resources and investment
  - Match commitments — corporate and executive
- Nurture communications and the working relationship
  - Consciously care for the working relationship
  - Effective communication is key
  - Aim for trust and win/win deals

Source: INPUT

In the initial category of advice reported here, interviewees cite issues of commitment, objectives and goals, and shared understanding.

1. Understand Objectives and Benefits

Firms entering an alliance are urged to be sure that the partners' understanding of objectives and benefits is clear to both parties. This includes the specific advice to be sure that both the partner's objectives and the firm's own objectives are understood clearly. Also, be sure these are communicated accurately. In addition, look for mutual benefits within those objectives. One form of mutual benefit is profit sharing: 41% of the firms interviewed report that profit sharing is a partnership objective with which they have experience.

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2. Agree on Roles

Roles and responsibilities of each partner must be agreed upon prior to the start of the alliance. Who will undertake what roles — separately or jointly? Which responsibilities will be shared, and which will be assigned to only one of the partners? To help clarify these roles and responsibilities, it is recommended that shared measurements be clearly agreed to, and that each partner understand what metrics are used internally by the other to judge performance. Such clarity, including agreement about numerical measures and timelines that both partners can agree to, will help ensure that both partners' expectations are in line.

3. Identify Resource Commitments

One specific understanding that is critical to the success of the partnership is just what resources and investments are being committed to the alliance by each party. One recommendation is that the required resources be identified and committed to from the start. Further, a mentality of "investing in the alliance" on both sides will help to ensure success of the partnership.

4. Ensure Corporate Commitment

The issue of whether the commitment of the partners is matched at two levels, corporate commitment and commitment by key executives at each firm, must be resolved. Note that corporate commitment includes both financial commitments made by each side as well as being sure that the alliance fits each firm's long-term corporate strategy. Both corporate and executive commitments should be at matched levels from the outset. Moreover, it is advised that these commitments be consciously re-evaluated on a periodic basis, with ways devised to test for changes on either side in management commitment to or alignment with the goals of the partnership.

In order to best implement this advice about commitment issues, INPUT recommends that as many of these as possible be dealt with before the partnership agreement is finalised. Explicitly state both shared and separate corporate objectives, and benefits expected, for mutual sign-off as part of the agreement. Sign off also on separate versus shared roles and responsibilities, mutual expectations, and what forms of measurement of alliance success will be used. Define financial, investment, and other resource commitments as specifically as possible in writing. Finally, before the partnership is finalised, each firm should make a high-level, top-down review of the commitments being made by

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each organisation, confirming that the corporate and executive-level commitments of each are appropriate, solid, and well matched.

The other, closely related category of advice cited here is the need to nurture communications among all individuals in the partnership in order to continually strengthen the working relationship.

5. Develop Effective Communications and Working Relationship

What this means above all is consciously caring for the health of the working relationship. Interviewees said repeatedly that the key here is to communicate effectively. This includes a corporate-wide approach to coordinating the relationship and its communications, which may require the assignment of a manager of the business relationship. As always, "The devil is in the details"; be sure everyone impacted agrees to all details in clear communications. Make sure that expectations are clearly understood. And communicate with a spirit of patience for understanding by the other individual.

6. Build Trust

Such communications, and the working relationship itself, will be most effective when a spirit of trust prevails. This includes the key factor of agreeing not to pirate, or recruit away, the other partner's people. It also includes trying to err on the side of fairness to the other partner. And finally, it means aiming to structure relationships based on win/win deals, which by their very nature tend to foster open and clear communications.

Regarding these communication issues, INPUT recommends that a firm's care for the alliance's working relationship should start even before the agreement is signed. Those communicating between the firms to establish the partnership often will be those communicating frequently to implement it, so management should seek to foster the best possible communications channels from the start. Consciously focus a portion of both pre-alliance and ongoing internal discussions about the project on who is communicating with whom at the other firm and on which topics. Successful alliances look for opportunities to bring in other individuals or points of connection and communication to improve the effectiveness of the working relationship. Look carefully to see if trust and win/win deals are the prevailing tone of the relationship, and implement corrective actions if they are not.

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Exhibit IV-6 outlines other factors cited, but noted less frequently, by the firms interviewed.

Exhibit IV-6

Less Frequently Cited Success Factors

- Determine partner's strength overall and specific capabilities
- Look for market opportunities and leverage factors for the alliance
- Carefully manage partners' compensation, sales and expenses
- Aim initially for small, limited-scope projects

Source: INPUT

7. Seek Financial Strength and Stability

As mentioned earlier, the partner's overall financial strength and stability is a key factor in choosing a partner and in achieving success. Overall strength also refers to the partner's reputation and the experience of its management team. One specific factor in judging strength is to analyse and understand the partner's capabilities and limitations from the start, as well as its commitment of resources to the alliance.

8. Share Market Opportunities

Focusing on shared market opportunities and factors of leverage is critical, of course, to the success of almost all alliances. (Note that INPUT believes that interviewees' relatively infrequent mention of this factor relates less to its lack of importance and more to its status as a "given" factor in most alliances, and thus one often overlooked when answering a free-form, open-ended question.) In most instances, the key factors driving two firms into alliance are some combination of market opportunity that can be addressed more effectively together, and the leverage factors—the complementary, company-specific strengths that each firm brings to the partnership. The markets to be addressed by the alliance should relate to products that meet both current and likely future demands of customers. A leadership, or emerging leadership, market position held by one or both partners is ideal, and often is a key leverage factor. The partners' market strategies should relate well to one another, including complementary marketplace strengths to be contributed. A focus on common customers in the marketplace may be

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possible, yet it may also be important to acknowledge clearly that the firms are both competitors and partners: today's so-called "co-opetition".

9. Define Financial Rewards

As always, money is a key factor. For compensation, each partner must be happy with the money being made: Fair, win/win deals and ongoing working relationships should be the watchwords, as discussed earlier. This includes careful sorting out of profit sharing that accrues from sales generated by the alliance, and may require an attitude that one interviewee reported communicating to the team: "Sharing the money is better than no work at all" It also means that money going out (i.e., expenses) must be funded adequately, which means dedicating sufficient resources from the start; this fits with earlier advice about matched corporate commitments, including financial commitments. As noted earlier, an "investment mentality" regarding the expenses of the alliance is advised.

10. Start With Limited-Scope Projects

Finally, several interviewees advise starting with small or limited-scope projects at first. This may mean starting slowly, perhaps with just one project or a few projects at first. A narrow scope for the partnership that can be clearly focused may be useful. Within the alliance agreement's boundaries, one piece of advice is to try to regard each opportunity on its own merits.

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E
Alliance Objectives

One clear conclusion from the findings presented above is that alliance objectives are a very critical success factor. As Exhibit IV-7 shows, several types of objectives for alliance partnerships have been met most effectively by the firms interviewed.

Exhibit IV-7

Alliance Objectives That Worked Best

- Objectives that were most effectively met:
  - Joint marketing
  - Marketing of complementary services
  - Prime contractor/subcontractor relationship
  - Sales lead generation
- Less-successful objectives:
  - Sharing development
  - Joint project-operation responsibility

Source: INPUT

Two of the top objectives are directly related to marketing factors. Joint marketing by the partners of their products or services is the single most effectively met objective. Close behind is the marketing of complementary services—services that one partner offers but that are missing from the service mix of the other. Also effective, these firms reported, is their operation together in a prime contractor/subcontractor relationship. The fourth most effectively met objective is the generation of sales leads through the alliance partnership.

These firms report that they have been less effective in the operational objectives of sharing development work between partners, as well as in implementing joint responsibility for project operations.

As Exhibit IV-8 indicates, these firms report that certain of their pre-set expectations for the alliance's objectives were met better than others.

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Exhibit IV-8

How Well Did Alliance Objectives Meet Expectations?

Rating of Achievement	Factor Mentioned by Respondents
Best met expectations	- Prime contractor/subcontractor relationship - Joint marketing
Less so	- Marketing of complementary services - Sharing development - Joint project-operation responsibility
Lowest in meeting expectations	- Sales lead generation

Source: INPUT

At the top of the list, the firms interviewed reported the highest success for objectives relating to prime contractor/subcontractor alliances and for joint marketing of products and services. They have been relatively less successful, however, in fulfilling their expectations for marketing complementary services, for sharing development, and for joint project operations. Finally, although the previous exhibit (Exhibit IV-9) shows sales lead generation as a moderately achieved objective, partners' expectations for this objective must have been higher, as it falls at the bottom of this list.

Based on these responses, INPUT recommends that firms exercise extra caution when entering into or implementing strategic alliances that call for developmental or operational responsibilities to be shared between the firms, rather than divided in a more traditional prime contractor/subcontractor relationship. This data indicates that implementing such shared responsibilities is generally both less successful and less likely to meet a firm's expectations for the partnership, thus requiring more careful management if such arrangements are critical to the definition and success of the alliance. Caution is also in order regarding expectations for generation of sales leads.

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V

Alliance Problems and Success

This chapter identifies key problems encountered during alliances, indicates to what extent alliance success varied over time, and reviews the measures of success that have been used.

A Problems

The firms surveyed replied to questions on the top problems they have encountered with strategic alliances, providing the overall ranking of problems shown in Exhibit V-1.

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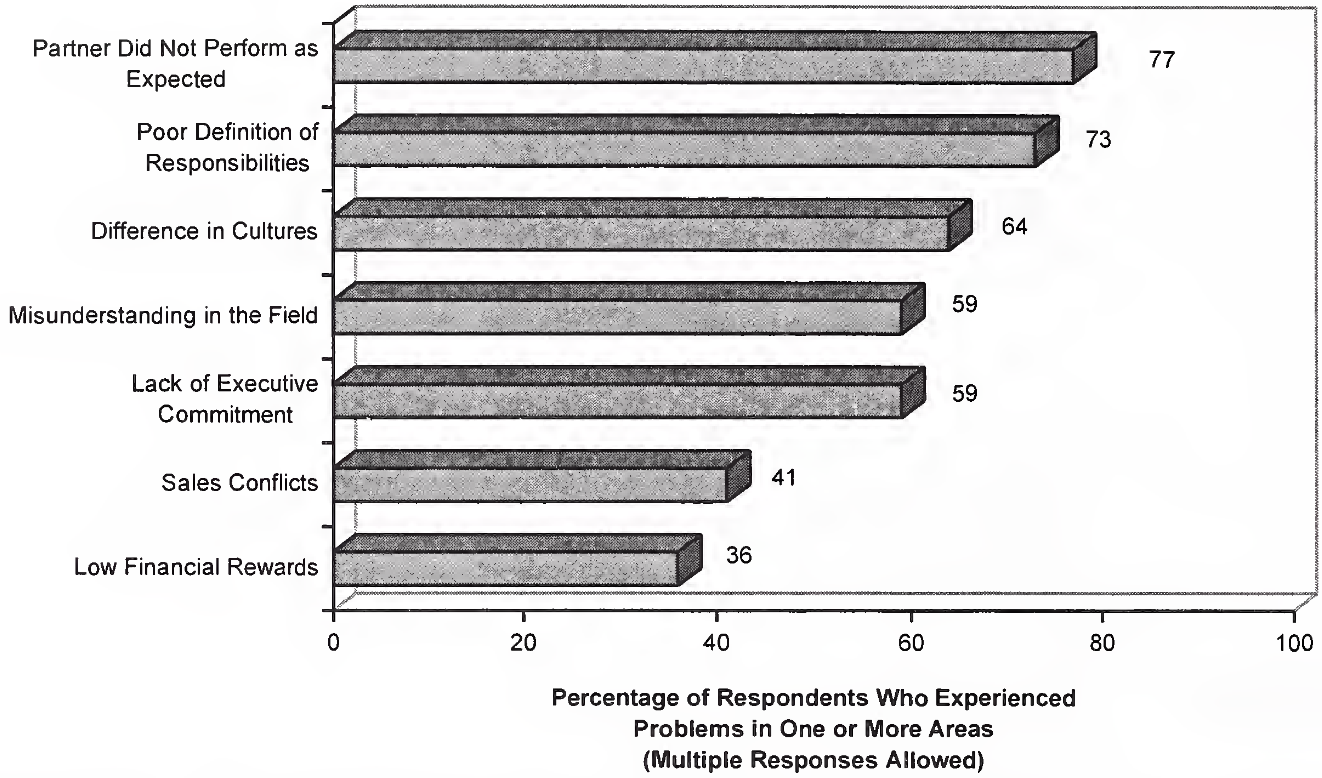
Exhibit V-1

Reported Problems with Alliances



22 Respondents *Source: INPUT*

Two problems stand out at the top of the list:

- Failure to perform as expected during the course of the alliance
- Responsibilities that were not clearly defined.

It comes as little surprise that there is a strong correlation between these two factors. Note that in three-quarters of the instances where a firm reports problems with a partner not performing up to expectations, it also mentions problems with poor definition of responsibilities. This fits directly, of course, with earlier-reported feedback about setting and communicating clear roles and responsibilities (see Exhibit IV-2). See Chapter IV of the report for INPUT's recommendations to firms aiming to prevent the closely related problems identified here.

Clustered together as moderately important are three other problem factors. First among these is a difference in cultures between the partnering firms. It is interesting to note that two-thirds of those reporting culture differences also report international alliance experience, which may have been a contributing factor; on the other hand, some with international experience report no culture-clash problem, and some without international alliances still report culture problems, presumably of the "corporate culture" type. Second in this group of moderate problems are situations of field-based misunderstandings within the alliance. These are mainly due to lack of, or poor, communications regarding the implementation aspects of the alliance. Third are problems that stem from lack of executive commitment, which once again is a key point of advice cited earlier in this report. Again, the INPUT recommendations made in Chapter IV are relevant in preventing these problems.

Significantly lower among alliance problems reported are sales conflicts between the partners and financial rewards that fall below expectations. This indicates that most firms are realistic with regard to their expectations of financial rewards from alliances, and they are effectively managing the sales activities related to their alliances.

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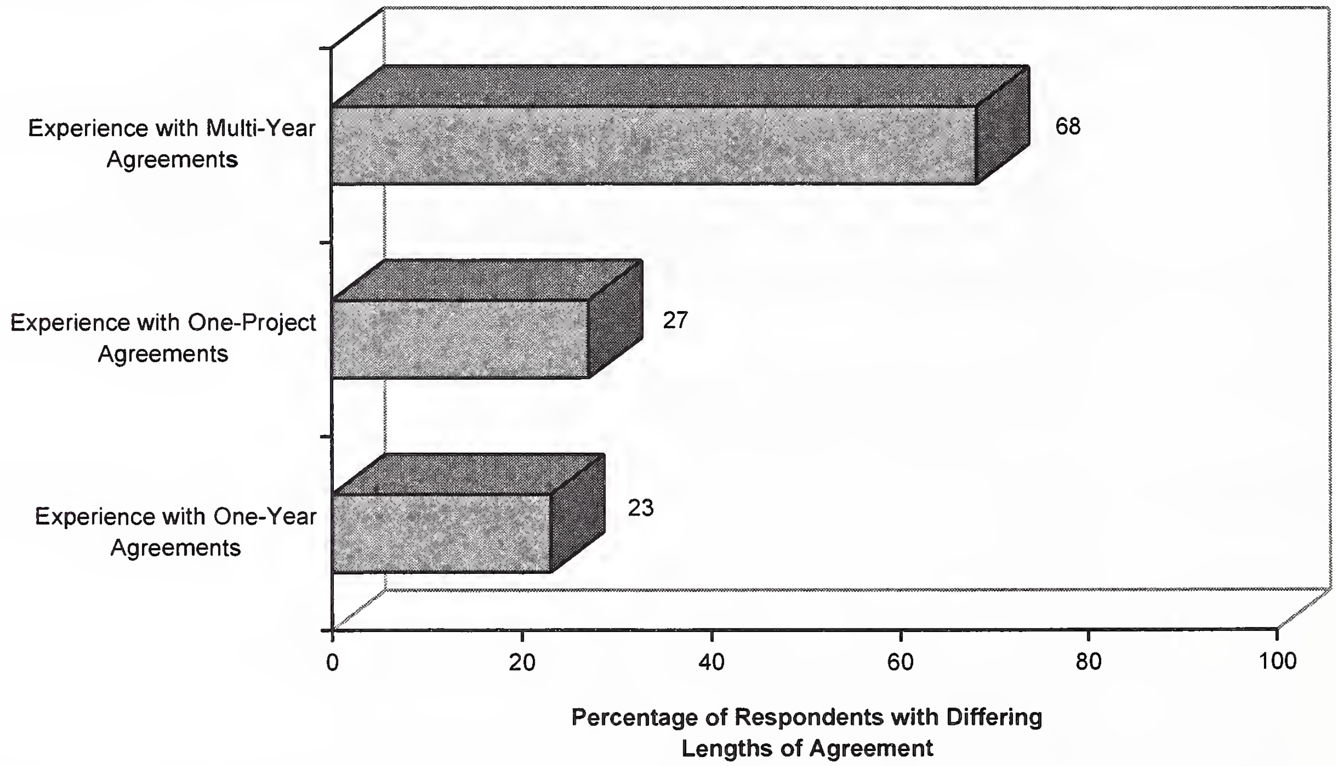
B

Success Over Time

As Exhibit V-2 shows, over two-thirds of the firms interviewed have experience with multi-year agreements, with far fewer (only about one-quarter) reporting project-by-project or single-year agreements.

Exhibit V-2

Length of Agreements



Note: Multiple Responses Allowed *Source: INPUT*

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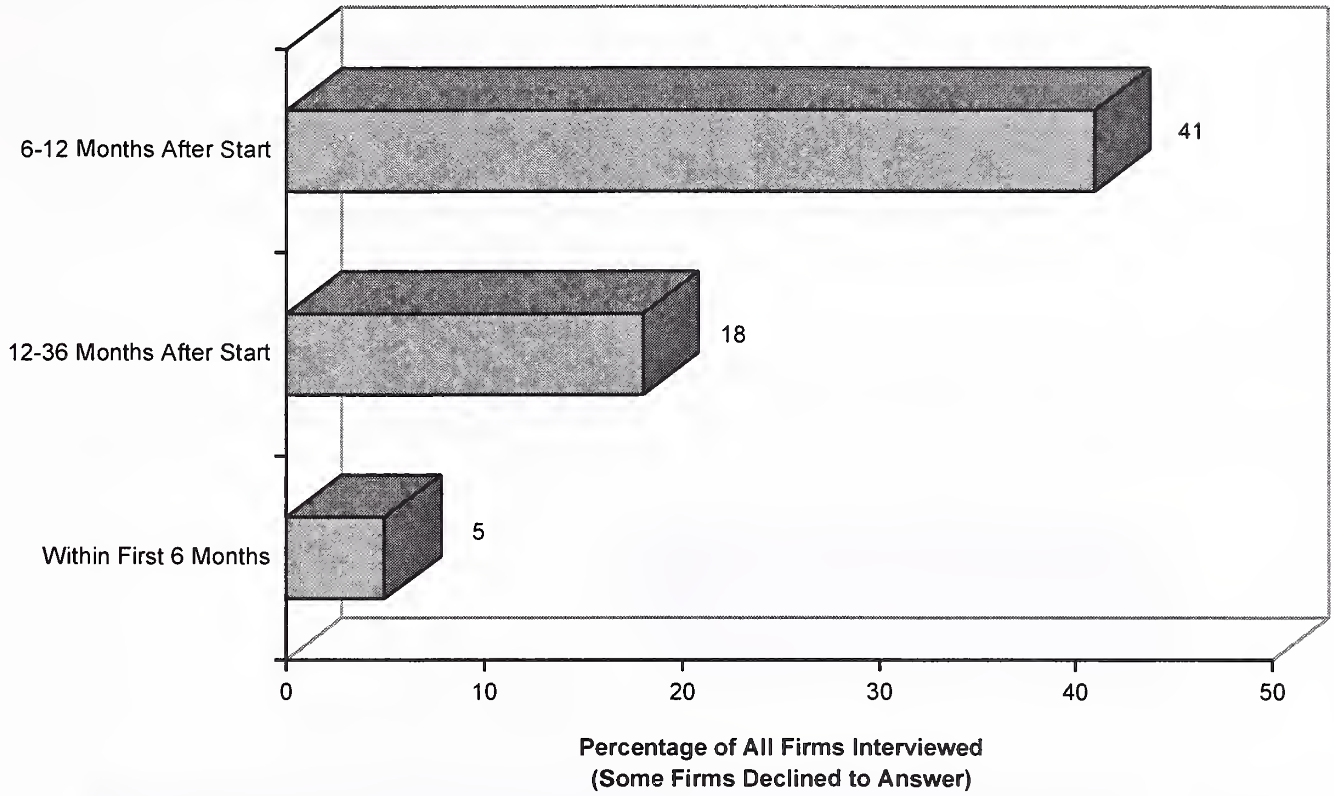
Exhibit V-3

Time Required to Achieve Greatest Success



Source: INPUT

Interestingly, however, Exhibit V-3 indicates that the second half of the first year of the agreement is the time of greatest success in the alliance. INPUT believes the lack of success in the first six months is due to the time required for the implementation of the alliance to take place within field organisations.

In today's fast-changing market, relatively few firms can afford to wait over 12 months for an alliance to achieve success, unless it is a partnership based on long-term technical development. Yet the response, by 18% of the interviewed firms, that greatest success is not achieved until 12-36 months after the start of the alliance indicates that between many organisations, the development of the working relationship and establishment of communications takes a long time.

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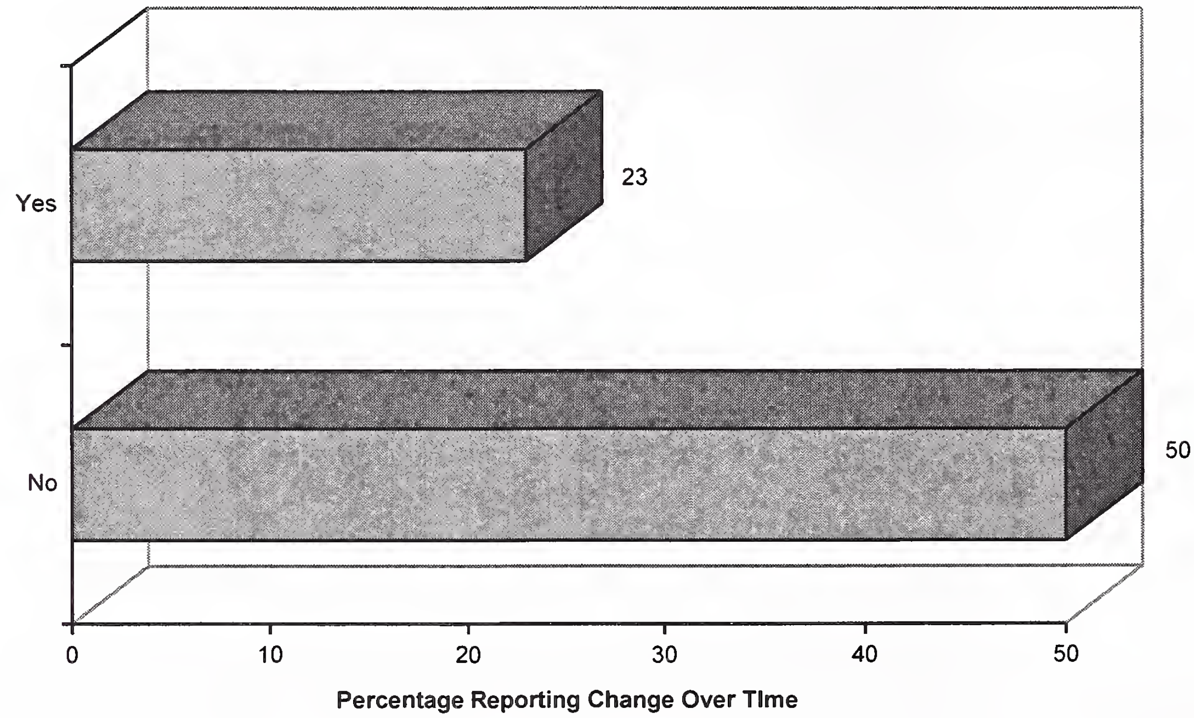
Exhibit V-4, and associated comments in Exhibit V-5, show an intriguing two-to-one ratio; twice as many firms believe that more time would not have generated more alliance success, versus those who believe that more time would have led to more success. Comments associated with the first "No" factor cited here appear to tie back mainly to the earlier discussion about the importance of shared objectives and commitment and effective communication. The second is a direct reference to the "time window" for effectiveness just discussed. On the "Yes" side, only one firm cited a "three-year-plus" time window for effectiveness.

Exhibit V-4

Are Alliances More Successful With More Time?



Source: INPUT

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Exhibit V-5

Are Alliances More Successful With More Time?—Comments

Why "No" ?:

- Alliance either works or does not—time is not the key
- A certain time window sees the highest success
- As conditions change, time may become a disadvantage

Why "Yes" ?:

- Over time, can better understand and adjust to other's approaches
- "Our alliances *mainly* become highly effective only after three years."

Source: INPUT

Although these findings regarding time impacts on the alliance in no way rule out the usefulness of multi-year agreements, INPUT does recommend that firms carefully evaluate alliance success at the end of the first year. They should look especially for success factors that surfaced in the six-to-twelve-month period, then aim to extend and maximise those factors in the second and any succeeding years.

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C
Measuring Success

Exhibit V-6 lists the ranking of five measurable results of alliance success. These were derived by asking these firms which results they rated as "most important"—the success factors that they most *want* to achieve.

Exhibit V-6

Measures of Alliance Success
That Firms *Rate* as "Most Important"

- Ranking, in descending importance of different measures of alliance success:
  1. Increase in revenue
  2. Increase in profit
  3. Volume of new types of business gained
  4. Number of new sales contracts
  5. Length of time the partnership exists

Source: INPUT

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Exhibit V-7, on the other hand, indicates the result of these firms re-ranking those same success factors to show which ones they consider themselves to have been "highly successful" in actually *achieving* that measurable result in their alliances.

Exhibit V-7

Measures of Alliance Success Where Firms Actually *Achieved* "Highly Successful" Results

Ranked in order of the extent to which firms actually proved "highly successful" in alliances:

1. Increase in revenue
2. Length of time the partnership exists
3. Number of new sales contracts
4. Increase in profit
5. Volume of new types of business gained

Source: INPUT

In comparing these two rankings of measurable success factors, note that for only one of the most highly important measures (increase in revenue) did the importance of the measure match its successful achievement—number-one rankings for both.

In contrast, the second and third most *important* factors (increase in profit and volume of new types of business gained) ranked at the bottom of the list of alliance *successes*. These firms found that they were relatively more successful in achieving the lower importance success measures of length of time the partnership exists and number of new sales contacts. In other words, except for increasing revenue, these firms did not achieve their most important measures of alliance success.

Based on these findings, INPUT recommends that firms aim first to measure success in terms of revenue increases, and use other, generally less successful, measures on a secondary basis.

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D
INPUT Recommendations

As shown in Exhibit VI-8, INPUT derives eight key recommendations from the findings of this report.

Exhibit V-8

Summary of INPUT Recommendations for Alliance Success

1. Be sure that all the partners' commitments, objectives, and understanding of the terms of the alliance are in close alignment
2. Nurture carefully the alliance's communication channels and all aspects of the working relationship
3. For international alliances, watch out for cultural differences and different national business practices
4. When choosing a partner, pay close attention to the firm's financial stability, overall business track record, long-term commitment, and industry knowledge
5. Be more cautious if planning an alliance outside the most successful types: contractor relationships and joint marketing
6. Aim to avoid problems that stem from poor definition of partners' responsibilities
7. Expect variations in alliance success over time
8. Focus on increases in revenues as the most likely measure of success

Source: INPUT

First among the recommendations that INPUT makes is to focus carefully on alliance commitments, objectives, and understanding. Above all, this means that partners must agree explicitly on the commitment that they bring to the alliance and on the partnership's shared objectives. Most often these objectives will relate to shared market opportunities, plus factors of leverage between the firms partnering. Note that this agreement must be made at the start of the partnership and then reviewed and renewed periodically. Further, this means that a firm must be clear that each partner has the same shared understanding of the alliance's terms and conditions, both initially and over time. This recommendation relates closely to the next point.

Second, ensure that understanding of the terms and conditions of the partnership remains aligned over time. For the overall success of the alliance, each partner must focus continually on communication. Be sure

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that overall corporate-level communication channels are defined explicitly and structured for effectiveness. Seek to foster key person-to-person communication paths and practices. Communication is, however, just one key factor in the health of the working relationship. All aspects of that relationship will be more healthy to the extent that there is attention focused explicitly, as a key part of the alliance, on the mechanics of working together effectively.

Third, be cautious when there is an international aspect to the alliance. Problems in international relationships show up most often due to cultural differences and the resulting misunderstandings, so again it is important to pay careful attention to communications. Look for ways that culture clashes may undercut effective communication, then plan to protect against those factors. Also, watch out for business practices and customs that may be routine in one partner's nation but unusual or even out of the question in the other's, then plan how to handle those diverse business practices.

The fourth recommendation concerns factors regarding choosing a partner; "look before you leap" regarding a partner's finances. Recognise that if the partner is suffering financial instability before the alliance is agreed to, that may undercut the partnership's success, especially if the partnership itself or the commitment of resources to it later becomes jeopardised by a financial reverse suffered by the partner. Closely related is the requirement to examine the partnering firm's overall business track record, looking for signs of relevant success rather than failure—not just within alliances it has undertaken in the past, if any, but also in its business record in general. Note that there may be trouble with the alliance if the partner is not committed to long-term working relationships. Most partnerships take time to demonstrate success (see the seventh recommendation, below), so a lack of such commitment may create trouble. Those partners willing to commit to a long-term working relationship most likely will be the same ones that have strong knowledge of their industry based on their leadership over time—another key factor in choosing a partner.

Fifth, though other types of alliances may work effectively, aim to focus first on alliance opportunities that involve a prime contractor/ subcontractor relationship or a joint marketing agreement. These generally are the most successful alliances, so they should be looked for first. Be more cautious, and recognise that success is less likely though certainly still possible, in other types of alliances.

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Sixth, and closely related to the first and second points above, recognise that many alliance problems result from situations where the partners' responsibilities either were not defined effectively at first, or changed or needed to change over time but were not addressed clearly at the later date. Again, clear understanding and careful nurturing of the working relationship's communication will help avoid this problem.

Seventh, do not be surprised that the success of the alliance varies over time. In fact, plan for it. Look especially for the six-to-twelve-month time window to show early results that are better than those of the first six months. Consider carefully how long to extend the alliance, and examine any resulting need to modify commitments and objectives.

Eighth, and finally, when measuring success, focus first on increases in revenues, as this is the most likely high-priority outcome of an effective alliance. Though other positive outcomes may result as well, aim to make revenue increase the key objective, and regard the other objectives as desirable, yet not central, to measuring the success of the alliance.

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