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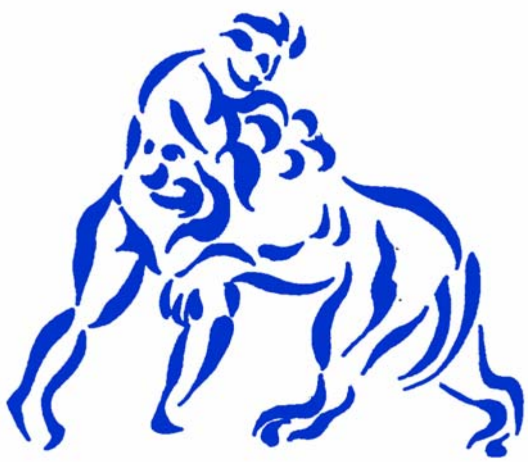
Aligning the Pieces

Grow A Business With Strategic Alliances That Pay Off
R&D Consortia as a Business Strategy



T*he greatest hero in all of Greece was Hercules. Although a man, his strength ensured that he was the equal of the gods and they looked to him as an ally many times. As the gods discovered with Hercules, forming strategic alliances can offer a number of significant benefits when growing a business. Benefits such as increased knowledge, networking with industry partners and competitors, cost-shared R&D, pooled technical and business resources are all designed to spread the risk and increase chances for success.*

ALIGNING THE PIECES

GROW A BUSINESS WITH STRATEGIC ALLIANCES THAT PAY OFF

Don't get the impression that licensing is THE solution to the technology puzzle. Licensing is a powerful piece in the technology puzzle. But, licensing is a subset of strategic alliances.

Priming the innovation pump to develop new product is critical to competing in a global economy. The stakes in this game, however, have risen beyond the resources of most companies. Small businesses must find ways to supplement and complement in-house resources to meet this challenge—without draining the cash they need to support their current businesses. Forming a strategic alliance may be an answer for some companies.

Strategic alliances differ from other standard business arrangements because of the greater degree of communication, collaboration, and integration between the companies. Alliances also represent a proactive approach to the development, marketing, and distribution of products.

The challenge in any strategic alliance is to analyze the strengths, needs, and concerns of both parties.

Forms. Strategic relationships can take many forms: raw materials sourcing, marketing arrangements, equity investments with purchase options, and industrial consortia. Several common themes are present in these relationships: development of a new product or technology by one party with manufacturing and distribution rights resting with the other; joint technology or product development with shared responsibility for manufacturing and distribution rights in the same or different markets; and consortia, multiparty contributions of know-how, resources, and funds to develop process technology collectively.

Strategic alliances can take the form of traditional arms-length or integrated relationships. In the latter, intellectual property and know-how are shared under cooperative marketing, original equipment manufacturing, and joint R&D agreements. Cross-licensing, toll manufacturing, equity investments, licensing, and mergers and acquisitions evolve from successful alliances. Allied to strategic alliances is "corporate partnering"—an equity investment in a smaller company with a license to use its technology.

The challenge in any strategic alliance is to analyze the strengths, needs, and concerns of both parties. Each party must understand clearly the purpose of the alliance and whether any third party relationships are necessary to meet common objectives. Such relationships must be structured to resolve and protect any proprietary interests, confidentiality, intellectual property rights, and future ownership of any technology that may be developed.

Do's And Don'ts. There are some do's and don'ts to be mindful of in forming strategic alliances.

Don't form an alliance to correct a weakness. Many companies form relationships to correct an inherent weakness. The company that brings a weakness to the table will be forever at the mercy of the other party. Even if the alliance is a 50-50 cash deal, the weak partner will never be an equal partner.

Don't form an alliance with a partner that is trying to correct a weakness of its own. The theory, again, is simple. The company will inherit the weakness and will be the worse for it. The dominant partner becomes responsible for the others.

Don't license proprietary technology. Consider the lessons Japan has taught us in the last decade. Break-through technologies such as transistors and LCDs were acquired and developed into profitable, competitive products knocking some of our biggest companies (RCA and Zenith) out of the game. Think of a strategic alliance as a cooperative collaboration. Using this definition, it is very clear that the company should not transfer core technologies and skills to potential competitors. Technology might be used as a weapon against the company in the future.

Do exploit strengths to develop applications and markets for the technology. By contributing proprietary technology, the company position can be strengthened and amplified through the relationship. Forming an alliance with a partner who also has a unique strength has its advantages. Combining the synergies of a manufacturing company with a skilled marketing and distribution firm is a good example. This is one of the key rules of successful alliances—neither party should be a future threat to the other.

How To Plan. There are a few critical elements involved in forming and maintaining successful alliances.

Know how to play before starting the game. Save time, money, and heartburn by reaching consensus on objectives and constraints before entering a negotiation.

Build relationships at the appropriate level. Strategic alliances are unlike marketing or purchasing agreements. They require the attention and support of senior executives because of the commitment needed.

Discuss, in preliminary stages, what each party wants and expects to gain from the relationship—no surprises. It is critical to make sure that the goals of each company are compatible. Strategic alliances require a win-win posture.

Maintain a healthy empathy for the position of the other party to determine whether the relationship might be beneficial.

Recognize that the alliance is a collaborative venture and that its foundations and negotiations must reflect this. Avoid a win-lose attitude. When the negotiation is finished, the companies must view each other as partners in a collaborative, long-term enterprise and not as adversaries.

Plan an exit strategy upfront. All relationships eventually end. Know when the alliance has met the objectives and what is the appropriate exit strategy.

Legal Forms. In simplest terms, the issue is whether the alliance will be established as a new separate entity or whether it will be a contract between the existing parties. Both forms have their own advantages.

Separate Entity. If the goals require a long-term commitment of management, resources, and significant capital and operating investments, a separate entity might be appropriate. Generally, the choice defaults to a partnership or a corporation. There are various tax considerations for which we should seek legal advice.

Contractual. The contractual form is usually simpler and more flexible. It also avoids many of the difficulties associated with management issues that may arise in forming a separate entity. On the other hand, the question must be addressed as to whether this is an effective commitment of resources over a long period of time. Spell out any residual rights at the conclusion of the alliance and ownership of any new developments before, during, and after.

Management Issues. Another critical issue to be faced is one of control. This issue takes two forms: policy and day-to-day operation. Policy issues represent the most difficult problems since they are most likely to affect the success or failure of the alliance. Decisions on these issues also are likely to require the greatest obligations financially or otherwise on the parties. Policy issues are generally decided by a board of directors for a separate entity and an advisory committee for a partnership.

Day-to-day operations can be handled in a variety of ways. If a project is significant, we may wish to recruit an independent manager or group that is not associated with either party and, therefore, is objective. Otherwise, day-to-day operations can be performed by management loaned from one or both of the parties depending on the number of functions being undertaken. A variation of this, of course, is to switch managers over a period of time or to have one party manage the entity under a management contract with appropriate milestones.

Technology Rights. Strategic alliances must define the scope and use of the technology that either is provided to, or developed by, the alliance. The decision affects markets and whether the alliance is contributory or competitive. Future technology rights will always be an issue, particularly if one party is contributing proprietary technology that will be developed further through the alliance.

The ownership of developed technology is one of the most difficult issues. If the development work is performed by a small-business partner without the creation of a separate entity, that partner will control the technology. However, if the development work is collaborative, the parties must carefully define their respective future technology rights.

One party may suggest joint ownership to solve the problem. This approach has many pitfalls. First, the effect of joint ownership varies between different intellectual properties (i.e., patents, copyrights) even within the same country. For example, the joint owner of a patent in the U.S. can license its rights exclusively without any obligation to the other joint owner. On the other hand, joint copyright owners may license exclusively yet still be required to account for profits to the other owner.

Joint ownership also affects future litigation because joint owners are often considered a necessary party to any lawsuits. Call a lawyer on this one.

Technical Support. If one party is a small business, it must carefully allocate its limited technical resources without peril to its current business. It also may wish to recover its expenses for providing technical support and to limit the scope of support to a fixed schedule.

To be successful, the collective interests of each party must be balanced by the individual objectives, skills, and resources of the parties to the alliance. It is critical to remain flexible and creative in addressing these issues.

R&D Consortia as a Business Strategy

The big bang theory holds that the universe was created from a monstrous explosion eons ago. There's a similar theory evolving financially. Known as the Big Bang Theory of Modern Economics, it holds that we expect the best value for every dollar we spend—the biggest bang for the buck.

This theory drives business decision-making today. In fact, it is driving business decision-making to the point where businesses are killing themselves by focusing on the short-term, present bottom line at the "expense" of their futures.

Corporate decision-makers enslaved by the "bottom line" have all too often sacrificed R&D to ensure favorable balance sheets. This short-term adherence to the pressures of toeing the bottom line mortgages the future of the enterprise. In today's technology-driven global economy, failure to invest in R&D is a prescription for extinction.

Fortunately, there is a way of maximizing the amount spent on research and development—and guaranteeing a return—without destroying the bottom line. It comes in the form of R&D consortia.

Consortia are a bargain. They offer one of the most cost-effective means to conduct essential R&D. Through consortia, companies in diverse industries gain a cost-effective alternative to traditional applied R&D.

Why conduct R&D? Surveys confirm that technology-based firms who pursued applied R&D grew the fastest during the 1980s. Technology, and the products it yields, is a proven opportunity creator. It keeps companies abreast of changes in the world, and allows them to compete effectively with their domestic and foreign competitors. Clearly, applied R&D is pivotal, and is the foundation on which future growth for technology-based companies must be built.

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What are the "bottom line" benefits of consortia? The R&D cost/benefit ratio improves substantially in a consortia. For example, a small corporate investment of $150,000 compounds with the contributions of a consortia of 10 members. Consortia members also get the pooled knowledge, resources, and capabilities of the members and, if they're lucky, academic or government lab partners.

When financial, brain power and facility resources are pooled, common problems are identified, attacked, and solved.

Which gets around to another fundamental law of nature—strength in numbers. That strength is vitally important in these cost-conscious times.

What about potential competition between companies participating within consortia? This is not a problem when consortia focus on technology-related issues of common interest. Companies compete on product margin, not on process technology—a fact many Fortune 500 companies learned is difficult and costly to protect.

Generally, when we sit down and talk over the problems within our business, we don't disclose, let alone analyze, trade secrets or problems. This is true within a consortium. Company trade secrets, know-how, and show-how are not shared. Consortia are not encounter groups where we share our innermost secrets. Moreover, choosing to disclose individual interests rests with each company. A company may decide to share sensitive information if such disclosure will advance its interests—and the interests of the group as a whole. No pressure is placed either way.

Consortia focus on the larger picture: deploying technology, finding ways to remain competitive, streamlining operations, improving efficiencies, and researching the how-to, for example, of basic manufacturing practices that are common to all members.

Members play key roles in developing and applying new technology that may have significant impact both on production and downstream products. In the process, members gain access to newly developed proprietary information that may impact their industry—all while performing R&D at a fraction of the cost of traditional R&D programs.

Two consortia I had the pleasure of forming and managing had a unique partner—a research institute. Not-for-profits can be objective, noncompetitive, and protect and advance the interests of the member companies. Research institutes can put industry in the driver's seat and marry the needs, resources, and capabilities of industry with the brains and talents of the government or universities—the public sector largely created by our tax base.

To stay competitive, domestic business must take advantage of all available avenues to meet the challenges posed by Japan, Germany, Korea, and a host of other nations battling for position in a global marketplace. Our competitors have gained a technological foothold because of the failure of the majority of our companies to match their ability to effectively apply and rapidly develop new technology.

Leveraging financial resources is an essential advantage for firms that occupy niche markets. It is imperative to take a long, hard look into the future and find ways to be competitive.

In these cost-reduction times, the risk/reward ratio requires companies to be lean and mean and have a plan that guarantees the biggest bang for the buck, i.e., value. When small business or industry leaders consider the future, they need to look at ways of maximizing their investment. Joining consortia is an enterprising way to network, pool resources to leverage R&D investment, and apply technology while the window is open.

Consortia are much like wading across a stream—with help. Alone, we face all the risks. We may not know where the water is deepest or swiftest with the result of having our feet swept out from under us. That's what individual R&D efforts can be like—we may even have an idea of where we want to go but the "bottom line" leaves us vulnerable.

Consortia create lifelines of sorts that allow everybody to cross the river at the same time—safely linked in the process. If one partner gets into deep water or caught in the swift current, the other partners can pull them out and try for a safer crossing down stream.

Consortia seek to meet global competition, deploy the latest technologies, conduct ongoing applied research, and strive for continuous improvement among all their business and industry members. The buck can start here.