TUCK SCHOOL OF BUSINESS AT DARTMOUTH
GLASSMEYER/MCNAMEE CENTER FOR DIGITAL STRATEGIES

# Strategic Partnering: Managing Joint Ventures and Alliances

A Thought Leadership Roundtable on Digital Strategies

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## Thought Leadership Roundtable on Digital Strategies

*An executive roundtable series of the*
*Center for Digital Strategies at the Tuck School of Business*

*The Thought Leadership Roundtable on Digital Strategies recently convened for a discussion on how companies are managing strategic partnerships. In a global environment where partnerships are often crucial to business success, what does it take to do joint ventures and alliances[1] well? What are the best practices in building partnerships in both developed and developing markets? This roundtable included academics and business leaders from Bechtel, Cargill, China Strategic Advisory, Cisco Systems, Dell, Eastman Chemical, Hasbro, IBM, McKinsey and Co., Columbia University, and the Tuck School of Business at Dartmouth.*

**Key Insights Discussed in this Article:**



[1] For this discussion, we defined an "Alliance" as an agreement between two or more separate companies in which there is shared risk, returns, control, and some operational integration and mutual dependence—essentially, anything between, but not including, an arms-length deal and a full merger. A "Joint Venture" was defined as an alliance in which both firms have an equity stake in an entity—operational integration and mutual dependence are often higher than in other forms of alliance.

 
The Thought Leadership Roundtable on Digital Strategies (www.tuck.dartmouth.edu/roundtable) publication series is edited by Hans Brechbühl, Executive Director of the Center for Digital Strategies.

## Introduction

In a global environment where collaboration is critical to business success, managing strategic partnerships is a crucial yet elusive competency—almost 50% of joint ventures, for instance, fail.

How should CIOs and Corporate Development executives think about strategic partnering? What are the keys to making JVs and alliances work? What's the best role for IT? And in a global market, how can these lessons learned be extended to developing markets like China?

## The Rationale for (and against) JVs and Alliances

What are the right reasons to enter into a joint venture or strategic alliance, and the best ways to think about process, structure, and goals for these partnerships? Participants made the case for and against these two very different partnership types, and the situations in which they are best leveraged.

McKinsey's David Ernst cited research showing that 60% of JVs and alliances for new products or markets succeed, versus only a 40% success rate for core business partnerships. "If it's new business, complementary skills, or there's a real proposition around sharing risks, such as huge capital expenditures, then it makes sense," he said. "If it's really a core business and you're partnering with somebody who's a future competitor, then you need to think about it as a vehicle towards an eventual acquisition."

Ernst also noted that JVs are more complex than alliances when it comes to issues like control, strategy, and, most importantly, people. "Joint ventures were great when you're setting up a new business like Siemens and Corning in fiber optics—you can have a whole new group of people driving the new business," he explained. "But most of today's JVs are very integrated. It's hard to attract talent, hard to figure out the comp systems, hard to make people loyal. The bar for deciding [whether] it's worth doing a JV is pretty high."

Hasbro's Doug Schwinn said his company uses JVs primarily to enter new markets: "Our brands are pretty well-known where we operate. But if you move into China or other virgin markets, there isn't Monopoly or Mr. Potato Head. Nobody knows what they are." The right partners, he said, can provide the local knowledge and penetration to help "introduce our brands in a logical manner."

IBM's Paul Van Dyke said his company considers JVs a last resort where other approaches won't work. "JVs for innovation in IT don't seem to work very well, we don't do those often. Currently, when we want to take an equity position in innovation, such as in our software business, we prefer a complete acquisition. We've done many of those in the last several years," he explained. "But we do JVs with suppliers or customers, especially in Europe as they relate to outsourcing." Often IBM's JVs are driven by government regulations, Van Dyke noted, such as a partnership requirement in India or European labor regulations.

Van Dyke added that frequently JV partners have divergent business interests, which sets the stage for conflict and control issues. "You're both weak in some area and feel that only by combining do you get strong enough to do whatever it is," he said. "As soon as the JV's CEO is overruled the first time on some investment decision by one or the other partner, he's compromised, and the whole JV gets into marriage counseling mode."

Eastman Chemical's Jerry Hale, while noting that his company prefers more straightforward alliances to JVs, said there are some situations where JVs still make sense, such as long term capital investment projects to assure a steady supply of two different raw materials by-products from the same process. But he cautioned that with JVs, it's more crucial (than in contractual alliances) that the partners have complementary interests: "If both partners wanted the same thing, we'd be inclined to just acquire that company and have total control. We're talking about a 50-year payoff on these investments—it pays to take time up-front to get it right."

Cargill's Jim Prokopanko said his company is involved in 200-some JVs focused on product innovation, access to new markets, and sometimes even access to capital. He cited the company's partnership with Monsanto to bring a new type of seed to market by leveraging Monsanto's gene implant technology and Cargill's supply chain and food production facility knowledge. "The new enterprise can create something that neither partner could do on their own," explained Prokopanko.

Most such partnerships are driven by Cargill's individual business units, Prokopanko reported, although there's a corporate process for vetting potential deals, including divorce clauses, financial structure, balance sheet impact, and intellectual property exposure. And of course, valuing each partner's contribution can be challenging, he acknowledged. "We've had our failures—a lot of JV negotiations that have gone nowhere. Either you understand what value each other brings or you don't go forward."

Eastman Chemical's Lee Whisman said his company is taking a more top-down view toward alliances these days, noting that Eastman pulled back from JVs after a new CEO re-focused the company on core operations: "We were running all over the place. Let's try that. Let's try this. Where we're going now is that we are good at certain types of chemicals."

Dell's Susan Sheskey echoed Whisman's comments, saying her company has "an institutional bias to not do M&A" and has not done many big partnerships, aside from two successful alliances with Lexmark and EMC. Those deals, she noted, grew out of clear strategic thinking about "what are the revenue and profit pools we wish to target, and how do we extend our lowest-cost model to adjacencies." Sheskey emphasized Dell's desire to avoid entanglements that can "add a tremendous amount of chaos to your business. We're focused on doing what we're fundamentally good at, as opposed to trying to sort through a whole host of issues and complexity."

**Laying the Groundwork: Control and Performance Management**

One reason JVs tend to underperform, said McKinsey's Ernst, is the difficulty of contractually building performance management and reporting into partnership deals. "A huge challenge is putting in the performance measurement systems where you're not necessarily the operator," he said. "There's kind of this patchwork of 'let's do a little of yours and a little of ours'." JV partners should try to "set up who is going to do what in a very granular way," while the deal is being negotiated.

Government regulations regarding minority investment reporting can also constrain a parent company's influence on a JV, added Columbia University's Kathryn Harrigan, as can the desire not to stifle innovation through excessive controls. "Do you fix them and then knock all the innovation out of them, or do you walk away from it?" she asked.

Cargill's Prokopanko added that being the deep-pocketed partner in a JV can carry legal restrictions that may preclude hands-on control or tight integration. "If there's financing involved we often expect it to be non-recourse financing, and you've got to be very careful that you're not behind the curtains moving the strings," he explained. "Pretty soon … you can barely take their phone calls."
Expectations about parental involvement in JVs are often set up-front and difficult to change over time, added Eastman's Hale. "After you've told them you're going to lead them arms-length they sure resist being integrated," he said.

Cargill's Rita Heise proposed that thinking strategically up-front about how a JV might evolve over time, especially how much parental involvement they'll need, is crucial to effective management: "We've had some where they've moved very rapidly, where initially we kind of didn't care. Now we're trying to look at 'Where do we think this JV is going to go? How do we set it up to make that journey a little bit less painful?'"

Bechtel's Geir Ramleth said his company is constantly involved in a series of construction projects and partnerships, often more than 50% of them JVs, often among competitors. The most important decisions, Ramleth said, are around which partnerships to take on and how to structure them. "Some of our best protected intellectual property is our methodology for how to deal with that risk. We do not like to be in these partnerships and be the underdog … we prefer to be the leader of them."

IBM's Van Dyke said control in JVs is important because his company wants to present a single, integrated face to the company world-wide. "So you're buying the IBM brand," he explained, "and if we happen to be making it with a JV on the manufacturing side or we have some other minority stake someplace, that's between us and our suppliers."

Hasbro's Schwinn proposed that having a clear, mutual understanding of specific issues and documenting potential remedies is just as important as having formal control—a lesson Hasbro learned from its South American JVs, which were more relationship-based. "You need much more up-front work on how would you operate … there wasn't a lot documented, so when it came to friction you didn't have anything to build a discussion on, you had to stay away."

And Cargill's Prokopanko noted that while everyone likes to have control in JVs, "when things do go bad that gives you small comfort." There are situations where Cargill wants only a minority stake without a board seat, he said, in industries which may not yet warrant a long-term commitment—"a hedge-your-bets kind of approach."

In contractual alliances (as opposed to JVs) participants agreed that some similar control and performance dynamics come into play, but must be managed through executive relationships and by emphasizing win-win outcomes and balanced distribution of value.

Cisco's Brad Boston explained that his company prefers alliances to JVs, and has complex, multi-faceted partnerships with IBM, HP, and Dell that include buying each other's equipment, selling together to extend market reach, and supply chain collaboration. "As long as we don't get too greedy on what we're asking of each other, it works. But when we start saying, 'I want all of your internal business and you want all my internal business,' it starts to fray," Boston noted.

McKinsey's Ernst proposed that while the value reaped by each alliance partner need not be perfectly equal, "it has to be perceived as fair and sustainable, with both companies over time getting more out than they're putting in." Whereas in the world of JVs, he noted, it's crucial to closely model the economics and make sure transfer price arrangements don't cause distortions resulting in one partner being better off, "because in the not-too-long run that leads to real problems."

Boston added that executive oversight and sponsorship are crucial to maintaining the balance of value and smoothing out occasional ruffled feathers: "What makes our alliance with IBM work is we are in complementary businesses, but also that [Cisco CEO] John Chambers and [IBM CEO] Sam Palmisano feel the value that we can get by working together far exceeds any of the pain and friction that might be caused, and they personally go and diffuse it when it starts to surface."

## Getting Airborne: The First 100 Days

What are the critical success factors in the first hundred days of a strategic partnership? Participants agreed that not having a clear understanding of the venture's goals, scope, or roadmap was the number one cause of partnership failure during the first hundred days.

Bechtel's Geir Ramleth said his company has created a methodology for partnership team-building that starts with a clear understanding of what the end customer needs and values: "When you join forces you don't necessarily come from the same background and so you have to be sure, 'what is the driver of this new thing?'" In the case of a recent large project, Ramleth noted that the JV team went to the various customer stakeholders to get that input, "to ensure that the central joint team is actually executing against that common end result wish. Building that team is a project by itself."

Ramleth stressed the importance of clarifying roles and the division of responsibilities between the partners during the first hundred days: "We make it very clear … it's kind of a subset of the governance piece."

David Ernst noted that McKinsey analyzed twenty-five large strategic partnerships, and found that in the 'design phase' there were four key areas that seemed to drive success:

- First, "that the team and the control tower function had a post-merger-like discipline to it … the software, the tracking, the functional teams underneath them."
- Second, that the high-level strategy had been 'drilled down' into a specific business plan focused on products and markets with specific responsibilities linked back to the JV CEO's contract and team alignment incentives.
- Third, that the interdependencies between JVs and each parent were thoroughly mapped, and minimized—"because the more touch points you have the more complex it is."
- Fourth, that the high-level understanding about control was converted into governance specifics: "What are the subcommittees? What's the board's agenda going to look like? How the heck do we get CapEx approved without having triple jeopardy of the JV and both parents?"

Ernst added that the starter CEO is likely to come from one of the two parents, because that person must be able to bridge the two cultures. But he cautioned against splitting top jobs evenly (beyond the top two spots) between the two parents: "If you put in slots then you get this thing that's pulling in two directions."

Participants also agreed that other HR issues loom large in the first hundred days, such as getting the right people into the partnership. "One of the big medium-term problems is you're starved for talent or not enough full-time people who really have skin in the game," said Ernst. "If you get that right, they can do the rest of this, and if you don't get that right, it's really hard to recover."

And watch out for mismatched expectations on the team, cautioned Cargill's Prokopanko. "We've had joint ventures where it's 'you go in, no safety net, no guarantees of return'," he recalled, "while the other partner says, 'take a chance and if it doesn't work out, we'll have a home for you back here.' You have people playing with entirely different piles of chips, which has a dramatic impact on whether you ever get a team to gel."

IBM's Van Dyke noted that if the JV is a supplier to one of the parents, the right leader may be the person with the best personal connections to the buying organization. "We had a software development JV in Singapore and the person who ended up leading it was out of the software lab in Austin, Texas, because he had the connections to make sure the JV was utilized correctly within the company."

IBM's Nancy DeLapp highlighted the importance of establishing communications vehicles to deal with rumors, problems, and issues in the first hundred days, "so if things get totally out of control … you act on it and the organization looks responsive." Eastman's Whisman added that his company has successfully used a 'steering team' concept to arbitrate key disagreements early on.

Cisco's Boston noted that alliances are often more short-term focused than JVs and have fewer moving parts to figure out. "With a strategic alliance, you can get it wrong for a while and learn from your mistakes and you haven't paid a huge price." But, warned Boston, with a JV or acquisition, you need to figure out whether you're trying to optimize on short-term revenue or longer-term outcomes—"if that's not clear then you can really botch it up."

Whisman agreed that the need to focus on the long view in the early going is what sets a JV apart from an alliance. "You can already see the energy you can start getting in the first hundred days of launch," explained Whisman. "This is the time to try and put something in place for a year, two, three years down the road, and then it may go to a great place that you hadn't even thought of."

## Cruising Altitude: Ensuring Success over Time

As with marriages and children in real life, participants agreed there were no simple answers—but a lot of ideas—on how to measure success and ensure the long-term viability of strategic partnerships.

Cargill's Jim Prokopanko said his company's innovation-oriented joint ventures typically have five- or seven-year product development cycles with milestones along the way, whereas the company's simpler, more production-oriented JVs use a balanced scorecard or bottom line number like free-cash flow as a success metric.

IBM's DeLapp noted that in a broad portfolio of partnerships, corporate parents must look at how the various ventures intersect over time. "Managing across the portfolio is important because everybody thinks they can do more than what you originally agreed to … somebody always has to keep the enterprise in mind because all these relationships can take over." Prokopanko agreed: "It's like one of your kids … they leave home and it's not long before they're running around and start having their own ideas."

Another key question is how to address performance issues at the JV or alliance when the parents are typically fully absorbed with their own businesses, and often hope the problem will just take care of itself. Anticipate this eventuality in the planning stages of the deal, advised Cargill's Rita Heise. And whatever you do, don't ignore performance issues when they first arise, said Cisco's Boston. "The biggest mistake is not dealing with it."

Several participants agreed that quarterly meetings between the partners' principals—often CEOs but sometimes business unit heads—can help resolve problems, many of which get flushed out and cleared up in the lead-up to the meeting. But others noted that making sure a partnership gets the visibility it needs in the context of two separate corporate planning cycles can be a challenge.

“IBM runs on an annual cycle, so when it comes to operating plan time that would be the time to ask ‘Is this JV working for us? Is it core or non-core? Has the market moved?’” said Van Dyke. But Hasbro’s Schwinn felt that often JVs underperform because they’re “just too small to get the exposure they need in the annual cycle, so problems don’t surface until they’re really in trouble.”

Prokopanko stressed the value of having a single individual at each parent who’s personally responsible for the partnership’s success. “On our larger JVs we’ve raised the level of representative on that JV,” he said. “It’s not just someone to sign some documents quarterly. That person has to account for performance as much as the CEO of the JV does.”

Tuck’s Eric Johnson described some research he’d recently done on why alliances among auto industry suppliers succeeded or failed. “In many cases when they failed,” he noted, “they had forgotten why they fell in love to begin with.” He cited the case of Ford and Lear, the seat assembly supplier that Ford decided to form a tight alliance with in the 1990s.

“Somewhere along the way Ford began to feel that Lear wasn’t that competitive anymore, so they started treating Lear more like every other supplier,” Johnson recalled. “There was a disastrous ’96 Ford Taurus rollout with all kinds of problems integrating a new seat design. Lear was mad because they were treated poorly during the process and didn’t feel like an alliance partner anymore.”

“When it transfers into a win-lose proposition,” agreed Cisco’s Boston, “that’s when it starts to go sideways. As soon as you start thinking that you’re not getting the same value in return and you start doing that internal measurement, it starts to unravel.”

Participants discussed several remedies for poor-performing partnerships, from simply shutting down a deal that’s accomplished its purpose or outlived its strategic usefulness, to trying to resurrect a deal or buying out one of the partners.

“If the market’s changed, sometimes it becomes very obvious,” said IBM’s Van Dyke. “The JVs that we’ve unwound basically were not self-supporting or hitting their targets anymore, whether they were free-cash flow, profitability, or market access.”

Often a struggling deal will suddenly get put under the microscope by top management, especially if there’s no immediately viable exit strategy, an experience Van Dyke likened to an “autopsy without the benefit of death.” “If we don’t have the option to end it,” explained Bechtel’s Ramleth, “we try to realign the roles and division of responsibilities. Another way is to go after the team and say ‘you have to figure out how to do this, you don’t want our senior executives to come in and run your project.’”

McKinsey’s Ernst described a diagnostic mechanism he uses to determine how bad the problems at a JV have gotten, and whether they can be fixed. If the problem is financial or operating performance, then it may be too late, “because it’s a ‘now’ problem.” However, Ernst added, if it’s governance and/or strategic fit, then there are almost always changes that can be made. It may just a matter of “good hygiene”: “Who’s on the board? How often do they meet? Do you have enough horse power, enough seniority? Do you have enough skills in operations?”

“Sometimes it’s the financial arrangements,” Ernst said. “You’re making a ton of money and your partner is only making a little—you need to give them some.” If you’re pretty sure you want to kill the partnership, Ernst advised, “you study the hell out of it and figure out all of the levers and clubs and carrots first.” If you think there’s an upside or you can fix it, “initiate a joint discussion that starts a level above the alliance, because the people in the alliance always have some sensitivity.”

In alliances, agreed Cisco’s Boston and Dell’s Sheskey, there’s often another, more straightforward option: change the partner. Each cited a case where a partner was underperforming and their company had to put financial pressure on until the partner got re-focused. But ‘Plan B,’ acknowledged Boston, is to start looking at your other options while trying to fix the problem: “when we see it hitting the skids, we just don’t let it fester for very long without dealing with it.”

## IT’s Role in Successful Strategic Partnerships

Getting involved as early as possible in the deal can be the key determinant of the CIO’s ability to help a partnership succeed, participants agreed. “We get invited to the table, but often late,” noted Cargill’s Heise. “What the IT professional brings to the table goes far beyond IT … we are an integrator within the company.”

“There’s a team that tends to be lawyers and finance guys, and they don’t want anybody in that discussion until they feel that they’re ready,” added Hasbro’s Schwinn. “Problem is, they don’t feel they’re ready until they’re well beyond locking in some supply chain or IT issues.

CIOs are often perceived as likely to throw cold water on ideas or impose rules and requirements, suggested IBM’s DeLapp. “It takes a while for them to understand that you’re not going to sit there and say ‘no’ to everything.” And there’s also an upside to getting IT involved early, noted Eastman’s Whisman: “Most of the deals we’ve done, the real hinge point has been getting the systems integrated quickly or setting up for transition service.”

Once the CIO does get involved, participants agreed, their first concern should be understanding the deal’s goals and structure: who has control, who’s responsible for IT, and will the venture be managed at arms length or integrated? “Try to understand the model they want to operate on and what the objective is,” said DeLapp.

“It’s very different if it’s an alliance, M&A, or a JV,” added Heise. “What comes to my mind is, ‘what’s the talent, what systems do they have, and what’s the long term vision of it?’” Added Schwinn: “Is the objective to acquire them at some point?”

"You have to decide if they're technically capable, what's their scope of decision making," said DeLapp. "You have to decide what your points are that you care about." Added Heise, "For me it's the basics. It would be great if they used all the same applications, but what's more important is the core infrastructure and controls environment."

Start with the business processes to figure out the right role for IT, advised Cargill's Prokopanko. "If it's a greenfield, we go find out what's best for that business today." Added IBM's Van Dyke: "We see IT as inextricably linked with business processes … there needs to be a clarity of which business processes the venture is going to use up-front."

"IT is not frequently enough and sufficiently preplanned," noted McKinsey's Ernst. "Not just IT, but the business process and blowing up how they will work. Doing that will improve the odds of avoiding the lag getting going that many JVs experience." And IT is also a route to power in partnerships, Ernst added, "because if you control the IT of the venture, it's really hard for your partner to take it away and much easier for you to do the performance management."

Eastman's Hale said he found it "almost useless" to try to discuss IT's role in a new partnership with business leaders, who assume the venture will succeed without help and don't want to integrate it for fear of destroying its ability to innovate. But Dell's Sheskey advised treading lightly for that very reason. "I try to understand what I have to have religion about, and what I have to have control of, versus the things that I can be agnostic about," she said. "Sometimes IT people want to bring a lot of mass and burden unnecessarily to a situation."

Participants discussed the possibility of offering a set of 'lite', modularized IT services, potentially hosted, which could provide transitional support for partnership ventures and enable flexibility down the road for the JV or alliance to become more or less integrated with one of the parents' IT environments. "I could give them the standard infrastructure, loosely connected back to corporate," proposed Eastman's Hale. "I can give them a set of the standard apps, but not the full capability, a skinnied down version of an ERP system. Sometimes you can sell them on that approach."

"I want to offer Software as a Service (SAAS) for all my JVs and projects," agreed Bechtel's Ramleth. "If I have that ASP service, I can control the 'information war'. When I go into a partner I can say I want to run it because I can run it faster and quicker then you … and therefore we are in a better position to control the outcome of the project."

A key issue is who pays for the cost of these transitional IT services—however 'lite'. Is it right to have the parent company subsidize this capability? Or does cost allocation make sense? "We try to do as little transfer pricing as possible because we never know how to do it right," argued Cisco's Boston with regard to alliances rather than JVs. "And it becomes a major disincentive."

But as IBM's DeLapp noted, there may be a lot of value in piggybacking on a parents' systems, and it may take a while for the new venture to figure that out. "These organizations don't really know what it means to be a part of the parent, it's not clear to them on day one that there is some value here. They have to decide if they can afford that value."

Preparing to handle uncertainty over the venture's life cycle is another key thing CIOs can do to help make partnerships successful, suggested Cargill's Heise. "We had a JV not long ago in India where, when we did the deal, they were in the process of putting in an ERP system, one we didn't have anywhere else in Cargill. Since it was their business, we let them go ahead with it. But four months after the deal had closed they still couldn't close the books, and we had primary ownership. Now what do you do? Those are the tough ones."

Finally, CIOs must manage the security and IP protection issues surrounding partnerships closely, as they often involve sharing networks and data with outsiders—even competitors—on a tight timeline. Segmentation and enforcing arms-length relationships are the keys to getting this right, according to participants.

When IBM partners with Accenture on a services deal, for example, "often the IT is not partitionable down to just the little piece that their consultants would say that they need," said Van Dyke. So sometimes you need to get creative, he explained—even going so far as setting up special rooms where competitors can come view their data, but without access to the system it resides on.

## Managing Partnerships in China

Because China is one of the world's top growth areas for JVs and alliances, the group devoted time to discussing the specific issues surrounding partnerships there, particularly the difficulty of designing ventures in a market that's rapidly changing and will be dramatically different in only 2-3 years. China Strategic Advisory's Dan Rosen attributed the many recent struggles of JVs in China to U.S. companies rushing in because they wanted to get to market quickly, but without properly setting up control mechanisms they would insist on anywhere else.

"What makes China different is irrational excitement," said Rosen. "[Companies] bought the story that there are only so many dates to go to the dance with, which turned out to be bunk."

McKinsey's David Ernst offered some thoughts about what makes Chinese partnerships different—including the fact that they're often government-mandated. "There are more multiple partner situations, where you have a government partner (or two or three) and an operating partner and an investor," he said. "There's a shorter average life cycle before restructuring, and more creative deal structuring required to meet local regulations and ownership issues."

Participants voiced a variety of concerns about partnerships in China, including risks of IP theft and counterfeiting, environmental and human safety issues, the magnitude and volatility of the market, and uncertainty over rule of law and U.S./Chinese government relations.

Bechtel's Ramleth recalled that his company was asked to join a JV building a very large project in China, but passed due to long-term environmental concerns. "We felt this is something we don't want to be associated with, that could actually come back to haunt us in 10, 20, 30 years," he explained.

Health and safety standards are also an issue, added Ramleth, claiming that the Chinese (and other cultures) "just have a different measuring stick, the value of life is not the same." He described a petrochemical plant Bechtel helped build with thousands of local workers: "We saw the accident ratios go up as they got more comfortable. You can set all these standards up-front, but then you get more of their own management in there and it's difficult to maintain the levels you want."

Cisco's Boston noted the volatility of the Chinese markets and the hard-to-predict influence of the Chinese government. "Our biggest customers in China are the emerging cellular phone companies," he explained, noting that their investments come in huge start-and-stop waves. "It's very unpredictable and it just causes us all sorts of pain and agony … we're much more suspicious because of lack of total trust of the Chinese government."

But the most pressing topic for participants was how to protect intellectual property when doing partner-ships in China. Ramleth recalled that his firm has had to turn down projects because they were asked to share and/or transfer too much know-how.

McKinsey's Ernst, citing research into Japanese JVs, proposed that the most valuable "institutional knowledge" often gets transferred not contractually, but informally during the course of project. "The key gap is not being aware of the value of the IP, and that you can't protect it," he explained. "If this softer IP in people's heads isn't protected by clear rules of engagement, it's really during the operating phase that leakage is most severe."

IBM's Van Dyke said his company is trying to partition IP more among its own workforce including China. Given that that many Chinese employees eventually go back to work in domestic businesses, "how much do those employees consider themselves Chinese first and IBM employees second, and where is that going to over time?" he asked. "I think you have to worry about both the culture and the enforcement mechanism to protect your intellectual capital … and both of them are working against you."

The group dismissed some IP protection strategies as unworkable for competitive reasons, such as going into the Chinese market with earlier-generation IP or assuming the Chinese won't have the know-how to make use of the high-tech IP they acquire. Other approaches, like negotiating with multiple partners or economic zone governments to reduce their up-front IP demands might work in some cases, said Ernst.

Cargill's Prokopanko cautioned the group to avoid thinking of China as one entity. "It's a massive place. As you get out of Shanghai and Beijing, the local governors write their own rules and laws." Rosen noted that governments historically start focusing on IP protection when per capita income hits $7-10,000, a level that Shanghai is just now attaining compared to an overall $1,500 for China. “The problem with taking the legal route,” he added, “is that being right and getting it enforced in China are two different things.”

In the absence of enforceable legal protections for IP, Tuck’s Eric Johnson suggested a heightened focus on business alignment: “Does your Chinese partner have the right incentives to help you protect your IP?” This was supported by Hasbro’s Schwinn, who explained that the best way his company had found to prevent unauthorized distribution of its products by its own supply chain partners was to keep their molds busy 100% of the time. “You go in knowing it’s happening, and you try to drive 100% of the mold capacity that supports you so there’s no incentive for them to counterfeit.”

A recurring theme of the China discussion was the dramatic pace of change in China and the challenge of figuring out partnership alignment issues in these fast-moving waters. “There’s so much strategic tumult in the marketplace,” said Rosen, “it’s very hard to have strategic clarity on where things are going. Knowing what your potential partner JV interests are is just awfully difficult to do.”

## Looking Forward

The day ended with participants revisiting some key insights about strategic partnering. Eastman’s Lee Whisman noted that doing up-front planning well seemed to be a theme, “especially on JVs because they do have a much longer life cycle.” IBM’s DeLapp agreed: “The first question in a JV or strategic alliance discussion is what the enterprise is trying to get out of it … that has to be top of mind.”

Tuck’s Eric Johnson observed that this up-front work is even more challenging, yet crucial, in China. “It’s a moving target … how do you prepare for that and manage against it?” Bechtel’s Ramleth was also intrigued by the question of “how do you take a more forward-looking view” on partnerships: “With China, we are scared of what it is today and what it can be tomorrow because it’s so big and so different … we definitely look a lot in the rearview mirror.”

The group noted a shared skepticism about joint ventures in general, based on their complexity and high failure rate. “I’m glad we don’t have any,” joked Cisco’s Boston, noting that non-equity alliances are more straightforward. “I have my stuff, you have your stuff, together our stuff is better—let’s go sell it … that’s a different proposition than trying to go build a new cell phone together.”

“I was struck by the fear and the loathing of doing any kind of equity joint venture,” said Columbia’s Harrigan. “Nobody wants to get into them and nobody wants to govern them and nobody knows how to put the brakes on them.” But Hasbro’s Schwinn said he’d become more optimistic about JVs during the day. “I was somewhat jaundiced on my view on JVs, but if you do preplanning and set the structure correctly, when they do they go off the rails you at least have the opportunity to course-correct.”

Cargill's Prokopanko commented that JVs are not the only organizational structure that can give you a headache: "We've got wholly-owned businesses that drive me nuts too … anything with people is challenging." He hypothesized that JVs will become more, not less, common in the future and said the discussion about processes for successful strategic partnering had opened his eyes to more possibilities.

McKinsey's Ernst said he felt there was a "huge opportunity" around taking struggling JVs and restructuring them, noting that there are 500 JVs larger than $1 billion and probably even more contractual alliances that size. "Alliances are pretty complicated too—they just may not have a separate company," he noted. "There are lots of opportunities for improvement."

And Cargill's Heise captured the group's sentiment that while similar considerations affect both JVs and contractual alliances, the execution best practices are very different: JVs, for example, seem to demand the greatest up-front planning specificity, potentially at the expense of open-ended opportunity, whereas alliances require less long-term scripting, but more constant handholding.

Whatever the relative prospects for equity JVs or non-equity contractual alliances in an increasingly interconnected global marketplace, participants agreed, they are distinctly different forms, appropriate for different situations and requiring different best practices.

Whereas equity JVs are more appropriate for long-term relationships between partners with complementary capabilities and objectives (e.g., new market entry, new product development, capital risk sharing), alliances may be better suited to shorter-term opportunistic ventures in rapidly changing markets or where the two partners may soon end up competing. And whereas JVs sink or swim based on careful up-front planning for the long-term life of the venture, alliances require much more focus on creating win-win balance in the present.

## Participants in
## Thought Leadership Roundtable on Digital Strategies
## February 28, 2006

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| **Brad Boston** | Senior VP & CIO<br>Cisco Systems, Inc. |
| **Hans Brechbühl** | Executive Director<br>Center for Digital Strategies<br>Tuck School of Business, Dartmouth College |
| **Nancy DeLapp** | VP, Global I/T Infrastructure Center of Excellence<br>IBM |
| **David Ernst** | Partner & Global Practice Leader<br>McKinsey & Company, Inc. |
| **John Gallant** (moderator) | Editorial Director & President<br>Network World |
| **Jerry Hale** | VP, eInformation Services & CIO<br>Eastman Chemical Company |
| **Kathryn Rudie Harrigan** | Henry R. Kravis Professor of Business Leadership<br>Columbia University |
| **Rita J. Heise** | Corporate VP & CIO<br>Cargill, Incorporated |
| **M. Eric Johnson** | Professor of Operations Management<br>Director, Center for Digital Strategies<br>Tuck School of Business, Dartmouth College |
| **Dave Margulius** | Analyst<br>Enterprise Insight |
| **James Prokopanko** | Corporate VP<br>Cargill, Incorporated |
| **Thor Geir Ramleth** | Senior VP & CIO<br>Bechtel Group, Inc. |

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| **Dan Rosen** | Principal<br>China Strategic Advisory |
| **Douglas J. Schwinn** | Senior VP & CIO<br>Hasbro Incorporated |
| **Susan Sheskey** | VP & CIO<br>Dell Inc. |
| **Paul Van Dyke** | Director, M&A IT Transitions, CIO Office<br>IBM |
| **Lee Whisman** | Relationship Manager, Corporate Development<br>Eastman Chemical Company |