Corporate alliances? Don't forget portfolio effects!

How much value will a new corporate partnership bring your firm? To maximize benefits and avoid hidden dangers it's crucial to look beyond that one resource exchange alone and assess your full network of business relations. This is the conclusion of original research that ***BMI lecturer Pierre Dussauge****, Dean of Faculty and Research at HEC Paris, and* ***Ulrich Wassmer*** *of EMLYON Business School in Lyon, France, recently published in the* ***Strategic Management Journal****.*

Companies form alliances to access valuable resources, whether property or knowledge, which they otherwise couldn't get, at least not without great cost: infrastructure, geographic reach, expertise and exclusive rights, for example. Partnerships let firms focus on those activities where they are most competitive and benefit from partners' advantages. Thus airlines seek code-sharing arrangements and mobile communication firms build roaming networks, while software and biotechnology companies enter licensing agreements for making, using and marketing protected products.

Previous research of value creation in networks took a single-alliance perspective, examining the identification and realisation of synergies between two partner firms. Yet rare is the company that doesn't have strategic links with multiple other firms. Thus, to more fully capture the value-creating capacity of alliances for a firm, Wassmer and Dussauge add a portfolio perspective. They analyse interdependencies among network resources accessed through simultaneous alliances with multiple partners. Adding a new partnership to a firm's existing portfolio of alliances, they explain, can create value not only through the combination of newly accessed resources with the firm's own resources, but also through combination with resources from all the firm's other partnerships.

To take a simple example, an airline flying Vilnius-Warsaw will benefit from code sharing with a second airline flying Warsaw-London since it can now offer customers a Vilnius-London itinerary. If, however, it already has a code-sharing agreement with a third airline that flies London-Washington, it can now also offer the itinerary Vilnius-Washington. This extra benefit is an alliance-portfolio effect, which would be ignored if the new alliance's value were assessed merely on a stand-alone basis.

But not all alliance-portfolio effects yield positive value! They can also destroy it. The main reason is that resource combinations in a new link-up may create substitutes –

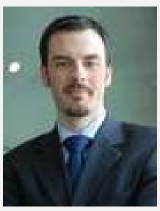
competitors! – for offerings of the firm's other partners and so may harm relations with those partners. In the previous example, if the third airline has European flights to Washington, it may well lose business because of our firm's alliance with the second airline. We would thus need to spend more time and effort to re-establish trust and goodwill with that existing partner, who might even terminate the partnership. Such portfolio transaction and coordination costs decrease a firm's overall value from any new alliance.

Wassmer and Dussauge test their insights empirically using data for actual alliance activity and equity performance in the global passenger air transportation industry, where firms regularly engage in alliances with resources that can be clearly identified. Controlling for other important factors in network value creation, such as direct resource complementarity between a firm and its new partner, its experience managing alliances, recent financial performance and market size, they find, with statistical significance, that portfolio-synergy potential increases the value that firms get from new alliances as measured by otherwise unexplained changes in their stock prices, while network-resource substitutability decreases the value firms get, also as measured by stock prices.

Managers, they conclude, should stop treating alliance formations as stand-alone transactions. Companies need to effectively configure, monitor and coordinate their full alliance portfolio in order to optimally exploit all synergies between network resources and avoid competitive overlap. In other words, managers should not only evaluate the benefits of new network resources, but must also always consider potential costs related to conflict with existing partners.

By Bryan P. Bradley, BMI, based on: Ulrich Wassmer and Pierre Dussauge. Network resource stocks and flows: how do alliance portfolios affect the value of new alliance formations? Strategic Management Journal, Vol. 33, No. 7 (July 2012), p. 871-883.

Pierre Dussauge, who lectures in BMI Executive Education programmes, is a strategy professor and Dean of Faculty and Research at HEC Paris in France who has been a visiting professor at INSEAD, IESE and other top business schools around the world. He is author or co-author of several books on strategic management and many articles published in academic journals. P. Dussauge has also consulted corporations including Mars, Fiat, Schneider, EADS, American Airlines, IBM, Unilever, France-Telecom, Air France-KLM, Publicis, and others.



Ulrich Wassmer is Associate Professor of Strategy at EMLYON Business School in France. He researches antecedents and consequences of inter-organizational collaboration, including strategic alliances and joint ventures. Dr. Wassmer was previously on the faculty of Canada’s Molson School of Business and has taught at Wharton School in the U.S. and ESADE Business School in Spain. He has also been a consultant to senior executives of multinational clients in the packaged goods, retail, pharmaceutical, industrial equipment, and automotive sector.

Young Firm Internationalization: Five Survival Secrets

Any firm that's tried to expand abroad knows the promise of booming sales in new markets can also bring critical new risks. What characterises companies that survive the adventure of expanding beyond their home? This is the focus of original research recently published in the International Small Business Journal by R. Coeurderoy of ESCP Europe and BMI founding partner Louvain School of Management in Belgium with M. Cowling and G. Murray of the UK's University of Exeter Business School and G. Licht of Germany's Centre for European Economic Studies.

Experience and past research show that internationalisation is a double-edged sword. The benefits of exploiting new markets come with additional risks and costs that are hard to plan. It's not just about figuring out how to transfer your home-based competitive advantage to foreign markets. You also have to quickly get new knowledge and skills to manage logistics, labour, etc. in unfamiliar territory, to assess exposure to economic conditions in a broader context and to defuse potential threats such as intellectual property theft. In general, being 'foreign' sharply increases the challenge of being 'new' to a market.

Prof. Coeurderoy and his co-authors examine some 600 young firms (5-11 years old) from the UK and Germany in new technology fields. Surveys explore the firms' international experiences, focusing on how survival rates during foreign expansion relate to the (a) knowledge-intensity of operations, (b) relationships with customers and others, and (c) commitment to foreign markets in terms of revenue share, number of markets and entry model. Controlling for factors such as company size and managers' international experience, they obtain statistically significant results with practical managerial implications. We summarise some of their most interesting findings in the following five recommendations:

1. All or nothing – choose one. Firms that centre their strategy on international expansion and, conversely, firms that clearly choose to prioritise the home market, are more likely to survive than firms internationalising on a limited scale, according to this study. At least for young firms, it seems trying to balance attention between home and foreign markets means splitting management and other resources, with the risk that neither will get enough.

2. Don't rush to put boots on the ground. Companies that enter foreign markets by direct exporting, using a foreign distributor or using a foreign agent are significantly more likely to survive that those that set up foreign subsidiaries or rely on licensing. Young firms probably shouldn't initially burden themselves with big sunk costs when agents or distributors with local market knowledge and incentives can usually sell more there and channel the most useful information back from customers to the producer.

3. Build a safety net of relationships. Having interdependent relationships, with customers especially, increased survival chances for these companies. Mutual obligations and complementary resources create common interests that motivate partners to help you.

4. Don't put all your foreign eggs in one basket. Survival probabilities for the firms in this study increased as they were able to extend operations across additional countries, with the most significant beneficial effect linked to each of the first four countries entered. The authors note that this is consistent with the logic of risk diversification. It also may reflect a 'learning-by-doing' process, where entry into successive international markets is easier and less costly than entering previous ones. Results also showed lower survival for firms whose first foreign market was the USA, suggesting it is more risky to begin internationalisation from markets that are especially tough, even if they offer big opportunities.

5. Keep up R&D to keep your advantage. One of the key findings is that firms which constantly engage in research and development activity are much more likely to survive than those who do R&D only occasionally. This is consistent with theories that investments in knowledge help newly internationalising firms develop and adapt. It shows that exploiting knowledge resources to create and maintain competitive advantage is of great importance for international success.

By Bryan P. Bradley, BMI, based on: Regis Coeurderoy, Marc Cowling, Georg Licht and Gordon Murray. Young firm internationalization and survival: Empirical tests on a panel of 'adolescent' new technology-based firms in Germany and the UK. International Small Business Journal, 2012: Vol. 30, No. 5, pp 472-492.

Regis Coeurderoy is Professor of Strategic Management and Entrepreneurship at ESCP Europe and the Louvain School of Management in Belgium. After leading LSM's Centre of Research in Entrepreneurial Change and Innovative Strategies, he is now Director of the Institute for Innovation and Competitiveness at ESCP Europe. His research interests centre on international entrepreneurship and the governance of innovation.

Marc Cowling is Professor of Management at University of Exeter Business School. His research centres on the economics of small business with a strong interest in the econometric evaluation of public policies.

Georg Licht is Head of the Department of Industrial Economics and International Management at the Centre for European Economic Policy (ZEW) in Karlsruhe, Germany. His interests focus on how government may intervene effectively via economic policy instruments, particularly in the key areas of innovation and R&D.

Gordon Murray, Emeritus Professor of Management at the University of Exeter Business School, has conducted policy research and evaluations on the financing of early-state entrepreneurship and innovation at the request of governments including the UK, Australia, Denmark, Finland, Ireland and New Zealand. He created the original Anglo-German Foundation long-term study of internationalising businesses in 1997.

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Inside an International Success Story: Huawei Europe

Huawei Technologies is currently the world's 1st or 2nd largest maker of telecommunications equipment, depending how you count. Founded in 1987 and headquartered in Shenzhen, China, the company now has more than 140,000 employees, with 46% of them engaged in R&D. Huawei competes globally in the network infrastructure market with Ericsson, Cisco Systems, Nokia and Alcatel-Lucent. It's also the world's third-largest vendor of smartphones, ahead of Lenovo and LG and behind only Samsung and Apple. Europe plays a strategic role in Huawei's approach of intense product development and disciplined, organic growth. The company set up its first European office in Kista, Sweden in 2000 and now has 11 offices with some 800 staff in the Nordic and Baltic region. ***Leo Sun, the President of Huawei's main European office*** *in Brussels since 2011, shared his personal views on the company's strategy in an* ***exclusive interview for BMI KNOWLEDGE*** *with Jean-Paul Larçon of BMI and Geneviève Barré of BMI partner school HEC Paris.*

J.P.Larçon & G.Barré: What are the sources of Huawei's competitive advantage?

Leo Sun: Huawei has a quite strong advantage in terms of technology. Besides being present in niches, the company is probably the only one to address all technology domains in the ICT sector, both horizontally and vertically. Management decided from the beginning to invest heavily in R&D. Huawei's R&D budget is more than 10% of annual revenue, a very significant ratio in the industry. In 2012, Huawei even increased R&D investments to $4.8 billion, or more than 14% of revenues.

Though historically we're an engineering and technology driven company, Huawei from the start made a customer-centric approach its key priority. This means the customer's specific needs are the starting point of our business and solutions. In recent years, we had an internal debate about this positioning and we decided to strike a slightly new balance: Huawei will retain the customer-centric approach as its key focal point, but we also want to get ahead of the customer in developing solutions for future needs. Thus Huawei changed the name of its central R&D lab to "2012 Laboratories" – a reference to the tsunami in the film "2012". We've decided to invest massively in all key ICT fields because we believe we're facing a real tsunami in the digital society.

J.P.Larçon & G.Barré: Huawei recently entered the smartphone business. What are the synergies between these consumer products and your traditional telecom infrastructure business?

> "The **brand** is important, but **product innovation** is gaining more and more importance."

Leo Sun: We entered the smartphone business because the industry is changing drastically, with a convergence taking place between telecom and IT, and with radical changes at the level of terminal devices as well as in cloud computing. We don't know what the industry will look like in 5 or 10 years. But even if the technology, business models, and value chain all change, the overall structure of the industry will be based on three sectors: at the top is content – the cloud in the air; at the bottom are terminal devices to connect people and machines; and third is the pipe to connect the two. We've already developed a lot of consumer products such as data modems, we have a very good position in the pipe – telecom infrastructure, and we also have strong competencies in software and applications. So we think we can position ourselves successfully in all three sectors.

Marketing and distribution are very important in the smart phone business, but the changes introduced by the Internet are even more important: new distribution channels and opportunities for newcomers. Probably thanks to the arrival of smartphones, the consumer is more and more educated. Each consumer knows what he wants and what he needs personally. People's knowledge of how to choose the right product is much better than in the past. Selection power favors more the consumer than the manufacturer. The brand is important, but product innovation is gaining more and more importance. If you have a very good product – and it's not only the phone itself, but also the operating system, the application behind, the whole value chain – then you have much better chance than before to sell it and to succeed in the market.

"**Talents** are not equally distributed worldwide."

J.P.Larçon & G.Barré: What are the missions of Huawei R&D centres in Europe?

Leo Sun: It's quite a mix as our R&D organization is very big, with some 70,000 people. Huawei's R&D centres in Europe contribute to the global effort with specific objectives. Our general vision is to transform the whole company into a truly global enterprise and to acquire the best talents in the industry no matter where they are. We've found that these talents are not equally distributed worldwide. For example, competencies in system architecture, which are quite rare in China, are on the contrary well developed in Europe and probably the US because of the accumulation of experience. But besides acquiring these competences wherever they are, we also need to be closer to the market because each market has different specific requirements. The European telecom market is probably the most sophisticated; it's at the top of the pyramid in terms of both technology requirements and consumer needs. So if we can meet these European requirements, we feel very confident that we can succeed on a global basis.

J.P.Larçon & G.Barré: What's the role of alliances and cooperative agreements in Huawei's strategy?

Leo Sun: Huawei is more and more open to cooperation with selected business partners. That helps create more harmony, more stability in the system. It can make the cake bigger, even if you get a smaller piece. It's also a way for a foreign company to be better accepted by the local ecosystem.

"It makes sense for Europeans and Chinese to **collaborate**."

We strongly support having a strategic partnership between the Chinese and European telecom industries. Europe is strong in telecoms. But the Americans are stronger in IT, both internet and services, and these two sectors, telecom and IT, are now merging. Compared to the telecom sector, which is very standardized, the IT sector is not. So it makes sense for Europeans and Chinese to collaborate to make the ICT system more standardized. We need an ICT system in which everybody can invest and compete with common rules. That's why we're lobbying Chinese and European governments to work on common standards, for example the 5G standard.

We're also developing bilateral agreements with European companies. Huawei entered into a strategic partnership with the UK company ARM, which has developed a completely new chipset architecture. We're the first and so far only company to use this new architecture not only in our infrastructure products but also in our consumer products. A second example is our cooperation with German giant SAP. SAP is very good in software products, cloud computing, and integration, and Huawei is very strong in hardware and infrastructure. SAP and Huawei share R&D plans and develop the market together.

"There's no **model** yet for a Chinese global company!"

J.P.Larçon & G.Barré: What is Huawei Human Resource Policy in Europe?

Leo Sun: Europeans hold major positions at Huawei Europe. That's especially true for our staff working directly with clients and local partners, as well as for our service engineers. The majority of operational positions are taken by Europeans. We've been discussing for six or seven years how to promote more Europeans into top management positions, and we've developed internal guidance and plans for this. Things are improving, but it's going less quickly than expected. Today most country Vice Presidents are Europeans, but all the country CEOs are still of Chinese origin.

As Huawei transforms itself into a global company, our top leaders at headquarters are pragmatic. Rember that there's no model yet for a Chinese global company! So there's no rush, we'll make the decision when we have the right person.

Leo Sun is President of the European Public Affairs and Communications Office of Huawei Technologies Co. Ltd. since 2011. He was previously product marketing director for Huawei in Guizhou Province and created Huawei France. He's an engineering graduate of Tsinghua University (Beijing).

Jean-Paul Larçon is Dean of Faculty and Research of BMI Baltic Management Institute and Emeritus Professor of Strategy and International Business at HEC Paris.

Geneviève Barré is Director International Development Asia-Pacific at HEC Paris.