companies, the risk of losing control of their management skills to franchisees or joint-venture partners is not that great. The reason is that the valuable asset of such companies is their brand name, and brand names are generally well protected by intellectual property laws pertaining to trademarks. Given this fact, many issues that arise in the case of technological knowhow do not arise in the case of management knowhow. As a result, many service companies favor a combination of franchising and subsidiaries to control franchisees within a particular country or region. The subsidiary may be wholly owned or a joint venture. In most cases, however, service companies have found that entering into a joint venture with a local partner in order to set up a controlling subsidiary in a country or region works best because a joint venture is often politically more acceptable and brings a degree of local knowledge to the subsidiary.

Pressures for Cost Reduction and Entry Mode The greater the pressures for cost reductions, the more likely that a company will want to pursue some combination of exporting and wholly owned subsidiaries. By manufacturing in the locations where factor conditions are optimal and then exporting to the rest of the world, a company may be able to realize substantial location economies and substantial scale economies. The company might then want to export the finished product to marketing subsidiaries based in various countries. Typically, these subsidiaries would be wholly owned and have the responsibility for overseeing distribution in a particular country. Setting up wholly owned marketing subsidiaries is preferable to a joint-venture arrangement or using a foreign marketing agent because it gives the company the tight control over marketing that might be required to coordinate a globally dispersed value chain. In addition, tight control over a local operation enables the company to use the profits generated in one market to improve its competitive position in another market. Hence companies pursuing global or transnational strategies prefer to establish wholly owned subsidiaries.

GLOBAL STRATEGIC ALLIANCES

Global strategic alliances are cooperative agreements between companies from different countries that are actual or potential competitors. Strategic alliances range from formal joint ventures in which two or more companies have an equity stake, to short-term contractual agreements in which two companies may agree to cooperate on a particular problem (such as developing a new product).

global strategic alliances
Cooperative agreements between companies from different countries that are actual or potential competitors.

Advantages of Strategic Alliances

Companies enter into strategic alliances with competitors to achieve a number of strategic objectives.[27] First, strategic alliances may facilitate entry into a foreign market. For example, many firms feel that if they are to successfully enter the Chinese market, they need a local partner who understands business conditions and has good connections. Thus, Warner Brothers entered into a joint venture with two Chinese partners to produce and distribute films in China. As a foreign film company, Warner found that if it wanted to produce films on its own for the Chinese market, it had to go through a complex approval process for every film. It also had to farm out distribution to a local company, which made doing business in China very difficult. Due to the participation of Chinese firms, however, the joint-venture films will require a streamlined approval process, and the venture will be able to distribute any films it produces. Moreover, the joint venture will be able to produce films for Chinese TV, something that foreign firms are not allowed to do.[28]

Second, strategic alliances allow firms to share the fixed costs (and associated risks) of developing new products or processes. An alliance between Boeing and a number of Japanese companies to build Boeing's latest commercial jetliner, the 787, was motivated by Boeing's desire to share the estimated $8-billion investment required to develop the aircraft.

Third, an alliance is a way to bring together complementary skills and assets that neither company could easily develop on its own.[29] In 2011, for example, Microsoft and Nokia established an alliance aimed at developing and marketing smartphones that used Microsoft's Windows 8 operating system. Microsoft contributed its software engineering skills, particularly with regard to the development of a version of its Windows operating system for smartphones, and Nokia contributed its design, engineering, and marketing knowhow. The first phones resulting from this collaboration reached the market in late 2012 (Microsoft subsequently purchased Nokia's mobile phone business in 2013.)

Fourth, it can make sense to form an alliance that will help firms establish technological standards for the industry that will benefit them. This was also a goal of the alliance between Microsoft and Nokia. The idea is to try to establish Windows 8 as the de facto operating system for smartphones in the face of strong competition from Apple, with its iPhone, and Google, whose Android operating system was the most widely used smartphone operating system in the world in 2012.

Disadvantages of Strategic Alliances

The advantages we have discussed can be very significant. Despite this, some commentators have criticized strategic alliances on the grounds that they give competitors a low-cost route to new technology and markets.[30] For example, a few years ago, some commentators argued that many strategic alliances between U.S. and Japanese firms were part of an implicit Japanese strategy to keep high-paying, high-value-added jobs in Japan while gaining the project engineering and production process skills that underlie the competitive success of many U.S. companies.[31] They argued that Japanese success in the machine tool and semiconductor industries was built on U.S. technology acquired through strategic alliances. And they argued that U.S. managers were aiding the Japanese by entering alliances that channel new inventions to Japan and provide a U.S. sales and distribution network for the resulting products. Although such deals may generate short-term profits, the argument goes, in the long term, the result is to "hollow out" U.S. firms, leaving them with no competitive advantage in the global marketplace.

These critics have a point; alliances have risks. Unless a firm is careful, it can give away more than it receives. But there are so many examples of apparently successful alliances between firms—including alliances between U.S. and Japanese firms—that this position appears extreme. It is difficult to see how the Boeing–Mitsubishi alliance for the 787, or the long-term Fuji–Xerox alliance, fit the critics' thesis. In these cases, both partners seem to have gained from the alliance. Why do some alliances benefit both firms while others benefit one firm and hurt the other? The next section provides an answer to this question.

Making Strategic Alliances Work

The failure rate for international strategic alliances is quite high. For example, one study of 49 international strategic alliances found that two-thirds run into serious managerial and financial troubles within 2 years of their formation, and that although many of these problems are ultimately solved, 33% are rated as failures by the parties involved.[32] The success of an alliance seems to be a function of three main factors: partner selection, alliance structure, and the manner in which the alliance is managed.

Partner Selection One key to making a strategic alliance work is selecting the right partner. A good partner has three principal characteristics. First, a good partner helps the company achieve strategic goals such as achieving market access, sharing the costs and risks of new-product development, or gaining access to critical core competencies. In other words, the partner must have capabilities that the company lacks and that it values. Second, a good partner shares the firm's vision for the purpose of the alliance. If two companies approach an alliance with radically different agendas, the chances are great that the relationship will not be harmonious and the partnership will end.

Third, a good partner is unlikely to try to exploit the alliance for its own ends—that is, to expropriate the company's technological knowhow while giving away little in return. In this respect, firms with reputations for fair play probably make the best partners. For example, IBM is involved in so many strategic alliances that it would not pay for the company to trample over its individual alliance partners.[33] This would tarnish IBM's reputation of being a good ally and would make it more difficult for it to attract alliance partners. Because IBM attaches great importance to its alliances, it is unlikely to engage in the kind of opportunistic behavior that critics highlight. Similarly, their reputations make it less likely (but by no means impossible) that such Japanese firms as Sony, Toshiba, and Fuji, which have histories of alliances with non-Japanese firms, would exploit an alliance partner.

To select a partner with these three characteristics, a company needs to conduct comprehensive research on potential alliance candidates. To increase the probability of selecting a good partner, the company should collect as much pertinent, publicly available information about potential allies as possible; collect data from informed third parties, including companies that have had alliances with the potential partners, investment bankers who have had dealings with them, and former employees; and get to know potential partners as well as possible before committing to an alliance. This last step should include face-to-face meetings between senior managers (and perhaps middle-level managers) to ensure that the chemistry is right.

Alliance Structure Having selected a partner, the alliance should be structured so that the company's risk of giving too much away to the partner is reduced to an acceptable level. First, alliances can be designed to make it difficult (if not impossible) to transfer technology not meant to be transferred. Specifically, the design, development, manufacture, and service of a product manufactured by an alliance can be structured to "wall off" sensitive technologies to prevent their leakage to the other participant. In the alliance between General Electric and Snecma to build commercial aircraft engines, for example, GE reduced the risk of "excess transfer" by walling off certain steps of the production process. The modularization effectively cut off the transfer of what GE regarded as key competitive technology while permitting Snecma access to final assembly. Similarly, in the alliance between Boeing and the Japanese to build the 787, Boeing walled off research, design, and marketing functions considered central to its competitive position, while allowing the Japanese to share in production technology. Boeing also walled off new technologies not required for 787 production.[34]

Second, contractual safeguards can be written into an alliance agreement to guard against the risk of **opportunism** by a partner. For example, TRW has three strategic alliances with large Japanese auto component suppliers to produce seat belts, engine valves, and steering gears for sale to Japanese-owned auto assembly plants in the United States. TRW has clauses in each of its alliance contracts that bar the Japanese firms from competing with TRW to supply U.S.-owned auto companies with component parts. By doing this, TRW protects itself against the possibility that the Japanese companies are entering into the alliances merely as a means of gaining access to the North American market to compete with TRW in its home market.

opportunism
Seeking one's own self-interest, often through the use of guile.

Third, both parties in an alliance can agree in advance to exchange skills and technologies that the other covets, thereby ensuring a chance for equitable gain. Cross-licensing agreements are one way to achieve this goal.

Fourth, the risk of opportunism by an alliance partner can be reduced if the firm extracts a significant, credible commitment from its partner in advance. The long-term alliance between Xerox and Fuji to build photocopiers for the Asian market perhaps best illustrates this. Rather than enter into an informal agreement or a licensing arrangement (which Fujifilm initially preferred), Xerox insisted that Fuji invest in a 50/50 joint venture to serve Japan and East Asia. This venture constituted such a significant investment in people, equipment, and facilities that Fujifilm was committed from the outset to making the alliance work in order to earn a return on its investment. By agreeing to the joint venture, Fuji essentially made a credible commitment to the alliance. In turn, Xerox felt secure in transferring its photocopier technology to Fuji.

Managing the Alliance Once a partner has been selected and an appropriate alliance structure agreed upon, the task facing the company is to maximize benefits from the alliance. One important ingredient of success appears to be sensitivity to cultural differences. Many differences in management style are attributable to cultural differences, and managers need to make allowances for these when dealing with their partners. Beyond this, maximizing benefits from an alliance seems to involve building trust between partners and learning from partners.[35]

Managing an alliance successfully requires building interpersonal relationships between the firms' managers, or what is sometimes referred to as *relational capital*.[36] This is one lesson that can be drawn from the strategic alliance between Ford and Mazda. Ford and Mazda set up a framework of meetings within which their managers not only discuss matters pertaining to the alliance, but also have time to get to know one another. The belief is that the resulting friendships help build trust and facilitate harmonious relations between the two firms. Personal relationships also foster an informal management network between the firms. This network can then be used to help solve problems arising in more formal contexts (such as in joint committee meetings between personnel from the two firms).

Academics have argued that a major determinant of how much knowledge a company acquires from an alliance is its ability to learn from its alliance partner.[37]

For example, in a study of 15 strategic alliances between major multinationals, Gary Hamel, Yves Doz, and C. K. Prahalad focused on a number of alliances between Japanese companies and Western (European or American) partners.[38] In every case in which a Japanese company emerged from an alliance stronger than its Western partner, the Japanese company had made a greater effort to learn. Few Western companies studied seemed to want to learn from their Japanese partners. They tended to regard the alliance purely as a cost-sharing or risk-sharing arrangement, rather than an opportunity to learn how a potential competitor does business.

For an example of an alliance in which there was a clear learning asymmetry, consider the agreement between General Motors and Toyota Motor Corp. to build the Chevrolet Nova. This alliance was structured as a formal joint venture, New United Motor Manufacturing, in which both parties had a 50% equity stake. The venture owned an auto plant in Fremont, California. According to one of the Japanese managers, Toyota achieved most of its objectives from the alliance: "We learned about U.S. supply and transportation. And we got the confidence to manage U.S. workers." All that knowledge was then quickly transferred to Georgetown, Kentucky, where Toyota opened a plant of its own. By contrast, although General Motors (GM) got a new product, the Chevrolet Nova, some GM managers complained that their new knowledge was never put to good use inside GM. They say that they should have been kept together as a team to educate GM's engineers and workers about the Japanese system. Instead, they were dispersed to different GM subsidiaries.

When entering an alliance, a company must take measures to ensure that it learns from its alliance partner and then puts that knowledge to good use within its own organization. One suggested approach is to educate all operating employees about the partner's strengths and weaknesses and make clear to them how acquiring particular skills will bolster their company's competitive position. For such learning to be of value, the knowledge acquired from an alliance must be diffused throughout the organization—which did not happen at GM. To spread knowledge, the managers involved in an alliance should be used as a resource to educate others within the company about the skills of the alliance partner.

KEY TERMS

multinational company 247
location economies 248
global standardization strategy 256
localization strategy 257
transnational strategy 258
global strategic alliances 269
opportunism 272

TAKEAWAYS FOR STRATEGIC MANAGERS

1. For some companies, international expansion represents a way of earning greater returns by transferring the skills and product offerings derived from their distinctive competencies to markets where indigenous competitors lack those skills. As barriers to international trade