Deloitte.

Strategic alliances

An essential weapon in the growth arsenal

Partnerships are ever more important in a fast-changing business environment, making it vital for organizations to understand and overcome the challenges their development and execution present.

Contents

Introduction

As change accelerates in the business world and technological disruption dominates, organizations need a clear strategy and competent execution to create or access the capabilities they require to keep pace and seize new opportunities. Against this backdrop, strategic alliances are increasingly important as a complement to build or buy options. But there are hurdles. Getting partnerships done right requires deliberate efforts to tackle challenges in strategy and prioritization; partner evaluation and negotiation; and longer-term strategic alliance management.

This paper begins with the disruptive business context that has created a new urgency for business leaders to understand how to gain access to specific capabilities. It then presents a framework by which partnership opportunities can be evaluated against build or buy alternatives. Examples of how companies are embracing partnerships can be seen across many industries, including life sciences and the automotive sector, where the advent of digital health care solutions and autonomous vehicle technology create broad marketplace uncertainty.

Once an organization moves to consider strategic alliances as part of its growth arsenal, a novel set of potential barriers to success arise. The leading practices that might help more strategic alliances attain their goals are often not consistently adopted, even as partnerships become more popular. Deloitte's Strategic Alliance Life Cycle framework divides creation and execution into three phases that can help organizations develop a successful partnership effort: setting alliance strategy, developing the deal, and managing the resulting partnership.

Our goal is to provide a clearer view of the motivations, the opportunities, and the management challenges along with a broad outline for how to capture the value potential in strategic alliances.

Backdrop: New prominence for strategic alliances

As innovation blurs sector lines and disrupts old business models, strategic alliances provide an important lever to help organizations gain access to vital external capabilities.

Entire industries are being transformed as computer-based automation fundamentally changes how business is done. In this Fourth Industrial Revolution, the digital technologies disrupting the business environment range from big data analytics to artificial intelligence (AI) to the Internet of Things.[1] The result is a shift in which physical and digital technologies are merging to create ever more interconnection. This fundamentally alters the way organizations understand information, make decisions, develop products, and serve their customers and markets.

Amid demands for a faster pace of technological innovation and shorter time-to-market, and faced with the increasing complexity of the marketplace, organizations are being forced to reevaluate and broaden their strategies for developing or accessing new capabilities. In-house research and development is a powerful tool, but its disadvantages include long cycle times and high costs. The challenges are evident in the biopharma sector, for example, where returns on R&D have decreased from 10 percent in 2010 to 2 percent in 2018.[2]

In this context, executives have to carefully examine opportunities to leverage external capabilities through strategic alliances—alongside R&D and acquisitions. Partnerships often provide faster, less costly, and less risky access to assets and capabilities, particularly in areas that fall outside an organization's core competencies.

The ways in which the convergence of Technology with other sectors is affecting business decisions can be easily observed in Life Sciences. For example, GlaxoSmithKline established a collaboration with Propeller Health, a technology startup focused on connected sensor technology, to track and optimize the use of inhalers for asthma and other conditions—an advance that significantly reduces health care costs and drives growth in a market that was otherwise slowing.[3] Similarly, Proteus Digital Health and Otsuka Pharmaceuticals signed an $88 million agreement to develop a digital pill with a sensor that allows medication use to be tracked, giving doctors new insight into treatment adherence and creating a novel advantage in a highly competitive market.[4]

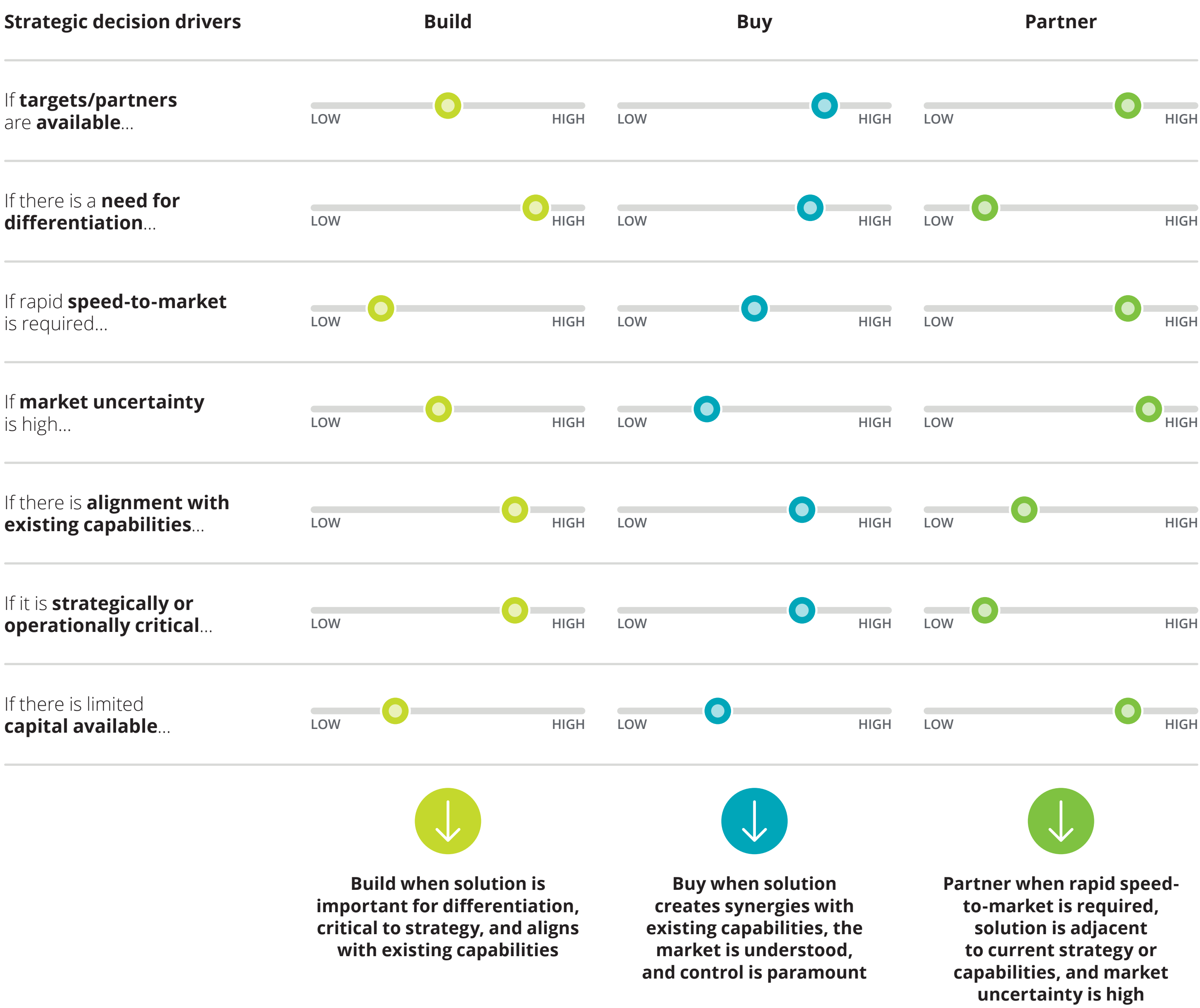
The business currents pushing companies to assign greater urgency to their efforts to access new capabilities can be seen across many industries. The need in the auto industry to keep up with advances in autonomous vehicle technology provides a good example; see "The drive for self-driving cars," page 4.

Once an organization has defined its vision and strategy and has identified the assets and capabilities required to win in the markets in which it chooses to play, it is then faced with the question of how to obtain those assets and capabilities. The organization's leaders need to be able to answer—with confidence—the question of whether to build, buy, or partner.

Deciding when to partner

A company's decision to build, buy, or partner may be evaluated based on key strategic decision drivers and the suitability of each option given these drivers.

Figure 1. The Build-Buy-Partner framework



Deloitte's Build-Buy-Partner framework (see figure 1) can guide an organization in determining which approach may best suit its growth initiatives based on criteria such as criticality of assets or capabilities; degree of market uncertainty; and desired speed of execution, level of control, or size of investment.

When industry dynamics are well understood, and an asset or capability is central to a well-defined strategy, an acquisition or internal development may serve as the optimal growth path. In other situations, particularly when there is significant market uncertainty or the proposed initiative is not central to the organization's strategy, a greater number of exploratory partnerships may be the stronger alternative. In the latter case, forming alliances can create strategic optionality by allowing organizations to learn rapidly about a new capability or a new market space without devoting an outsized investment of time or capital. In either case, the ability for an organization to acquire or partner may be dictated by the availability of viable acquisition targets or partners.

Given the degree to which competitive dynamics and sources of advantage are changing quickly or are unclear, business leaders must be prepared to work in an unstable environment—to function well amid uncertainty. This is certainly the case in the automotive industry, for example, given the disruption of the internal combustion engine by electric motors, the rise of ride-hailing models, and the advent of autonomous vehicles.

One specific benefit of a strategic alliance, as the Build-Buy-Partner framework suggests, is the potential for accelerated speed-to-market. This dovetails nicely with the concept of minimum viable transformation (MVT), which aims to reduce initial investment and time-to-market through incremental product and service development.[9] Based on small, fast implementations combined with feedback and iterative learning cycles, the MVT approach is modeled after the agile methodology often used in software development. It enables organizations to learn and adapt more quickly than when they follow a "big bang" approach, which entails planning, blueprinting, and implementation all in one linear effort.

The drive for self-driving cars

The race to bring autonomous vehicles to market at scale shows companies across an industry answering the build-buy-partner question very differently.

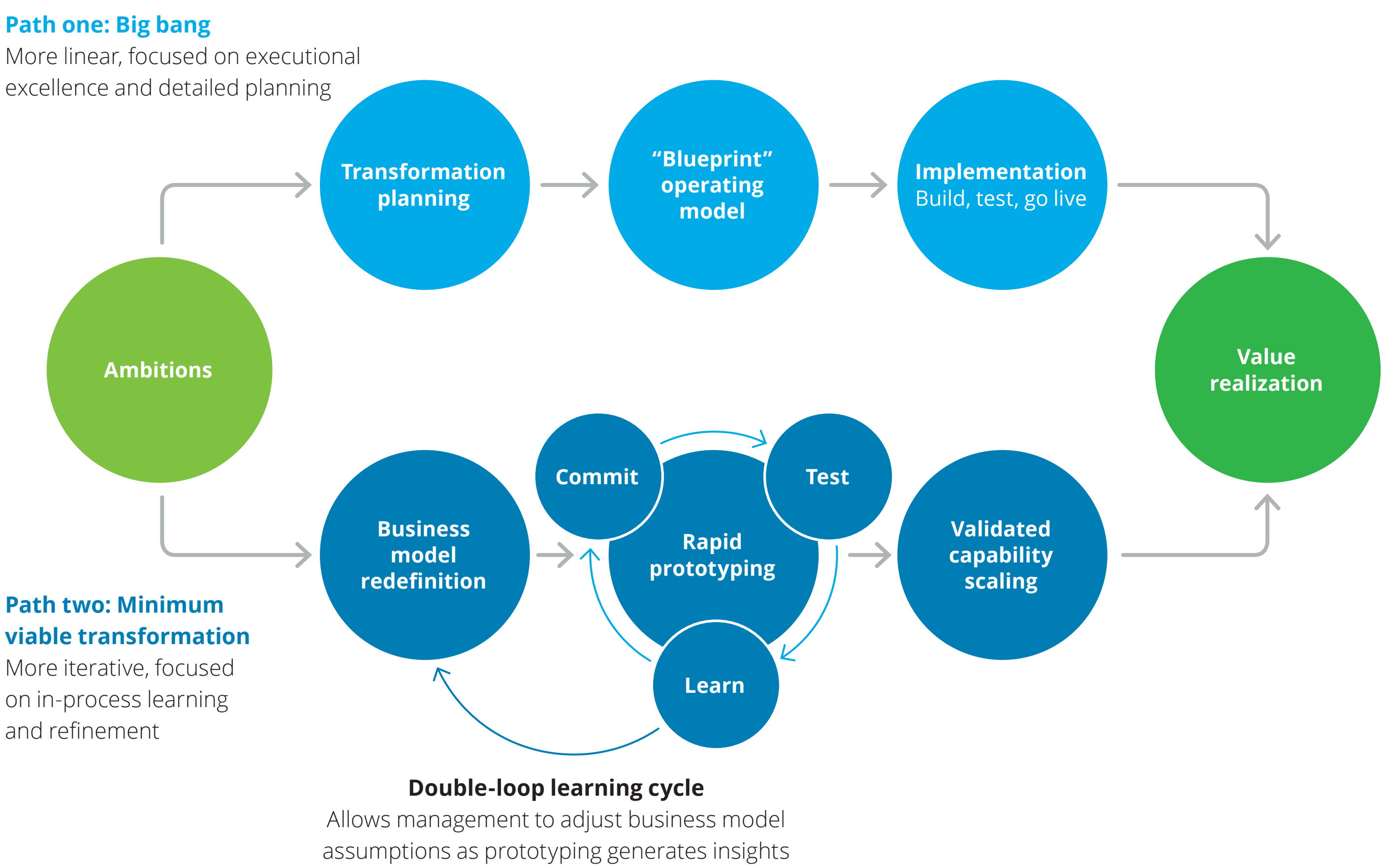
The advent of self-driving cars and trucks is bringing dramatic change to the transportation sector. Automakers face an imperative to access a suite of new, rapidly advancing technologies that make this shift possible. Major participants are embracing radically different approaches.

Build: Tesla has been developing in-house AI chips and software and related technology intended to allow its electric cars to lead the self-driving advance.[5]

Buy: General Motors has gained key driverless technologies such as AI and laser imaging through acquisition of startups including Cruise Automation and Strobe.[6]

Partner: Toyota Motor Corp is taking a different approach through an alliance with, and investment in, Uber Technologies that combines Uber's autonomous driving system with Toyota Motor Corp's Guardian suite of automated safety features.[7]

Figure 2. Business transformation alternatives



The choice between the big bang and the MVT paths can be seen as analogous to the buy-versus-partner decision. Buying represents a more traditional inorganic growth path that requires time-intensive deal planning and integration, along with greater capital commitment. Partnering represents a more agile approach that enables companies to quickly access external capabilities, test growth strategies, and refine their investment priorities iteratively.

By applying the MVT approach to an organization's growth strategy, corporate development executives can leverage an agile methodology to test desired capabilities and accelerate the time to value capture. A recent strategic alliance between ExxonMobil and Petrobras illustrates an application of the MVT concept. The companies agreed to evaluate areas of mutual interest collaboratively across the oil and gas exploration value chain.[9] Through this initial agreement the two companies are jointly creating an opportunity to iteratively learn, adapt, and build trust in a way that could ultimately lead to larger opportunities for Joint exploration and production of assets.

In addition to creating strategic optionality and accelerating the time to value capture, alliances provide the added advantage of reducing capital requirements—thereby reducing risk. At a time when valuations are at historic highs,[10] strategic alliances are increasingly viewed as an important alternative to purchases. Record-high valuations increase the capital required for acquisitions, leading to an increase in the risk of underperformance relative to price paid.

As companies continue to develop growth strategies, there will be a need to balance internal factors—including organizational aspirations and capabilities—against external factors such as competition and regulation. The increasing pace of innovation, ballooning valuations, and regulatory uncertainty help to position alliances as valuable alternatives to M&A.

Success in strategic alliances

While the use of alliances is growing rapidly, many organizations have yet to fully embrace the leading practices that can enable full realization of their potential value.

As much as strategic alliances are an important tool to drive growth and deliver needed capabilities, they are not without their own challenges and risks. More than a decade and a half of data from Alliance Best Practice, a UK-based research and benchmarking firm, show that 40 percent of alliances fail to comprehensively address the commercial, strategic, operational, cultural, and technical leading practices that together contribute to the success of such efforts.[11]

Benchmarking data on the most common ways in which alliances fail to embrace specific leading practices show persistent management shortfalls (see figure 3).

Figure 3. Where alliance practices come up short
Proportion of alliances that fail to adhere to best practices

Source: Alliance Best Practice

Many organizations either do not have an understanding of the leading practices that can foster the success of a strategic alliance or they grasp these key practices but do not have the necessary management structures in place to implement them. In order to successfully execute alliances and realize their potential value, organizations need a robust alliance management capability that provides for appropriate strategic alignment, due diligence, and operational excellence.

A strong alliance management capability is characterized by the ability to formulate a clear vision, define growth pathways, and then develop a partnership with rigorous diligence and effective negotiation. Deloitte's Strategic Alliance Life Cycle framework identifies specific phases in partnership creation and execution and, within each phase, specific activities that require attention (see figure 4).

The Strategic Alliance Life Cycle framework can help companies to organize and improve their partnering effort. Each phase is discussed in the sections that follow.

Figure 4. Strategic Alliance Life Cycle: Key phases and activities

Alliance strategy	Deal development	Alliance management
Define strategic objectives; Explore opportunities	Develop concept; Perform diligence; Negotiate and execute deal	Launch; Manage and terminate
Main activities Build-buy-partner evaluation Strategic rationale Partner landscape evaluation and prioritization Deal prioritization	**Main activities** Preliminary partner evaluation Contact partner and establish deal process Due-diligence and compatibility review Alliance governance and operating model Business case Adjust governance structure and deal team Negotiate partnership terms Update business case and finalize operating guidelines Finalize and announce the deal	**Main activities** Kick off partnership Develop partnership processes Track partnership performance Analyze performance and identify corrective measures Ensure successful alliance termination

Alliance strategy

In the initial phase, the organization should define its overarching strategic objectives and determine if external partnerships can enable that strategy. This requires close alignment among corporate strategy, business development, and functional leadership to assess desired capabilities and examine strategic decision factors outlined in the Build-Buy-Partner framework.

The most common potential pitfall in the initial phase is misalignment between business strategy and alliance strategy. The former has to drive the latter. In many cases, however, the alliance strategy is not clearly articulated, or it may have been formulated in isolation without proper consideration of key business objectives. With such a strategic misalignment, significant time and resources can be expended in the pursuit of a partnership that may fail to meet financial goals or strategic objectives.

To avoid this, it's important to ensure that the strategic rationale for any proposed alliance is set early in concept development. It's crucial to articulate the anticipated sources of alliance value and to link this value to specific performance metrics such as increased sales, enhanced innovation capability, or operational improvement.

Because development and management of an alliance is often resource intensive, it is vital to clearly identify a formal business sponsor. This sponsor should have the requisite authority to prioritize and allocate resources to the partnership. And the sponsor should be accountable for its alignment to the organization's strategy and, ultimately, for its performance.

Once strategy for an alliance is formulated and a business sponsor is identified, evaluation of the landscape of potential partners and the screening of partnership candidates begins. Possible partners need to be evaluated to ensure that an alliance can be structured based on shared incentives without undue cost or risk.

Deal development

Once a prospective partner has been identified from a prioritized short list, the process moves to deal development. This phase is focused on taking the prospective alliance from a preliminary assessment of the strategic fit and partner suitability through a detailed partner evaluation. This entails a combination of due diligence, business case development, structuring, and negotiation.

One of the common mistakes in the deal development stage is to only focus on the technical nature and commercial return of the joint offering, rather than the nature of the relationship that's being established. In most cases, the level of collaboration and interdependence is correlated with the level of risk, complexity, and potential value that may be expected, suggesting a need for increasingly rigorous diligence and dedicated effort during the deal development phase.

Careful consideration of the risks and early planning in each of the three activities that make up the deal development phase can help drive better results. These three activities are: 1) developing the concept; 2) performing diligence; and 3) negotiating and executing the deal.

Develop concept

- A partnership concept, which includes the strategic rationale and proposed deal structure, should be designed and vetted internally before contact is initiated with the prospective partner or partners.
- The primary objective of the deal concept is to validate how the partnership is likely to deliver sufficient strategic or financial value to the organization.
- A set of go/no-go criteria should be developed based on the anticipated value drivers to guide the decisions and the areas on which due diligence efforts need to be focused.

Perform diligence

- The amount, complexity, and sophistication of partner due diligence varies markedly depending on the scope and opportunity value of the deal—and the speed of innovation and change in the industry. Identifying the most pertinent issues, based on a specific decision framework, is crucial to help focus the partner diligence.
- Many companies conduct due diligence targeted toward only two areas: commercial and technical viability. Limiting diligence in this way means business development teams may fail to uncover strategic, cultural, and operational risks.
- Research suggests most alliances do not fail for commercial or technical reasons, but rather due to strategic, operational, or cultural misalignment.[12] Including these latter points in the go/no-go criteria can help ensure a critical focus for the team when diligence is performed.

Negotiate and execute

- A common issue in alliance negotiations is the failure to use the negotiation as an opportunity to set the collaborative tone for the partnership. Negotiating teams often conduct their discussions in an aggressive, adversarial environment in which each side is battling to get concessions from the other. This may result in abandoned negotiations; even if an agreement on terms is reached, this may create resentment that inhibits effective collaboration and value delivery.
- Prospective partners must think differently: The goal is less about setting deal terms that each side can live with and more about creating a deal that fosters an ongoing, value-enhancing relationship.
- A leading practice is to have continuity between the team developing and negotiating the deal and the team that will manage the alliance once it is operational.

Goals and incentives for those tasked with supporting partnership development should be carefully considered so that they do not create adverse incentives that result in substandard partnerships.[13] Business development teams that structure and negotiate partnerships need to be cognizant of the operational implications of any agreed-upon terms. This often requires that they engage the stakeholders across functions who will be responsible for delivering against the alliance's objectives.

Alliance management

With alliance preparation and development efforts concluded, the partnership can be launched and then must be managed on an ongoing basis. Regular monitoring of performance metrics should inform adjustments to alliance design. Ongoing engagement from stakeholders at an appropriate level of seniority is crucial to ensure that the alliance meets performance targets and delivers on the collective vision that underpins its creation.

For some types of alliances, building a framework to audit and review each other's activities can enhance trust; an audit and review element can also help foster continuous improvement. In one example, a Fortune 50 industrial company has been in partnership with a software company for more than 20 years. These two organizations have promoted a long-lasting and trustworthy relationship by building into the partnership a process for auditing the software development effort and assessing the sales approach such that each partner can see what the other is doing.

Finally, adequate consideration must be given to termination of an alliance when goals have been reached or when the original rationale for partnering is no longer valid. Agreeing on this up front can avoid thorny issues later and improve trust along the way. Alliance termination can be viewed as similar to the discontinuation of a product in a product life cycle management context. While terms governing the process for alliance termination are generally included in original partnership agreements, it is also a leading practice to develop a strategy for an orderly unwinding of the relationship that includes the transition of jointly developed assets and joint operations.

Conclusion

Strategic alliances are a vital tool to driving growth by enabling access to external capabilities in a disrupted business environment and business leaders need to embrace the practices that foster success in partnership strategy, development, and implementation.

Alliances present a relatively rapid means of gaining access to external capabilities when time-to-market, financial, or legal issues preclude the development of capabilities in-house or the pursuit of an acquisition. Partnerships often create strategic optionality that can be valuable to companies operating in uncertain markets or expanding into adjacent products or services. Alliances can be seen as a highly effective alternative—or a preceding step—to an acquisition.

However, careful consideration of strategic alternatives, thorough partner evaluation, and diligent management are all required to ensure that a strategic alliance is appropriate and successful in delivering its intended value. Deloitte's Build-Buy-Partner framework and our Strategic Alliance Life Cycle framework are designed to assist business leaders in bringing rigorous analysis to their decision making around partnership strategy, development, and execution. Bilateral alliances only mark the starting point for a more fundamental evolution in how organizations and economies structure for growth. The impact of technological and commercial disruption is not just changing industries, but also inciting a reorientation from linear, sector-specific value chains to complex ecosystems in which a broad group of players brings unique capabilities and collaborates to address emerging customer and market needs.

The result should be a high degree of cross-organization collaboration in "value webs" through the forging of multilateral relationships—generating social value as well as economic profits and fostering a shift in mindset toward expedited entrepreneurial approaches across organizational boundaries.

As organizations look to enhance their alliance capabilities, they should also explore strategies that expand beyond individual alliances or an alliance program to understand how they may enable—and function within—a broader collaborative ecosystem.

Endnotes

1. Deloitte Insights, *The Fourth Industrial Revolution is here—are you ready?* 2018, https://www2.deloitte.com/content/dam/Deloitte/tr/Documents/manufacturing/Industry4-0_Are-you-ready_Report.pdf.
2. Mark Steedman, Karen Taylor, Mark Stockbridge, Casey Korba, Sonal Shah, and Matthew Thaxter, *Unlocking R&D productivity: Measuring the return from pharmaceutical innovation 2018,* Deloitte Centre for Health Solutions, 2018, https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/life-sciences-health-care/deloitte-uk-measuring-return-on-pharma-innovation-report-2018.pdf.
3. Propeller Health, "Propeller Health Announces Expansion of Digital Health Collaboration with GlaxoSmithKline to Improve Management of Asthma and COPD," Press Release, August 24, 2017, https://www.propellerhealth.com/2017/08/24/propeller-health-announces-expansion-of-digital-health-collaboration-with-glaxosmithkline-to-improve-management-of-asthma-and-copd/.
4. Otsuka America Pharmaceutical, "Otsuka and Proteus Digital Health Announce Expanded Collaboration Agreement to Advance Digital Medicines for Mental Health," Press Release, October 11, 2018, https://www.otsuka-us.com/discover/otsuka-and-proteus-announce-expanded-collaboration.
5. Jon Porter, "Elon Musk eyes early 2019 release for Tesla's custom AI chip," The Verge, October 16, 2018, https://www.theverge.com/2018/10/16/17982690/tesla-hardware-3-ai-chip-2019-release-6-months.
6. Bill Vlasic, "G.M. acquires Strobe, start-up focused on driverless technology," *New York Times,* October 9, 2017, https://www.nytimes.com/2017/10/09/business/general-motors-driverless.html.
7. Heather Somerville, "Toyota to invest $500 million in Uber for self-driving cars," Reuters, August 27, 2018, https://www.reuters.com/article/us-uber-toyota/toyota-to-invest-500-million-in-uber-for-self-driving-cars-idUSKCN1LC203.
8. Jacob Bruun-Jensen and John Hagel, "Minimum viable transformation," *Business Ecosystems Come of Age,* Deloitte University Press (2015), https://www2.deloitte.com/content/dam/insights/us/articles/platform-strategy-new-level-business-trends/DUP_1048-Business-ecosystems-come-of-age_MASTER_FINAL.pdf, pp. 91–101.
9. Ernest Scheyder, "Exxon, Petrobras form alliance to develop oil, gas projects," Reuters, December 14, 2017, https://www.reuters.com/article/us-exxon-mobil-petrobras/exxon-petrobras-form-alliance-to-develop-oil-gas-projects-idUSKBN1E833Q.
10. Middle market valuations in Q2 2018 range from 8.4 to 10.3 times EBITDA, and S&P 500 EV-to-EBITDA ratio has increased from 8.6 times in 2013 to 13.0 times in 2018, according to data from Quarton International, "North American Middle Market M&A Update Second Quarter 2018."
11. Alliance Best Practice, Ltd.
12. Ibid.
13. Danny Ertel and Mark Gordon, *The Point of the Deal: How to Negotiate When 'Yes' Is Not Enough* (Brighton, MA: Harvard Business Review Press, 2007).

About the authors

Will Engelbrecht leads Monitor Deloitte's M&A and Restructuring Strategy and Diligence practice where he advises Deloitte's most strategic clients on opportunities to create value through acquisitions, divestitures, restructuring, JVs, strategic alliances and ecosystem plays.

Tanay Shah is a Managing Director in the M&A and Restructuring Strategy and Diligence practice. He focuses on helping his clients grow through developing strategies that address buy, sell, build, or partner growth options, followed by diligence and potential restructurings. Tanay works with clients to grow and adapt during periods of rapid change and uncertainty.

Aaron Schoen is a manager in Deloitte's M&A and Restructuring Strategy and Diligence practice where he focuses on advising clients on growth strategy, M&A, and partnerships. He has expertise on advising clients on build-buy-partner decisioning making, alliance development and execution, and partnership best practices.

Mike Nevin is the founder and Managing Director of Alliance Best Practice Ltd (ABP), a UK based research and advisory firm that focuses on optimizing strategic alliances. Mike has published research in "The Strategic Alliance Handbook" and advises leading partnering companies across technology, telecom, and life sciences.

The authors would like to recognize the exceptional work of Alex Kang and Michiel ten Broeke for their contributions.

About Alliance Best Practice

Alliance Best Practice Ltd. (ABP) is a research and benchmarking consultancy based in the United Kingdom. The organization focuses on helping clients generate more value from their strategic alliance relationships through the discovery, dissemination and delivery of alliance best practices. Our consultants and associates are a group of international independent experts who each specialize in some aspect of strategic alliance formation, management or optimization.

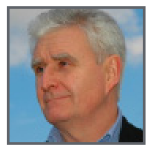
The firm is founded on 52 Common Success Factors (CSFs) that have been statistically proven to contribute to alliance success (Best Practices). The organization's unique offering is a world class database of over 200,000 observations of alliance best practices in action generated from examining in depth over 600 strategic alliance relationships in the last 17 years.

Contact us

Will Engelbrecht
Principal, M&A Strategy
Deloitte Consulting LLP
wiengelbrecht@deloitte.com

Aaron Schoen
Manager, M&A Strategy
Deloitte Consulting LLP
aschoen@deloitte.com

Tanay Shah
Managing Director, M&A Strategy
Deloitte Consulting LLP
tanshah@deloitte.com



Mike Nevin
Managing Director
Alliance Best Practice Ltd
mike.nevin@alliancebestpractice.com

About Deloitte
As used in this document, "Deloitte" means Deloitte & Touche LLP, which provides audit and risk advisory services; Deloitte Consulting LLP, which provides strategy, operations, technology, systems, outsourcing and human capital consulting services; Deloitte Tax LLP, which provides tax services; Deloitte Financial Advisory Services LLP, which provides forensic, dispute, and other consulting services, and its affiliate, Deloitte Transactions and Business Analytics LLP, which provides a wide range of advisory and analytics services. These entities are separate subsidiaries of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Deloitte Corporate Finance LLC ("DCF"), an SEC registered broker-dealer and member FINRA and SIPC, is an indirect wholly-owned subsidiary of Deloitte Financial Advisory Services LLP and affiliate of Deloitte Transactions and Business Analytics LLP. Deloitte Financial Advisory Services LLP is a subsidiary of Deloitte LLP. Investment banking products and services within the United States are offered exclusively through DCF.