EFFECTIVELY MANAGING RISKS IN ALLIANCES
Turn threats into opportunities and help add value to the business and its partners

Pressures are increasing on organisations to achieve more success with less resource and focus on what they do well so businesses are continually using alliances as a means of meeting their strategic goals. Reports and surveys[i] over the past few years have reinforced that firms will increasingly rely on alliances in the future. Indeed KPMG recently published a survey stating 70% of companies will use collaborations to achieve growth goals[ii].

With increasing legislation and regulation heightening requirements for transparency and disclosure, it means material alliance relationships will require greater scrutiny than ever before. This is not necessarily a bad thing however as up to 70% of alliances currently fail to meet their objectives. Of perhaps even greater concern is that around 8 out of 10 organisations are unable to effectively measure their overall alliance portfolios, lacking even basic detail such as the number of alliances and business relationships in place, let alone which ones offer the greatest return or have the highest business risks[iii].

For firms that execute alliances well and invest in an alliance capability the rewards are attractive; it has been reported that they enjoy a 25% higher long term alliance success rate, and see 1% higher ($54m) share price rises from announcing an alliance than those without an alliance capability[iv]. Clearly then there is case for improvement, offering groups like Internal Audit an opportunity to participate in raising standards and introducing methods to improve business success and mitigate the risk of failure from alliances in the future.

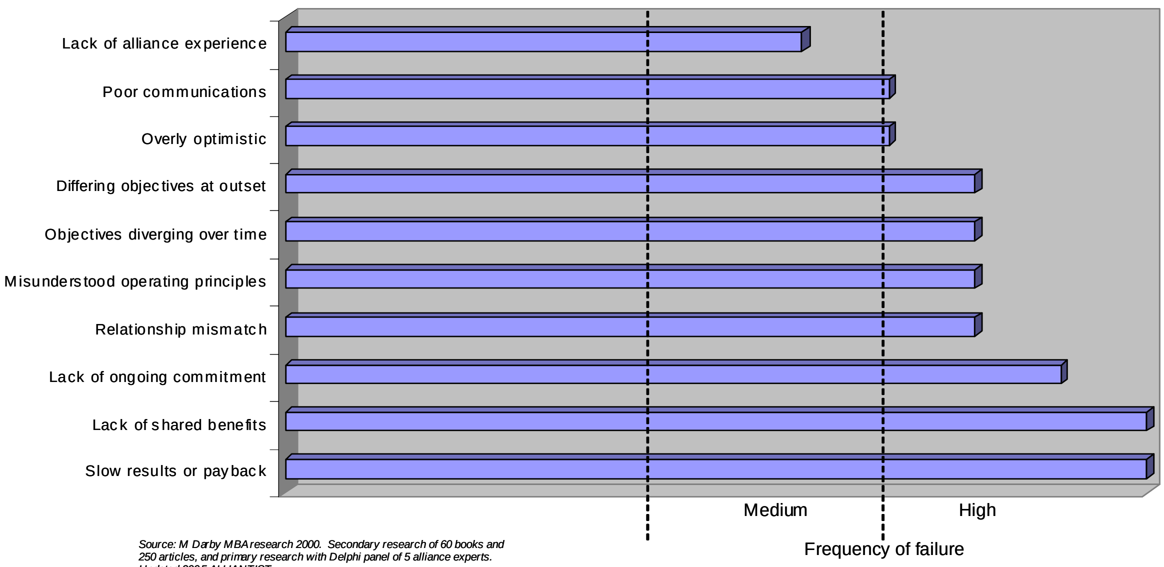
Alliances are simply but broadly defined as *'two or more organisations working together to achieve something that one cannot do or chooses not to do alone'*. Charateristics of alliances include collaboration, shared risk and reward, interdependence and trust based built with appropriate safeguards. 'Strategic' alliances also have a material impact on the organisation.

Whether for reducing costs, growing sales more quickly, improving operation or aiding innovation many organisations now have alliances throughout their value chain and greatly depend on other parties for some of their business success. Alliances are also owned or influenced by many different stakeholders including R&D, Purchasing, Operations, Sales, Marketing, Finance, Legal and HR, yet few of these stakeholders are familiar with what it takes to ensure alliance success. Given this broad stakeholder base and reliance, for example on supplier alliances for key supply inputs, outsourcing partners for a key business process, or sales partners for channels to market, it is evident that a material alliance failure could have significant business risk.

It is useful to understand the common reasons why individual alliances fail and consider other areas of risk in alliances, before sharing in more depth what an organisation needs for success, and how Internal Audit can help.

Figure 1 below highlights the most common reasons for failure which are caused by either poor preparation or ineffective ongoing management.

Figure 1 Top 10 Reasons for Alliance Failure



Source: M Darby MBA research 2000. Secondary research of 60 books and 250 articles, and primary research with Delphi panel of 5 alliance experts. Updated 2005 ALLIANTIST

In addition to these common pitfalls, consideration needs to be given to additional risks for the organisation that could be encountered when allying. These include sharing confidential information, and the inability to control partner organisation/s which could lead to indirect reputational or financial risks for example, if the partner started to behave opportunistically; this has high probability if the alliance is inequitable or the results have a slow payback.

The good news is that these conditions and pitfalls can be mitigated or eradicated with a little effort. Good partnering starts at home and a winning alliance capability is made up of 3 Critical Success Factors[v] (CSF) as shown below:

1. **Having a capability to partner yourself**
2. **Selection of the right partner/s**
3. **Appropriate relationship architectures underpinning the alliance/s**

CSF 1 - Having a capability to partner yourself
This summarises the need for an effective infrastructure within the firm to address all alliance activity and is based around having appropiate people, processes, tools, structure and systems, but also includes fundamental aspects like:

- Having clarity on your business strategy and direction
- Being clear about your core competences (existing and desired)
- Being able to determine whether to make, buy, or ally as a strategic option
- Having an ability to collaborate both internally and externally
- Being able to monitor and govern relationships effectively across the value chain
- Making it easy to do business with your partners

CSF 2 - Selection of the right partner/s
Organisations jump into selection without addressing CSF 1, primarily because they don't have appropriate tools, processes and resources in place and selecting partners can be a bit like

shopping with someone elses money; great fun! A simple alliance lifecycle process would help ensure the factors highlighted in CSF 1 are addressed before leaping into CSF 2. Without this process it is possible that the choice of partner/s may be flawed and leave the firm exposed to increased risk and opportunity cost. Examples of risks include future core competences (and profitability) being allied away for short term cost reduction, or lack of clarity in strategy meaning objectives changing earlier than planned, and the partner becoming a competitor or an unnecessary distraction. The key things to look for in selecting a partner are simply Credibility, Capability and Desire although at a more detailed level each alliance will have its own specific criteria. Using ALLIANTIST proprietary tools such as TOPSCORE™ it encourages clients to think holistically and consider aspects that may not get addressed at the formation stage of an alliance, but will come into play during its execution. TOPSCORE™ means:

- **T**echnical fit (are they technically capable of meeting your/ your clients needs)
- **O**perational impact (can they operationally deliver on their promises)
- **P**ortfolio fit (do they fit with your other partners and the overall portfolio)
- **S**trategic fit (do they fit you strategically and from an environment/market perspective)
- **C**o-opetition impact (are they also an existing customer, supplier, partner or competitor)
- **O**rganisation impact (are you organised to manage them and vice versa)
- **R**elationship fit (are you compatible and able to work together effectively)
- **E**conomic impact (what are the accounting financial, tax and related issues)

CSF 3 - Appropriate relationship architectures underpinning the alliance/s
Having identified the right partner/s this CSF highlights the need for architecting an appropriate relationship and governance model that will facilitate success of the alliance yet also mitigate against the risk of surprise or failure, in particular addressing those points highlighted above as being common causes of failure and risk. One size solution does not fit all however so we suggest the concept of 'balance' for designing a suitable Alliance Relationship Architecture©. Balance means addressing both the hard and soft factors around the alliance taking into account:

- The alliance and relationship objectives
- Each partner's ability to execute (i.e. how effective their alliance infrastructure is)
- The relationship maturity between the parties (i.e. how well they know each other)

For example an alliance with very clear objectives, partners who have worked together well in the past, don't compete and have good experience from other alliances may architect a light governance model introducing minimal safeguards whilst undertaking adhoc relationship management. However, if the alliance was between competitors and one had a reputation for failing to deliver on its past commitments, a completely different governance model might be needed. This could mean greater emphasis on the safeguards, real clarity of who is doing what, when, and how, with committed investments in building trust and ensuring that the two organisations resources were encouraged to collaborate at all touch points.

Taking into account the issues risks and opportunities from alliances, Internal Audit can engage and support the firm in alliance activity at three levels:

- **Alliance Portfolio Level**
  - Consider the business opportunities and risks from the overall alliance portfolio
  - Helping set perameters and standards for future alliance activity
- **Specific Alliance Level - Preparation**
  - Adding value in the pre-alliance stages to help ensure that the aims of the alliance are compatible with the firms needs
  - Assist in Due Diligence of the partner during the selection process

- **Specific Alliance Level – Ongoing Management**

- o Undertaking Alliance Assurance during the life of the alliance within the firm, and with the partner

This article has expressed how important and attractive alliances are for business today and noted why they go wrong, outlining the common pitfalls and risks. In addition it has highlighted the Critical Success Factors for winning with alliances and attempted to offer up areas where Internal Audit can use its skills, expertise and objectivity to make a difference.

Key Questions to ask the Board about their alliances and business relationships:

- What is the overall value of our alliance portfolio and related business relationships?
- How much of our business success today is dependant on other parties and are we managing those risks and opportunities effectively?
- Could we be doing more to remove costs, grow revenues and mitigate risks by developing an 'alliance strategy' instead of just 'strategic alliances'?
- Do all our alliance activities align with the firm's strategy and its core competences?
- Are we organised effectively to optimise our alliance portfolio and do our staff have the right processes, tools and systems to ensure alliance success?
- Do we co-ordinate effectively when a partner is also a customer, supplier, or competitor?
- If 70% of alliances fail to achieve their objectives, how do we fair and can we measure it?
- Increasing legislation and regulation means that you may be held responsible for alliance failure that has a material impact on the business – what are you doing to manage risks and comply with governance codes?
- When was the last time that you spent quality time with your key partners in each area of the value chain such as R&D, Supply, Operations, Infrastructure support (e.g. HR), Sales and Marketing, as well as Customers per se?

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1. [i] For example Deloitte –Survival of The Fittest 2004, PWC CFO perspective on alliances 2003
2. [ii] Alliances and Joint Ventures: Fit, Focus, and Follow-Through KPMG April 2005
3. [iii] ALLIANTIST research 2005, and Mark Darby MBA primary & secondary Research 1997-2000
4. [iv] Dyer, Kale and Singh – How to make strategic alliances work MIT Sloan Mgt Review Summer 2001
5. [v] Mark Darby Achieving Competitive Advantage in the age of the Virtual Enterprise; Critical Success Factors for Alliances