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Building Alliances to Penetrate European Markets

Robert Porter Lynch

Cooperative efforts, such as strategic alliances and joint ventures, are two of the most rapid and least costly methods for U.S. firms to gain a foothold in Europe

Each week, the business media run banner headlines exhorting American companies to gain a beachhead in Europe, as if 1992 were the new date set for the Normandy invasion. Envision boatloads of businessmen, armed with attaché cases, flanked by their bankers, accountants, and lawyers, landing on the shores of a unifying Europe, ready to make deals in a market of 320 million people—a market larger than the entire United States.

But the realities are different. The invasion is, for the most part, a dream and the opportunities remain largely unexploited.

Meanwhile, Europeans are embracing unification with an almost religious fervor. Undaunted by provincialism and cumbersome bureaucracies, EC-92 has uncannily cut through centuries of red tape and formed a European consensus that would make Metternich envious. (See the accompanying box "Keeping Abreast of EC-92" on page 7.)

Invariably, the lowering of trade and regulatory barriers, along with the establishment of a single European currency, will have profound strategic implications throughout the world. Long constrained by governmental restrictions, new, more powerful, and highly innovative combines—strategic alliances, joint ventures, acquisitions, and mergers—are being established in Europe to gain competitive position.

In the field of finance, West Germany's largest public sector bank, Westdeutsche Landesbank (WestLB) is forming a 50-50 joint venture with Britain's largest multinational bank, Standard Chartered. The goal is to create a new merchant bank joining WestLB's corporate finance divisions with Standard's investment banking division. The banks designed the cooperative venture to enhance their business strategy and to gain market share.

Just as Japan became a financial giant in the 1970s and the "four tigers" of the Pacific Rim (Hong Kong, Singapore, Korea, and Taiwan) have emerged in this decade, so will the Europeans. The new EC arena is their proving ground. With the active support of the public sector, these new combines ultimately have their sights set on lucrative U.S. markets, readying to invade our shores with money, buyout offers, and innovative products.

Airbus, a consortium of West German, French, British, and Spanish businesses, has now become one of Boeing's major competitors. Air France and Lufthansa have joined forces in cargo handling, pilot training, aircraft acquisitions, and marketing; these companies are seeking to include Iberia and JAL in this global network.

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U.S. companies must recognize the necessity of keeping foreign competitors on their toes on their home turf. By being strategically aggressive in Europe now, U.S. firms will force European competitors to spend their time and resources in their native markets.

If the European markets are conceded, the battle for market share will be fought here in America. Nestlés, the Swiss food giant, nearly doubled its U.S. candy market share with its acquisition of RJR-Nabisco's candy divisions. Unilever, the Anglo-Dutch conglomerate, has made over $2 billion of acquisitions in the United States, staking out the number-three position in the cosmetics market.

The typical U.S. corporate response to these competitive challenges has been to conquer through acquisition. But U.S. acquisition frenzy has been focused on our own shores, not overseas. Perhaps other, more effective strategic options should be considered.

Overseas Obstacles

Businesses fortified with acquisition experience in the United States are often frustrated by the lack of opportunities in Europe. Britain, with no language barrier, has attracted the most acquisition attention with its concentration of only one fifth of the EC's population and over 50 percent of its publicly listed companies. But English companies have historically looked toward America for their expansion. Few have seen continental Europe as their fundamental market base, leaving them without developed networks in the overall EC marketplace.

On the continent, most potential targets are smaller in size, closely held, and often family owned—not great acquisition fodder for the hungry investment banker. Several other critical impediments exist to deter acquisitions:

- Cash is the normal consideration used for European acquisitions because unique share structures make stock swaps impractical.
- Valuation is central to every acquisition; an analysis of the balance sheet, cash flow, and margins will normally yield a commonly agreed upon valuation range in both the United States and the United Kingdom. However, accounting procedures vary tremendously from country to country on the continent, and valuations often require extensive investigation.
- Trust is vital for negotiating a successful acquisition as well as retaining top-quality management afterwards. Both hostile and foreign takeovers, while more accepted in Britain, are not well regarded in other European countries. Building trust through cooperative ventures and then a later acquisition offer after building a relationship are better approaches.
- Information sources on businesses are lacking in many countries. While public companies in Great Britain, France, Germany, and Italy are relatively well documented, the European versions of Standard & Poor's directories, Dun & Bradstreet reports, and 10-K forms are simply not available in most of the other EC countries. According to the English merchant banking firm Hill Samuel, "information is of inconsistent quality, accounts are sometimes years out of date, directories often not verified, and corporate information filings incomplete or poorly maintained."

Furthermore, while Europe is becoming a united economy, it will remain a fragmented market with a wide diversity of cultural and nationalist traditions. This factor may necessitate several acquisitions for companies seeking to cover the breadth of the EC market. (Eurobranding is still an emerging concept.) Without a thorough understanding of the EC markets, an acquisition strategy should be considered risky.

For example, Vickers Office Furniture

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of the United Kingdom sought synergy when it acquired a Swiss-German office chair manufacturer. However, the Swiss-German designs did not marry well with their existing Anglo-French designs; as a result, the integrated marketing functions failed.

Finding the right acquisition targets with the proper strategic and operational "fit" could take two to five years—too late in a marketplace emerging with the rapidity of Europe.

"Given the riskiness of a start-up subsidiary, U.S. companies should consider forming cooperative ventures as the first strategic step into the European market-place."

Pursuing the establishment of a new start-up subsidiary can be a costly and time-consuming gambit that requires products and distribution systems properly matched in advance to the local markets. European economic development officials are trying to sell U.S. corporate executives on the idea of establishing subsidiary companies before 1992. These officials speak of efficient new plants subsidized heavily by government loan guarantees and staffed by local workers whose pay is underwritten by job tax credits.

This seduction strategy is as alluring as the sirens' song in Homer's *Odyssey* and is equally fraught with risk. The strategy makes sense only if a substantial amount of corporate revenue now comes from European markets. Intel, strong in the European computer and semiconductor market, has chosen to build a plant in Ireland. The reason: Some 25 percent of Intel's current revenues already originate from Europe, and the company knows that Europeans would rather buy from local manufacturers.

With such obstacles in the path of acquisitions and given the riskiness of a start-up subsidiary, U.S. companies should consider forming cooperative ventures as the first strategic step into the European marketplace.

The tremendous proliferation of cooperative ventures in the past decade has occurred because alliances are quicker to form, are more flexible to operate, are less risky, require less cash, and drain fewer resources from the sponsors. For the same amount of time and money to make one acquisition, several joint ventures could be consummated in multiple markets, as AT&T has done with Philips, Olivetti, and Italtel.

Cooperation can be a highly effective form of competition, as General Electric has realized with its CFM aircraft engine joint venture with France's SNECMA. CFM not only has orders worth billions of dollars for engines from European customers but also holds major contracts with the U.S. military. Therefore, the cooperative venture's competitive edge cuts advantageously both ways across the Atlantic.

Cooperative Ventures

Strategic alliances differ from joint ventures only in form. Alliances are usually consummated with a written contract, often with definable termination points, and do not result in the creation of an independent business organization. Typical examples of strategic alliances are:

- Minority equity stakes (usually 15–35 percent) often with an option or preemptive rights for more stock;
- Distribution agreements and trading relationships, especially those with

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features for mutual product development or cross licensing;

- Resource- and technology-sharing agreements.

Joint ventures are more formalized arrangements resulting in the creation of a new, separate business entity, such as joint manufacturing facilities, joint research and development projects, joint production and marketing arrangements, and systems integration ventures. The "acquisition joint venture" is a hybrid version whereby one company purchases a 50 percent interest in a subsidiary division of another company, which is then spun off as a separate joint venture corporation.

The strategic, structural, and operational principles are similar for both alliances and joint ventures. However, the levels of intensity, coordination required, and resource commitments are generally greater for joint ventures.

Inherently, the European business culture is more amenable to the cooperative venture from foreign businesses (especially as an initial overture) than the acquisition. Better to have a positive trading relationship first, assess the business's real potential, and gain the confidence and understanding of current management without the risk of a costly acquisition. When it was first proposed, Britain's Jaguar was far more receptive to General Motors' proposed alliance than to Ford's hostile takeover bid.

Later, let the alliance be transformed into an acquisition, if signs are positive and both sides are willing, or increase one's investment in the partnership, as AT&T has done with Olivetti.

If a joint venture fails, usually the cost may be only 25–35 percent the cost of a doomed acquisition. When Arco's joint venture with Sweden's Ericsson was unsuccessful in penetrating the office products market in the mid-1980s, the losses were so small that the press hardly bothered to report it. Compare this situation with Exxon's disastrous office products acquisition and integration strategy, which eventually cost over $1 billion in losses before abandonment.

Keeping Abreast of EC-92

Each week, the EC-92 Commission in Brussels issues new policy directives for economic unification. Digesting this constantly evolving material and promulgating it in the form of booklets and newsletters to U.S. businesses is being handled by the following agencies:

- U.S. Department of Commerce
  International Trade Administration
  Room 2106
  Washington, D.C. 20230
- American Chamber of Commerce
  EC Affairs Office
  Avenue des Arts Boite 50, B-1040
  Brussels, Belgium

Write to them for up-to-date materials.

Underpinning all successful alliances are several core elements: First, there must be a spirit of trust, cooperation, and integrity reinforced by a "win win" commitment by both parties.

Second, both strategic and operational synergy must prevail among the partners. Ideally, the strengths of one partner should complement the weaknesses of the other partner and vice versa.

Third, as the venture matures, sponsoring companies must be willing to address new risks, must be committed to flexibility and creativity, and must be ready to transform the structure of the alliance as strategic and operational conditions change.

Managing the Alliance

The ultimate success of the venture will depend not on its legal agreements but on the success of the operations. Yet, most companies approach venture management "seat of the pants" style, encounter problems, and learn the hard way.

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Research and experience have uncovered several key factors that can help companies in managing alliances:

- Control will be an important negotiating issue. The resolution of the control issue should be positive, resulting in a decision-making structure that is efficient, collaborative, and truly synergistic. If negotiations about control become adversarial, the alliance will probably be doomed before it starts. Control should be a business decision first and a legal decision second.
- Structure the venture based on operational expertise, ownership of equity, and distribution of risks and rewards. Excellent consensus decision-making skills are required for 50-50 ventures. Some companies avoid 50-50 deals, but there are numerous examples of highly effective ventures lasting twenty or more years using this structure.
- Clarity of focus is vital. Ambiguous goals, fuzzy directions, and uncoordinated activities are the primary causes of failure of cooperative ventures.
- Management support from the sponsors in the form of resource allocation and executive commitment will make or break most ventures. The presence of a strong, high-ranking "champion" within each of the sponsoring companies is a key factor.
- Coordinative skills, according to Peter Drucker, are critical because no one company is in complete control and because alliances cannot be "commanded"; the two companies must work together. Managers need person-to-person skills to compensate for cultural and organizational differences between partners.
- Venture manager selection should be based on the presence of excellent "integrative" skills—the ability to effectively manage the diverse perspectives of a wide variety of specialists. Some alliances choose outsiders (people not loyal to either partner) as key managers.

Detecting Pitfalls

Seldom is failure the result of the quality of the legal agreements. During the negotiations phase, avoid placing excessive emphasis on legal technicalities, ownership formulas, and decision-making processes. Many organizations pay too little attention to operations planning, clarity of goals, personnel selection, resource allocations, teamwork, reporting systems, cost controls, and desired results. Always organize and manage for mutual success, regardless of the legal agreements.

Failures typically result from inattention, dramatically changing strategic conditions, or lack of quality management. Managers incapable of working in a collaborative environment will always yield disappointing results for their organizations.

Avoid "double management," with joint auditors, joint legal and financial advisors, joint chairmen, and especially joint venture managers; these overlapping jobs are an unnecessary and costly waste.

"Ideally, the strengths of one venture partner should complement the weaknesses of the other partner and vice versa."

Alliances are established to tackle inherently risky environments. Neglecting contingency plans to deal with the unpredictable and unknown will leave the venture on shaky ground.

Lastly, avoid the "start-up" joint venture. Instead, spin off and reorganize a division or department of an existing company, enabling operations to begin with a running start. ■

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