# Teaming For Success

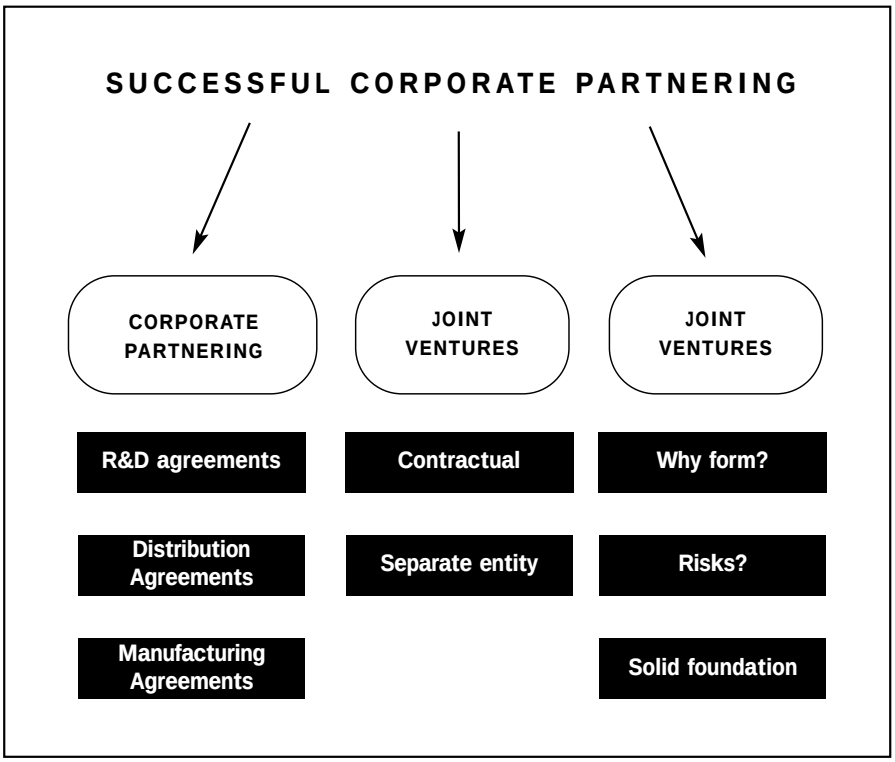


CHAPTER 6

## Advanced Organizer

The expense of bringing products to market in highly competitive industries such as pharmaceuticals and semiconductors—as well as the need to accelerate product introduction and shore up competitive positions—have led many large and small firms to collaborate. Once fierce competitors, companies such as General Motors and Toyota, Siemens and Philips, and Canon and Kodak have become allies (Hamel *et al*., 1989). The purpose of this chapter is to examine **corporate partnering**, and to provide insight into when and how you may wish to consider corporate partnering as a commercialization strategy.

**FIGURE 6-1: CORPORATE PARTNERING ADVANCED ORGANIZER**



## Definitions

*Villeneuve, Thomas, F., Gunderson Jr., Robert V., and Kaufman, Daniel M.,* Corporate Partnering: Structuring and Negotiating Domestic and International Strategic Alliances. *Aspen Law & Business, 1995.*

Corporate partnering is not the same as a strategic alliance (Villeneuve *et al.*, 1995). The former is distinguished by the presence of the following:

- Two or more organizations (e.g., a customer and a supplier or two or more competitors),
- A relationship which requires performance over time
- Two or more contractual or transactional elements, such as a licensing agreement, a research and development agreement, a distribution agreement, equity financing, a manufacturing agreement, or debt financing
- A system of interdependencies

By contrast, a strategic alliance may be short in duration, less formal, and/or contain fewer contractual or transactional elements. Some of these elements are described below.

*This section describes partnering primarily at the later stages of R&D and for commercialization. Partnering in an ATP joint venture involves a somewhat different set of motivations and challenges, not fully covered here.*

### The Research and Development Agreement

***Many ATP awardees have already formed some research and development partnerships. The intent of this chapter is to provide insight into additional options.***

A research and development agreement is a common element of corporate partnering arrangements. Such agreements clarify the following: (1) the research and development responsibilities of each party; (2) who will fund the components of the effort; and (3) what rights will be divided among the players upon completion of the research and development. As was mentioned at the outset, corporate partnering arrangements involve a family of contractual elements. For example, it is not uncommon with pharmaceutical research and development agreements that another contractual element be a license and supply agreement. Villeneuve provides an example of a research and development agreement with an option (Villeneuve *et al.*, Chapter 13).

Because of the risk associated with research and development activities, it is best for the developer (the junior party) to maintain its obligation level to "reasonable commercial efforts" (Radcliffe and Clowes, 1991). This is suggested because research and development outcomes cannot be guaranteed. In addition, the R&D agreement should clarify how changes in specifications will be handled.

### The Distribution Agreement

A distribution agreement is a common element of many corporate partnering arrangements between small and large firms. The smaller firm typically provides the product, while the larger company provides the distribution channel. The benefit of this arrangement to the small firm is quicker time to market and money saved

through bypassing an investment in the development of an effective distribution channel (often an impossible task when there are strong incumbents). For the large company, the benefit comes in the form of revenue generation, which results from having new product to pump through existing distribution channels. The large company also saves money in this arrangement, by having the option to invest less in internal research and development.

Villeneuve *et al.* indicate that many contractual agreements are really variations of a supply/distribution agreement. These variations include the **Supply Agreement**, the **Original Equipment Manufacturer (OEM) Agreement**, the **Value-Added Reseller (VAR) Agreement**, and the **Distribution Agreement**.

In most supply agreements, the purchaser agrees to purchase and use the supplied material in the production of its own product. An OEM agreement is similar, but in this case, the purchaser typically bundles the supplied product with, or incorporates it into, its own products. Labeling needs to be clarified in such agreements. With a Value-Added Re-seller agreement (VAR), the supplier may customize the product for a specific vertical market application and/or provide the end-user with services. Under a distribution agreement, the supplied product in its original form is distributed under the supplier's trademark. An excellent example of a Supply Agreement for a biotechnology firm can be found in Villeneuve *et al.* (Chapter 7).

***SUPPLIER AGREEMENT***

- ***buyer is obligated to purchase from seller***
- ***buyer is required to provide forecasts***
- ***seller has delivery obligations***
- ***product acceptance procedures are clarified***
- ***liability and compliance requirements are clarified***

## The Manufacturing Agreement

Hamel recommends a change in focus with respect to OEM agreements, especially when corporate partnering crosses international lines (Hamel *et al.*, 1989). U.S. firms, he maintains, typically enter OEM agreements as a way to avoid costs, as well as to gain competitive edge quickly and with minimum effort. By contrast, many overseas firms enter an arrangement with the intent to learn as much as possible about their partner's customers, methods of doing business, and markets. For example, Hamel mentions that in the case of one particular alliance between a European and Japanese firm, every time the European firm asked for manufacturing design modifications to be made, the Japanese partner asked for detailed information about customers and competitors before it would respond to the request. In this fashion, the Japanese partner developed very detailed information about the marketplace. Hamel recommends that U.S. firms adopt a similar attitude toward partnering—namely, to view it as a means of strategic learning. In addition, he recommends that special precautions be taken to minimize the unwanted transfer of information.

Collaboration is competition in a different form, according to Hamel. Successful companies never forget that their new partners may be out to disarm

them. It is therefore important that companies engaged in corporate partnerships inform employees at all levels as to which skills and technologies they should not share. In addition, companies should consider restricting access to their facilities.

## Joint Ventures

Most corporate partnerships are purely contractual in nature, although some result in the formation of a new corporate entity. In contractual joint ventures, the larger company is often referred to as the **senior party**, while the smaller company is referred to as the **junior party**. The objective of the relationship is to sell product and finance additional research and development (Radcliffe and Clowes, 1991). Technology, research and development, or products are usually provided by the smaller entity, while the senior party provides financing (debt, equity, or R&D funding), as well as services.

The allocation of subsequent manufacturing and distribution rights is another key element of the agreement. In some cases, the junior party may wish to establish and expand its manufacturing capabilities, utilizing capital from the senior party to build such facilities. It may give up marketing and distribution rights but insist that it retain manufacturing rights. Furthermore, it may insist on minimum and firm purchase orders to justify and support the expanded manufacturing capacity (Villeneuve *et al.*, 1995). The contractual relationship between the two parties may also be useful in attracting financing from a third party.

*In joint ventures between software developers and computer manufacturers or operating system vendors, the senior party typically provides funding, equipment, and tools in exchange for rights to market the ported product (Villeneuve* et al., *1995).*

In some situations, the joint venture may take the form of a new corporate entity. This option is typically considered when it is not anticipated that there will be significant early losses (Greeley, 1990). In such cases, the investment may take the form of preferred stock because of the preference it offers on liquidation, anti-dilution protection, and special voting rights. Valuation and control issues come to the foreground when a new corporate entity is formed.

## Why Form a Corporate Partnership?

A corporate partnership is a competitive tool. "The challenge is to share enough skills to create advantage vis a vis companies outside the alliance, while preventing a wholesale transfer of core skills to the partner (Hamel *et al.*, 1989)." When opportunity costs and entry risk are extremely high, it is often not feasible to conduct all development work in-house (Krubasik, 1988). In such instances, joint ventures may be the preferable choice.

According to Harrigan (1986), joint ventures provide tremendous opportunities for an organization to strengthen its current strategic platform. In emerging fields, joint ventures enable companies to:

- influence the evolution of an industry's structure
- pre-empt competitors
- share cost and risk
- obtain additional financing
- expand corporate intelligence
- retain entrepreneurial employees

In some instances, a joint venture does not offer a fast enough response to changing conditions. Under such circumstances, an acquisition may be necessary in order to quickly obtain the desired competitive advantage.

## What Are the Risks of Corporate Partnering?

Whenever an interdependency is formed, both parties assume risk. If a company of any size comes to rely upon another for a specific business function, it is unlikely to develop that capacity itself. Unless a partner makes itself indispensable to the relationship, an ally could become a competitor.

Other risks are loss of flexibility and future opportunities. This is more likely to occur with inexperienced, smaller companies which may be naive when first entering a corporate partnering arrangement. The terms and conditions of the joint venture could potentially be so inclusive as to be, in essence, an acquisition. According to Villeneuve *et al.*, potential investors in the smaller firms have often walked away from deals that on the surface seemed attractive, but which due diligence revealed to be little more than an research and development arm locked into a relationship with a large firm.

## How Is a Successful Corporate Partnership Structured?

Corporate partnerships are not panaceas, and they require a great deal of attention to make them function well over the long haul. As with most relationships, when corporate partnerships fail, it is due to poor initial choice of partners, unrealistic expectations, poorly articulated objectives, and changes in corporate direction. When considering a corporate partnership, it is a good idea to keep in mind the strategic planning and competitive intelligence tips discussed in Chapters 4 and 5. In addition, Badaracco (1991) recommends that the following:

(1) Have a clear understanding of your company's present and future capabilities.
(2) Carefully consider the strengths and weaknesses of potential partners.
(3) Examine your own and your partner's values, capabilities, and commitment level.

If you determine that a corporate partnership is appropriate for the commercialization of your technology platform, and if you have chosen a partner carefully, remember that the corporate partnership will take considerable time and attention to develop trust and understanding. As Badaracco notes, alliances need to be led, not just managed.

Lay the foundation well, beginning with the ***Letter of Intent***— also called a ***Memorandum of Understanding (MOU)*** or an ***Agreement in Principle***. The Letter of Intent should be reviewed by legal counsel to minimize delays and frustrations. Immediately after signing the letter, begin preparation and negotiation of the family of interrelated final agreements (e.g., a research and development agreement, a supply agreement, and a financing agreement). These documents are negotiated as a package, even though they constitute separate agreements. (See Chapter 1 of Villeneuve *et al*., 1995, for numerous tips on how to prepare for negotiations.)

## Conclusion

Corporate partnering can provide many strategic benefits. In the next chapter we see that with some technologies, corporate partnering may be the only way to adequately share risk and obtain the investment required. Although the equity investment market is growing, it is focused on a limited number of markets—those that can yield a short-term payback.