

## Winning in the Partnership Era

*In the partnership era, as much as 60 percent of the value chain is outsourced to partners. Few companies have effectively managed the myriad of partner relationships inherent to this new industry structure.*

### The Partnering Imperative

One of the most striking trends in business over the past decade is the emergence of business webs – loose networks of companies that work together to deliver a full range of products and services to a set of similar customers. While the most talked about examples are in relatively new industries – Cisco in networking equipment and Amazon in electronic retailing – this pattern can be seen even in more traditional industries ranging from industrial products to consumer goods to chemicals. Companies that used to be vertically integrated increasingly rely on business partners to make their products, provide complementary products or services, and reach their customers. By some estimates, 30 to 40% of the value chain is outsourced in traditional manufacturing industries; the numbers are as high as 60% in other industry sectors such as electronics and communications.

This evolution in industry structure was supposed to help companies simplify operations and focus on core competencies while increasing returns. However, few businesses that have headed down the path of extensive partnering have reaped the full extent of the benefits they envisioned. The most glaring examples, of course, are the legions of Internet start-ups that struck up hundreds of “strategic partnerships” that they touted as part of their competitive advantage; these partnerships failed to keep companies afloat when the Internet bubble burst.

Failure to realize value from partnering stems largely from the fact that companies at the core of these business webs have not effectively managed the myriad of partner relationships inherent to their new industry structure. And as business partnering becomes more pervasive and complex, this challenge will only become more acute.

### Common Pitfalls

Why is collaborating with others so difficult? If companies are becoming more focused, shouldn't things be getting easier? Why do so few business partnerships live up to their full

potential?

While there are a number of situation-specific factors that affect the outcomes of partnering, there are also some common themes. Most companies that established business partnerships to outsource non-core activities, improve their market reach, or provide more comprehensive solutions to their customers did so without defining the operating norms for these partner relationships upfront. Companies attempting to collaborate with each other – as suppliers, distributors or providers of complementary products and services – may have a common high-level vision, but are often vague about the specifics. Few companies initiate partnerships by defining what success for each party should look like, how the relationship is likely to evolve over time, or how they will balance close collaboration in some areas with active competition in other areas.

Another common problem is that as companies use business partners to take over tasks that previously were done in-house, they expose their Achilles heel of weak internal processes and lack of effective coordination across functions. Deficiencies such as poor forecasts from a company's internal sales force that may lead to cost and delivery bottlenecks in their manufacturing operations are compounded as businesses rely on multiple sales channels. The connectivity and ease of information transfer that the Internet has enabled further magnifies these problems; incorrect information now flows faster to all participants in the industry chain. This is a lesson United Airlines recently learned to its chagrin, when an inaccurate posting of ticket prices on its Web channel led to tens of thousands of unprofitable ticket sales in a matter of hours. Similarly, Cisco's optimistic sales forecasts, which were available instantaneously to their suppliers and distributors, led to a tremendous build-up of inventory – and subsequent write-offs.

Companies often fall into the trap of taking a standardized approach to their partner relationships. They treat all their suppliers,

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distributors and delivery partners in the same manner rather than differentiating among individual players based on factors such as size, skill, or degree of mutual dependency. It is common, for example, for companies that add indirect channels – be they dealers, distributors or value added resellers -- to have similar marketing, compensation, training and support programs for their channel partners. While this creates organizational simplicity, it often sub-optimizes the overall value of the channel to the company.

Finally, companies often enter into partner relationships without an astute understanding of the underlying economics and key business drivers of their partners. Without such an understanding, companies can end up structuring their partner relationships in a way that adds unnecessary costs or reduces the efficiency of creating and delivering products to the final customer, which defeats the goal at the heart of these partnerships. Furthermore, companies can enter into inappropriate contractual arrangements without taking into account their ability to affect their partners' economics and their relative influence in the industry value chain.

**Tailoring Contractual Arrangements**

Company's Impact on Partner Economics	High	Risk Sharing	Cost Plus
	Low	Fixed Price	Fixed Return
		Low	High
		Company's Power in Industry Value Chain	

**Keys to Profitable Partnerships**

In order to maximize relationships with their business partners, companies need to pay more attention to how they define, structure and operate these partnerships. Developing a

shared vision, ensuring cultural fit, and easing information flow with business partners are only the starting points. In our experience, there are three other crucial elements companies must address upfront in their business partnerships:

- Define the desired evolution path for business partner relationships. The idea is to provide a consistent company-wide approach to business partnering, but at the same time take into account the fact that not all partnerships will start at the same stage or progress at the same pace as they mature. Companies need to develop a tailored approach for managing each partner relationship for maximum benefit based on their partners' capabilities and potential, as well as their stage in the relationship lifecycle.
- Develop an end-to-end view of processes and economics in the overall value chain or expanded business system - which includes a company and its vendors, co-producers and channels. The most significant opportunities to create value in complex, multi-tiered industries are through coordinating and streamlining inter-company tasks and information, rather than to have each company focus solely on the tasks that fall within its own four walls. A host of e-business technologies have recently been introduced to facilitate this efficient collaboration frontier. The players who best understand the connections and dependencies across the business network will be in the best position to profit.
- Create a balanced mix of competitive and collaborative incentives in business partner relationships. While the goal of most partnerships is to increase collaboration and create win-win situations, it is vital to preserve some competitive leverage in these partnering arrangements, especially early on in the relationship. Often this comes at a price – for example, reimbursing an existing supplier for historical R&D investment if a product they supply is switched to a new vendor.

We foresee companies entering into business partnerships in more and more areas over the next few years as the current trends accelerate. Creating and extracting value from these partnerships might well become the most vital ingredient for superior returns and growth in the future.

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