Strategic alliances

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Vysoká škola ekonomická v Praze
Internationalization of company operations

Company and its competitive advantage

Activities on local (domestic) market

Internationalization

Export

Production in foreign country

Without capital investments
Licences, agreements, etc.
Joint ventures

With capital investments
Purchase of existing company
Establishing branches
Inter-firm Relationships

Contractual agreements

Traditional contracts
- Arm’s-length
- Buy/Sell contracts
- Franchising
- Licensing

Non-Traditional contracts
- Joint research
- Joint product development
- Long-term sourcing agreements
- Joint manufacturing
- Joint marketing
- Shared distribution/services
- Research consortia

Equity arrangements

No new firm
- Minority equity investments
- Equity swaps

Dissolution of Entity
- M&A

Creation of Entity
- Non-subsidary JVs
- 50/50 JVs
- Unequal equity JVs

Subsidiaries of MNCs

STRATEGIC ALLIANCES
Close partnerships - dissolution of entity

Acquisition

Merger

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Horizontal vs. Vertical integration

- Materials
- Semi products
- Final products
- Additional services
- Wholesale
- Retail
- Customer

Vertical integration
- Full integration
- Partial integration
- Quasi integration

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Benefits of a successful integration strategy

- Company consolidation – opportunity to control distribution channel (quality, price, JIT)

- Economic advantages
  - Lower transactional costs
  - Economies of scale
  - Optimization

- Faster information flow about the market

- Wider portfolio of technologies

- Ability to monopolize the market (higher entrance barriers for new comers)

- Decrease of uncertainty regarding supplies and flows of products, capital and information

- Higher level of negotiating power

- Better understanding of customers and adjustment of a complex product incl. services
Disadvantages of an integration strategy

- Higher management and organizational costs
- Lower flexibility of business partners exchange (suppliers, customers)
- Higher barriers to leave the branch
- Required higher capital investments
- Diversion of concentration from a "core business"

Social disadvantages of integration

- Be aware of threatening market principles (transfer pricing)
- Market monopolization
- Inefficiency due to monopolization
Strategic alliance

= usually time limited cooperation of at least two legally, financially and economically independent firms considering mutual cooperation as strategically important

= goal: creation of a long-term competitive advantage

= each of subjects primary contributes in the area where it specializes and where it has eligibility and in return it expects the same contribution from other involved entities
Strategic alliances

Alliances

Equity strategic alliance
- No new entity
- New entity (JV)

Non-equity strategic alliance

Areas to be determined:
- project lifetime
- areas of cooperation
- types of operations
- legal form
- territorial scope
- etc.
Non-equity alliances

formal relationships between two or more parties to pursue a set of agreed upon goals or to meet a critical business needs while organizations remain independent

- Joint research
- Joint product development
- Long-term sourcing agreements
- Joint manufacturing
- Joint marketing
- Shared distribution/services
- Research consortia
Equity strategic alliances - SWAPS

Car manufacturer A
20 % shares

Car manufacturer B
20 % shares

engine development

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### Basic types of strategic alliances

<table>
<thead>
<tr>
<th>Strategic alliance profit division</th>
<th>Short-run</th>
<th>Long-run</th>
</tr>
</thead>
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<tr>
<td>More independent types of cooperation</td>
<td></td>
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<tr>
<td>Division of profit between SA members</td>
<td>Ad hoc partnerships</td>
<td>Consortiais</td>
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<tr>
<td>Closer types of cooperation</td>
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<tr>
<td>Profit reinvestments within SA</td>
<td>Project joint ventures</td>
<td>Full joint ventures</td>
</tr>
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</table>

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Joint Venture - creation of a new entity

Entity A, a.s.  Entity B, Ltd.

- Contractual Joint Venture
- Property Joint Venture
- Hybrid Joint Venture

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Vertical strategic alliances

Designed to reduce:

- Transaction costs
- Quality costs
- Product development costs
- Logistics costs (warehousing and transportation)
- Inventory costs

Benefits:

- Facilitates access to technologies or customers, especially when these needs may be only temporary
- Provides opportunities to rapidly reach scale in needed capabilities
- Supplies opportunities for learning that can be used also later

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SA x Mergers & Acquisitions

+ • higher flexibility to market needs
  • no need to change ownership structure
  • flexible in cooperation
  • company’s joint cooperation only in areas which are considered as beneficial
  • win-win approach

- • risks during implementation
  • worse control from A or B point of view
  • possible roughness in decision making and control processes
  • tendency of dominance larger caps over smaller partners
  • Trojan horse strategy
## SA x Mergers & Acquisitions

<table>
<thead>
<tr>
<th></th>
<th>Availability to step back from an unsuccessful aims</th>
<th>Higher flexibility</th>
<th>Changes in ownership structure are undesirable</th>
<th>Participation only on rewarding transactions</th>
<th>Risks in the control and implementation</th>
<th>Integration of decision structures</th>
<th>Possible control only by one party</th>
<th>Process of decision making and control processes</th>
<th>Availability of a joint cooperation with other subjects</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>M &amp; A</strong></td>
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<td><strong>Strategic alliances</strong></td>
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</table>
### SAs x M & A x Green Field investments x Exports

<table>
<thead>
<tr>
<th></th>
<th>Creation of a strategic effect</th>
<th>Immediate rewards from a business</th>
<th>Availability to join partners value chain</th>
<th>Trojan horse potential</th>
<th>Local firms have a better knowledge of local markets</th>
<th>Cheaper inputs in abroad</th>
<th>Investments incentives abroad and better taxation system</th>
<th>Availability to share partners sources and skills</th>
<th>Availability to reduce possible competition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>M &amp; A</strong></td>
<td>+</td>
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<tr>
<td><strong>Property JV</strong></td>
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<tr>
<td><strong>Green Field investments</strong></td>
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<tr>
<td><strong>Exports</strong></td>
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JOINT VENTURE
Preparation for doing business in international environment

Selection of a type of business activities in international environment

Strategy development

Selection of a suitable partner

Sending a Letter of Intent, further partner assessment

Valuation of every partner contribution, setting competencies

Joint Venture Agreement

Joint Venture Management

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Selection of a type of business activities in international environment

Reasons for forming joint venture:

• higher company efficiency
• economies of scale
• sharing of know-how and technologies
• build up an existing market position
• expansion and entering foreign markets
• creation of synergies
• reduction of costs
• penetration to markets with a different culture and customs
• diversification
• access to new technologies and customers
• access to new financial sources
• etc.
Selection of a type of business activities in international environment

Why are we looking at an alliance now?

What do we want to achieve from the alliance?

Is an alliance the best way for us to achieve our goals?

What resources are we willing to commit to this relationship in terms of dollars and staff time?

How is our association most comfortable in the creation of alliance relationships?

How much control are we willing to cede to an alliance partner?

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Selection of a type of business activities in international environment
Strategy development

- Risks
- Sharing
- Costs
- Profits
Selection of a suitable partner

- Cultural aspects
- Financial aspects
- Strategic aspects
- Organizational aspects

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Selection of a suitable partner

Selection criteria

- common mutual goals
- brand
- image, tradition
- size and stability of capital
- market share
- chance for a long life
- economic power, development at last 3 years
- price level of products
- technological level and innovation perceptiveness
- proximity of corporate culture
- conceptions about joint management
- previous cooperation with our company
Selection of a suitable partner

Market position

- Leader
- Other lower positions

Key

- JV strategic importance for a partner
- Minor

<table>
<thead>
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<th>Defence</th>
<th>Challenge</th>
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<td>Preservation</td>
<td>Restructuralization</td>
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</table>

Case study
Letter of Intent

- Company presentation
- Plans and aims of joint business
- Offered conditions and possibilities
- Requirements from a partner

Feasibility study

Signature
Further partner assessment

Due Diligence
Deep audit of a company

auditing a partner to uncover its real legal, economic, technological, ecological, accounting and other status

- financial reports
- operating data
- contracts
- sales and marketing
- business plan
- due diligence of human resources
- ecological due diligence
- competition
- R & D, machinery, technology
- banking information
- etc
Valuation of every partner contribution, setting competencies

**Investment contribution:**
- monetary
- movable property
- real estates
- intellectual property (know-how, patents, trade marks, etc.)
- others

Subject A

- 50% equity share
- Provides:
  - technology
  - equipment
  - bank guarantee

Joint Venture

Subject B

- 50% equity share
- Provides:
  - work place
  - manufacturing plant
  - work force
  - distribution channel
Valuation of every partner contribution, setting competencies

Maximal foreign investor's contribution = 100 %

25 % = blocking minority
49 % = maximal minority share
51 % = minimal majority share
>76 % = no need to consider blocking minority
100 % = absolute acquisition by foreign partner
Joint Venture Agreement

Memorandum of association

Licence agreement
Investment agreement
Management agreement
Purchase agreement
Service agreement
Lease agreement
Joint venture agreement

1. Identification of Joint Venturers
2. Agreement about establishing JV entity
3. Company operation and management
4. Purchase of assets
5. Employees
6. Service agreement
7. Lease contract
8. Business shares
9. Ban on competition
10. Liability and compensations
11. Communication and contact persons

Sample Joint Venture agreement
Joint venture agreement

Memorandum of association

Most often used type of legal entity in the Czech Republic:
- S.R.O.
- A.S.

Most often used type of legal entity in the USA:
- Ltd.
- Inc.
Joint Venture management

1 : 1
capital invested : capital invested
x : y
Joint Venture management

- Dominant
- Shared
- Divided
- Rotating
- Independent
Examples of Joint Ventures

ESTEEMO, Ltd.
NEC Corporation + Panasonic Mobile Communications Co., Ltd.

Boing + Lockheed Martin  
(aerospace)

Hitachi + Nec Corporation
SONY – Leading producer of consumer electronics
Ericsson – technological leader in mobile communications
Capital share: 50/50
Both companies stopped their own single development and production of mobile phones
Headquarters: Hammersmith, GB
9400 employees, 2500 suppliers (18.7.2008)
President Hideki Komiyama, Vice-president Anders Runevald (rotating management)
Acquisition of UIQ Technology (from Swedish SW company Symbian Ltd.)
101,3 mil. telephones sold (2007)
Taxation of Joint Venture

Equity Joint Ventures

Subject A

Joint Venture

corporate profits

Subject B

Dividends - retention tax

Dividends - retention tax
Taxation of Joint Venture

Contractual Joint Venture

Subject A

- contracts

Subject B

- contracts

Direct profits
- from third party contracts
- from sales

mutual shareholding

dividends – retention tax

royalties, licences
- retention tax

Direct profits
- from third party contracts
- from sales

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Legal aspects of joint ventures

Fundamental sources of law
- international agreements
- civil and regulatory law

Auxiliary sources of law
- business conditions
- other rules (Incoterms etc.)
- sample contracts
- business customs
Legal aspects of joint ventures

Conditions for doing business in the CR for foreign citizens according to the Commercial code

Direct entrepreneurship of a foreign citizen in the CR

Equity holdings of foreign entities in Czech legal entities

Registered business place relocation

Entrepreneurship of foreign entity in the CR as a secret partner or a member of association
Legal aspects of joint ventures

It is necessary to respect following laws:

• The trade licensing act
• Foreign exchange act
• Labour code
• Employment law and Law about foreigners residency
• Accounting law
• Law about investment funds and investment companies
• Law of economic competition
• Tax laws and other legal enactments
• Law about prices