CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

# Strategic Partnerships

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**What is the issue?**
While strategic partnerships have grown in popularity in recent years, they often do not meet their intended objectives.

**Why is it important?**
Without proper planning and disciplined implementation, the partnering organizations are likely to experience impaired enterprise and shareholder value.

**What can be done?**
A properly structured approach enables organizations to efficiently and effectively plan and implement strategic partnerships, significantly increasing the probability of reaching their investment objectives.

**MANAGEMENT ACCOUNTING GUIDELINE** | **OVERVIEW**

## Introduction to the Concept

Consider the following scenario: You are the CEO of a large pharmaceutical company. Your drug pipeline is not yielding any new significant therapies and two of your major drugs are facing patent expiration within the next three years. For the last half decade your R&D operation has had little success testing potential diabetes drugs, a major gap in your drug portfolio and a substantial competitive weakness. This has obviously been disappointing to you, your stockholders, and the investment community and has driven the company's share price down. A small biotechnology company, DiGen Therapeutics, has had early success with clinical trials of its diabetes drug. During your company's annual strategic planning process, you and your executive team consider acquiring or forming a strategic alliance with DiGen. However, while DiGen has considerable appeal, it has yet to develop a successful drug or turn a profit in its seven-year existence so it is clear that an acquisition would entail substantial risk. As a result, you believe that a strategic partnership with DiGen, while providing less potential upside than an acquisition, is more aligned with the organization's risk tolerance.

While the circumstances vary, scenarios like this play out regularly in most markets. Certainly, the need for organizations to decide where to invest their finite resources is not a new phenomenon. However, an increasingly dynamic business environment has forced companies to react quicker and more creatively to market opportunities and competitive threats.

Over the last two decades, the pace of technological change has accelerated, shortening product life cycles. Globalization has intensified competition and corporations, particularly publicly traded corporations, continue to face unrelenting pressure to produce profitable growth and stockholder returns. As a result, organizations have become more innovative in their investment strategies and strategic partnerships have increasingly supplemented and supplanted traditional investment growth and profit- ability vehicles such as internal development and acquisition. Partnership arrangements have enabled organizations to enter new markets, test emerging technologies, and exploit existing capabilities faster while, in many cases, reducing downside risk.

## What are Strategic Partnerships?

Strategic partnerships, sometimes called strategic alliances, are collaborations between independent organizations in the pursuit of mutual or complementary objectives. These partnerships can take several forms and generally fall into three general categories: contractual arrangements, equity investments, and joint ventures.

Contractual arrangements involve non-equity alliances, such as distribution agreements, outsourcing relationships, franchise or licensing agreements, and R&D partnerships. They also include symbiotic relationships where organizations that serve seemingly unrelated markets collaborate. For example, many airlines collaborate with credit card companies and offer frequent flyer rewards.

Equity investments generally take the form of minority interests. These investments often occur when an investee company has a market position that is attractive but non-core to the investor company, or when the investee company possesses a technology or a product that is promising but has yet to be market-proven.

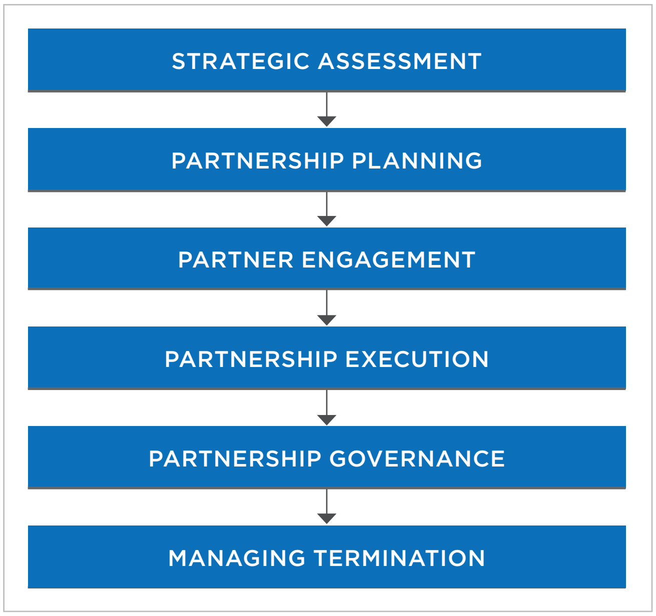
Joint ventures involve two independent companies forming a third entity. Each company contributes resources for a finite period and shares control (and profits or losses) of the venture. The venture can exist for one specific project, such as a major construction job, or for a long-term business relationship, a common strategy for companies that want to enter foreign markets. Such companies typically partner with domestic companies that already have a presence in the target market.

## A Strategic Partnering Process Model

A strategic partnership stands a better chance of succeeding when the companies involved employ a logical, structured, and disciplined approach in the partnership's formation and management. The following graphic (Figure 1) illustrates one such approach:

In the first step of this example, the company initiating a partnership thoroughly assesses, in the context of its own strategic objectives, the potential advantages and drawbacks of coming together with another organization. The company develops a plan that outlines the most desirable form of the alliance, the goals of the alliance, and the profile of prospective partners. It then engages with prospective partners and ultimately executes an agreement with one that is suitable. Once the alliance is launched, the companies implement management, monitoring, and evaluation mechanisms. Finally, many alliances have a finite life so the partners articulate provisions for the orderly unwinding of the relationship.

**FIGURE 1: STRATEGIC PARTNERING PROCESS MODEL**




## Why are Strategic Partnerships Important?

Historically, companies have grown their businesses organically (e.g., through internal investment or acquisition). However, in many instances, strategic alliances have become an attractive alternative to traditional investment approaches. Recently, the Boston Consulting Group estimated that more than 2,000 strategic partnerships are launched worldwide each year. Strategic partnerships have become so popular because, in today's dynamic environment, companies frequently struggle to unilaterally deal with the full range of opportunities and threats they encounter.

## What Differentiates Strategic Partnerships from Other Types of Investments?

While strategic partnerships can provide a lower cost of market entry and the ability to exploit cross-company synergies, they also present firms with some unique challenges:

- **A strong emphasis on cooperation.** Most company managers are hardwired to want control of their business. However, successful alliances (those that yield win-win outcomes), require a foundation of trust and a nuanced cooperative approach. Partnering companies must habitually consider each other's interests and perspective and they must emphasize influencing behaviours over dictating behaviours.
- **The potential for change.** Organizations and managers routinely deal with change, but the potential for change in a strategic partnership is particularly great. Even in the early stages of an agreement, the interests of the partners rarely, if ever, entirely coincide. And, over time, critical aspects of the relationship are unlikely to remain constant. Organizations must be able to react and adapt to

variables such as market change, personnel turnover, and shifts in the underlying strategies of the individual entities. This reality requires vigilance, a high degree of flexibility, and the willingness to terminate a relationship if the interests of the parties are no longer compatible.

- **The transitory nature of strategic partnerships.** Even the most successful strategic partnerships usually have limited useful lives. They are rarely an "end game." By their very nature, they are normally bridges to the future. Although there are exceptions, once the organizations acquire the access or the knowledge they sought when they initiated the partnership, they often change the form of the alliance (e.g., to an acquisition) or unwind it.

## How do Strategic Partnerships Ensure an Enterprise is Sustainable (RAISE)?

As the marketplace continues to evolve at a rapid pace, organizations are faced with the dilemma on how to be resilient, adapt and innovate in their quest not only to sustain a competitive advantage and meet customer/client needs but also to remain as a viable ongoing concern. A useful ideology for ensuring successful implementation of strategic partnerships is CPA Canada's RAISE philosophy (whereby Resilient + Adaptive + Innovative = Sustainable Enterprises).

Properly structured strategic partnerships have consistently been shown to provide ongoing value and relevance. They not only change the way organizations effectively operate; they also provide a repeatable and sustainable method for deriving ongoing value from an organization's customer/client base while the organization reaps ongoing value in return.

At its core, the RAISE philosophy can help guide an organization (or enterprise) towards a unique customer-centric and competitive strategy that provides an ongoing sustainable edge. Strategic partnerships leverage these philosophy drivers by developing resiliency in the face of challenges within competitive customer environments, adapting to sudden market changes, and innovating in response to the ever-evolving market needs. When these drivers of success are combined and leveraged, the outcome is a highly sustainable enterprise. This concept is explored further in this guideline.

## How do Professional Accountants in Business Add Value?

Professional accountants (CPAs) with a sound knowledge of strategic partnerships play a critical role in promoting the RAISE philosophy by assisting an organization in realizing the benefits described in this management accounting guideline series. Senior financial professionals (or professional accountants) are increasingly tasked with assisting in the process of implementing such strategic partnerships.

Although executed for strategic purposes, partnerships have a significant financial dimension. A fundamentally sound partnership arrangement draws on and sharpens the skills and expertise of its financial management team or professional accountant in several ways, in the following forms to ensure sustained value:

## Enabling Value

- **Strategic implementation:** Professional accountants are intimately involved in the strategic assessment, planning, and termination phases of the partnering process.

  For example, the financial team, which typically includes a senior financial executive, can provide modeling and detailed analysis for tasks such as outlining the potential structure of the partnership arrangement as well as articulate related financial projections and tax and accounting impacts.

  The financial team also plays an important role in the ongoing evaluation of the partnership and in any decision to unwind the relationship.

- **Operation participation:** Professional accountants are major contributors to the operational aspects of ongoing actions that are needed to keep the organization aligned with the strategy map. They must be actively involved in the process of linking the strategy map to the management of day-to-day operations.

## Preserving Value

- **Operational management:** Professional accountants in business are major contributors in all operational aspects of partnership transactions. They play a particularly important role in the staging and management of the due diligence process and in the ongoing monitoring of operating results.

This publication is one in a series on *Strategic Partnerships*. The entire series of **overview**, **guideline** and **case study** are available on our **website**. For additional information or for general inquiries, please contact us at **mags@cpacanada.ca**.

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