

Acredula

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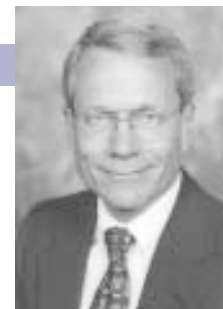
Acredula is the Latin word for "owl," connoting wisdom. This newsletter is intended as wise counsel for boards and executives.

Strategic Alliances Gain Popularity Over Mergers and Acquisitions

This month's issue of *Acredula* begins a series of articles on strategic alliances. Focusing more on partnering than on acquiring, strategic alliances are becoming a popular alternative to the traditional merger or acquisition. The underlying premise behind strategic alliances is that a business reaps greater benefits by forming alliances with other businesses that do certain things better than it does or could. If the other business' culture or infrastructure is key to its success, the alliance typically takes the form of outsourcing. If a separate culture or infrastructure would allow it to be

Editor's Note

more successful, the alliance typically takes the form of a joint venture. This month's feature article deals with strategic alliances, examining what they are and why they are popular. Next month's installment will focus on why some strategic alliances fail and what can be done to avoid those failures.



John P. Beavers
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Strategic Alliances: What They Are and Why They Are Popular

In its May 21, 2001 issue, *Forbes Magazine* examined strategic alliances, with its lead article, "Partner or Perish," setting the theme for the entire issue. The premise of the article, and the issue, is that businesses today are finding joint ventures, joint development agreements, marketing or distribution agreements, and other forms of strategic

alliances "a more productive way to keep companies going" than the traditional merger or acquisition.

So, what are strategic alliances and why are they so popular? This month's *Acredula* will focus on these two questions.



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What are strategic alliances?

A strategic alliance is a form of affiliation that involves a mutual sharing of resources or “partnering.” A strategic alliance differs from a traditional capital transaction as it is more than just an investment by one party in another and does not have an objective of a change in control.

On the continuum of transactions, on one end we have a traditional capital transaction where one party makes a passive investment in another and the resulting relationship is simply financial. On the other end of that continuum, we have the traditional acquisition where one party acquires, incorporates and then operates a business of another, and the resulting relationship is total domination by the acquirer, which typically operates the acquired business as its own.

Strategic alliances lie somewhere in between the traditional capital transaction and the traditional acquisition. In strategic alliances, there is a “sharing” of resources and

more than a passive investment by one party in another. Rather than seeking a change in control, the “sharing” of resources is to be mutual among the parties, focusing on the strengths of each.

Strategic alliances take many forms, from outsourcing a function by one party to another (especially to jump-start one party’s business, pursuant

to a marketing, warehousing or distribution agreement) to jointly performing a function pursuant to a joint agreement (such as researching or developing a product or marketing products) to its most developed form, a joint venture or partnership as a separate organization. The common theme among alliances is that each party does something better than the other, and the alliance allows each party to focus on what it does best.

Why are strategic alliances popular?

Last year, I had the opportunity to talk with G. Richard Wagoner, Jr., Chief Executive Officer of General Motors Corporation, before he gave the keynote presentation to the “Building a Better Board” Conference sponsored by The Ohio State University’s Fisher College of Business in September 2000. Although Wagoner acknowledged that there is much attention on consolidation to become “global and fast,” that is nothing new to industry or commerce. What is new, according to Wagoner, is the way some businesses, especially GM, are doing it—through alliances.

In an environment where many businesses are “buying” and as many others are “selling,” GM’s successful experience with alliances with Isuzu in 1971, Suzuki in 1981, and Saab in 1990 has led GM to conclude that “an alliance approach is a good way to go.”

According to Wagoner, there are several premises involved in GM’s strategic alliances:

1. A recognition that there are businesses, even within the automobile industry, that do things better than GM. Leveraging on someone who does it better allows you to get there faster.
2. A recognition that when one business does something better than another, it is the result of not only their management talent, but also their business culture. You often cannot keep critical management talent actively engaged if you involve them in a cultural change that results from a full merger.
3. A recognition that it takes less time for an alliance to get down to business than for the amalgamation resulting from a full merger or acquisition. A full merger or acquisition consumes time in assimilating one into the other, including distractions from political concerns about who’s taking over whom and who is winning, and instead focuses on getting business results.

Since 1999, GM has joined with Honda to supply GM with engines and transmissions to Honda’s markets and with Isuzu to supply Honda with diesel engines for the European market. There are additional alliances with Fiat and Fuji Heavy Industries. As a result, Wagoner believes that:

The best phrase to describe our company is ‘the General Motors network.’ It’s built around the idea

Bricker & Eckler LLP has been named to the 2001 *Corporate Board Member Magazine* list of Best Corporate Law Firms in America

Corporate Board Member, the only national magazine for the directors of publicly traded companies, released the results of its first annual survey of the best corporate law firms and lawyers in America. In that survey, Bricker & Eckler LLP was chosen as one of the top five firms in the Columbus, Ohio market. (The results are available in the magazine’s August 2001 special legal issue.)

that, with the right partnership approach, one-plus-one can sometimes equal more than two—and that’s why we are increasingly comfortable with leverage over limitation, cooperation over control, alliance over acquisition.

Why should strategic alliances be popular with emerging and mid-size companies?

Strategic alliances should not be dismissed as something that benefits only the likes of GM and other global companies that are trying to remain competitive. As Wagoner has said, an alliance requires another party that also wants to enter the relationship.

The traditional growth strategy for an emerging or mid-size business is to “develop it or buy it.” “Developing it” requires raising capital in a capital transaction that, whether in the form of a public offering or a private placement, consumes time and resources, diverting both from otherwise doing business. “Buying it” through a traditional merger or acquisition also consumes time and resources, and the assimilation required following the buy further diverts time and resources from doing business.

As a result, the current wave in alliance formations is with emerging and mid-size businesses that are looking to partner with larger businesses to accelerate both parties’ growth and profitability. The wave is likely to continue given the lack of availability of capital from venture capital firms or public offerings.

Strategic alliance statistics

Thomson Financial reports that the dollar volume of strategic alliance transactions doubled in the year 2000 from 1996 to nearly the same dollar volume as merger and acquisition transactions in the U.S. The dollar volume of strategic alliance transactions is projected to exceed that of mergers and acquisitions for the year 2001.

The investment banking firm of Houlihan, Lokey, Howard & Zukin reports that alliances have consistently produced average returns on investment that are nearly 50 percent greater than the average overall returns on investment in corporate America. It also projects that by 2004, the top 1,000 U.S. companies expect that more than 30 percent of their revenues will come from alliances.

Strategic alliance examples

In addition to GM’s strategic alliances, here are some examples of big and small companies in a variety of alli-

ances spanning a variety of industries. Many are reported in the May 21, 2001 issue of *Forbes*.

- **Joint venture between Coca-Cola and P&G in the food and beverage industry.** The alliance of Coca-Cola and Proctor & Gamble is perhaps the most noted because it was featured in *Forbes*’ “Partner or Perish” article. Coke changed its strategy from traditional acquisition to strategic alliance after its failed purchase of Quaker Oats. To gain fast access to the snack and non-carbonated beverage markets dominated by competitor Pepsi, Coke has created a 6,000 employee, \$4-million snack and beverage joint venture with P&G that will include Pringles, Hi-C, and Fruitopia along with Coke products.
- **Joint venture agreement of Rivio with Bank of America for online banking industry.** Small Rivio Software did not have the capital to begin marketing its web-based time card, accounting and online banking services. Instead of approaching the capital markets, it enticed Bank of America to contribute \$3 million and access to its 1.7 million customers in a joint venture created to market the web-based products.
- **Marketing agreement of OSI Pharmaceuticals with Genentech in the pharmaceutical industry.** Modest OSI Pharmaceuticals did not have the capital to begin marketing its anti-cancer agent, OSI-774. Instead of approaching the capital markets, it entered into a marketing agreement with giant Genentech. Genentech provided the capital to begin the marketing until breakeven, and thereafter assumed 50 percent of the costs in exchange for 50 percent of the profits.
- **Joint venture of Innovase with Dow Chemical in the chemical industry.** Biotech company Innovase enticed Dow Chemical to enter into a joint venture to allow Innovase to finish development of new

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enzymes that may replace those currently manufactured and marketed by Dow Chemical.

- **Product development agreement of Welch Allyn with Baxter International in the health equipment industry.** Small Welch Allyn, which had developed a patent-monitor system, entered into a product development agreement with Baxter International to combine the monitor system with Baxter's heart pump to form a single, improved product.
- **Joint venture of Robustion Technologies with Walkington, Inc. to manufacture and market fireplace logs.** Robustion Technologies, which had developed a fireplace log made of spent coffee grounds and the process for producing such logs, entered into a joint venture with Walkington, Inc., which has access to retail giants such as Home Depot, to fund the development of a manufacturing facility and the production and distribution of the logs.
- **Joint venture of giants in the telecommunications industry.** Even giants such as Sprint, Telecommunications, Comcast and Cox Communications found the capital markets prohibitively expensive for any of them to individually acquire PCS licenses in FCC auctions. Instead, they formed a joint venture where they pooled

their resources and collectively bought the licenses and funded the building of a PCS network.

- **Licensing arrangements of Polo Ralph Lauren in the consumer durables industry.** Polo Ralph Lauren has entered into license arrangements with West Point Stevens, ICI Paints and others for furniture and housewares that will be marketed under the "Polo" and "Ralph Lauren" names.
- **Technology sharing agreement between Canon and HP in the copier business.** Canon, which had developed the technology toner and toner cartridges, entered into an agreement to share that technology with Hewlett-Packard, which had developed the software and computer chips to operate the cartridges and spurt the toner on product.

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Most of these examples, whether involving small companies or giants, looked to an alliance because the capital markets were either too expensive for, or resistant to, the product, market or business being developed. However, an alliance requires hard work. Next month's issue will focus on why some alliances fail and what can be done to reduce the failure rate.

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