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Partnering for Success - Ways to ensure your partners are making you money



Firms operating in Asia widely accept the fact that external relationships with other companies are essential to viable success. Whether it be a firm's relationship with downstream channel partners, internal constituents, or buyers, complex cooperative partnerships in Asia act as the bloodline to the heart of a firm's success. But how does a firm integrate strategy within the broad notion of relationship management? How can a firm avoid the pitfalls of so many business horror stories of external relationships gone wrong? The managerial decision to enter into a partnership with another firm, such as a distributor or service agreement, can be extremely complicated. The company must consider protecting its resources and market positioning while at the same time maintaining its strategy and mitigating risks of lost profits, reduced leverage, or much more. Asia presents many risk factors – unreliable data, volatile markets, unfamiliar and/or unscrupulous business practices, etc. – that can create resource-consuming distractions for your business. We've all heard widely publicized stories of partnerships gone wrong in Asia such as Groupe Danone/ Wahaha in China that have ended in loss and damage. External relationships with other companies are necessary and vital to the success of a firm – especially in Asia where expectations of

relationships are different than in the West. Is there a way to support managerial decisions to structure optimal external partnerships while at the same time employing strategy to avoid inherent risks? – There is.

Governance Value Analysis (GVA) provides a framework to understand and structure optimal external partnerships and avoid their inherent risks. It is a model that seeks to address marketing strategy decisions, particularly those concerning cooperative relationships.

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Resources, positioning, and governance structure all affect the success of a firm's strategic decisions. GVA was first introduced in 1999 by Mrinal Ghosh, an Associate Professor of Marketing at the University of Arizona's Eller College of Management, and George John, the Chair in Marketing at the University of Minnesota's Carlson School of Management. Woodward Partners recently sat down with Dr. Ghosh to discuss how GVA provides a framework for aligning a firm's channel relationship structures with its strategy

and resources, thus enabling the firm to understand and structure optimal partnerships with other firms.

WP: What should managers consider when deciding on a relationship structure with an external company such as a downstream channel partner or distributor?

Dr. Ghosh: An optimal governance structure should create generated joint value. It should also protect a firm's resources. There are many types of relationship structures to consider. Should a relationship with another firm be based on arms-length exchanges or a cooperative partnership with information sharing? When should a firm choose to vertically integrate instead of opening up to the market? Not all firms react in the same way because of firm-specific differences and other factors that affect decision making – such as positioning, trust, conflict of interest, etc. Governance Value Analysis (GVA) takes this fact into consideration.

WP: With so many factors to consider, how does GVA help managers make these difficult decisions when partnering with another firm?

Dr. Ghosh: By providing a framework for understanding and structuring optimal partnerships, GVA can influence firm strategy in business partnerships. The key is the model's ability to pinpoint what factors affect the type of structure that a company gives to relationships with downstream channel partners, distributors, retailers, and so on. Each firm has a distinctly different set of specific resources that are different than their competitors. These brand resources, technology resources, managerial resources, and so forth affect how relationships should be formed with others. GVA improves managerial decisions by taking into consideration how these resources and positioning within the market affect the design of the supply chain.

WP: What steps should a company go through in the process of choosing the best relationship structure with external partners?

Dr. Ghosh: Firms first need to identify their resources that they possess such as positioning within the market, brand identity, and resources such as technological capabilities. Next, they need to identify the activities that will support and protect their specific assets. The value of the brand is communicated

through certain activities, so the firm needs to seriously consider what steps it needs to take in order to protect this positioning. For example, firms might consider where not to sell the product, the level of product expertise needed from distributors, and other specific requirements for those who would be selling the product or services.

Once firms have done this, they must determine the relationship structure that compliments the firm's strategy while protecting its resources and positioning. Firms may determine, for example, that a national distributor, series of distributorships, or even establishing their own distribution shop is best for their needs. This choice depends on the amount of control needed by the firm, the conditions within the market, and the brand identity as specified above. And what about the incentives in this relationship? It is easy to say, 'I want this to be done,' but who is going to do it? This is the part where you have to identify the incentives such as margins – who gets what – and consider constraints.

WP: Through your framework, have you seen examples where companies could have benefited from considering all these factors before entering into external partnerships?

Dr. Ghosh: Certainly. Take, for example, the decision to have vertical or forward integration in distribution. Strategic factors have to be considered to determine options. This is a balancing act between the beneficial control firms can have when they vertically integrate and the capital intensive costs that arise. Toyota's manufacturing, for instance, is highly vertically integrated due to the company's positioning on reliability. To support their brand positioning, Toyota can justify the high costs of vertical integration for the ability to ensure reliability through high control and protection of their assembly line technology. Our analysis framework shows that the more specific the investment such as knowledge intensive operations with specific technology, the more likely it is that a company would benefit from internalizing an operation. Smaller firms cannot vertically integrate as easily since the upfront costs often outweigh the benefits. GVA helps identify these options and the corresponding governance structure that best supports the firm's resources. Without the best relationship structure in place, given the circumstances, a firm runs the risk of losing precious assets such as profit margins.

WP: For Western firms, the process of entering into partnerships with Asian companies is complex, to say the least. Are there cases of Western firms entering into partnerships in Asia who could have benefited from GVA?

Dr. Ghosh: Yes. We applied GVA to a case study of a Western firm's recent expansion in Thailand. In this example, the Western firm had a strong brand and chose to distribute its products in Thailand through a national distributor. The distributor had a reputable national brand name but not a global one. At first glance it would seem that the Western firm would have a superior position in which to create a relationship with this distributor. It would be easy for the distributor to work with a strong brand name product that would be easier to sell. One would think that the Western firm with the strong brand equity would be in a position of power to negotiate a contract with a distributor for a low operating margin. However, while the brand of the national distributor gave the Western firm credibility in Thailand and a powerful distribution channel in the country, it also created a scenario in which the Western firm relied upon the distributor and reduced its own bargaining power.

Through this cooperative relationship with the Thai distributor, the firm had placed itself in a vulnerable position. In this arrangement, the Western firm faced the risk of entering into a dependent relationship with the distributor who now had high leverage and great bargaining power with the firm. Before entering into a cooperative relationship, the Western firm should have first questioned what the national distributor in Thailand was capable of. Take for example, they have to train their sales people to go into the middle of nowhere trying to sell the product. Are they really good? What are they saying about the brand? The governance structure that the Western firm chose has risks that are difficult to measure. It is so important that these non-observable, non-measurable efforts need to be considered before choosing the governance structure. To account for these risks, the GVA model calls for a firm to impose certain restrictions on the distributor. GVA calls for a contractual safeguarding against these kinds of performance ambiguities. For example, the firm can choose a

governance structure and demand the creation of certain kinds of training, marketing, and logistic procedures by its chosen distributor.

Despite having a powerful brand equity, the Western firm should have first identified its market position and valued resources and then decide upon the governance structure that would best protect itself from the supplier becoming opportunistic. While taking into consideration a firm's resources, positioning, and context, GVA shows that firms with strong brand equity should avoid relational governance structures such as cooperative partnerships. Rather, firms with strong brand equity should use market governance – arms length relationships – that allow for greater safeguarding. As brand equity increases certain bargaining power is reduced.

WP: Dr. Ghosh, thank you for your time and for sharing your insight with us.

For Western firms, the process of entering into partnerships with Asian companies is complex with many risks to consider. Considering the varying perspective and emphasis placed on relationships in Asia, a firm needs to integrate strategy within the broad notion of relationship management. GVA, a framework to structure optimal external partnerships and avoid their inherent risks, applies to both large and small firms either operating in, or considering entry into, Asian markets. Working through distributors in foreign markets entails many risks, and key factors need to be taken into account when selecting the right partners to structure relationships. Many Western companies come to Asia with advanced technology and other assets, such as brand names, but the distribution partners here also hold assets. Structuring the relationship so that both partners are aligned strategically and remain so over time requires careful thought—Woodward Partners helps firms align these relationships effectively.