



# BARBEAU & COMPANY

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## STRATEGIC ALLIANCES Going Global in a Changing World

In preparing this article, it was clear that the need and usefulness of strategic alliances, both domestic and international, continue their evolution in our ever advancing global economy. The existing global security and economic landscape provides a more compelling rationale for businesses to look at the advantages inherent in a well planned alliance. This newsletter will examine the planning issues underlying a successful strategic alliance and will be followed, in our next newsletter, with a review of various forms of alliances currently in vogue.

The inherent advantages of a well planned alliance have become even more significant in the current environment of diminishing hopes for a gentle economic recovery in the short term, and the related increase in national or regional protectionism arising from recent international events. In this environment, the right strategic alliance will provide business with an efficient and effective tool to enhance their business objectives in light of these new economic and global realities and limit their exposure to the corresponding risk that is difficult to quantify.

Alliances, whether created through agency or licensing agreements, or through contractual or corporate joint venture arrangements, have been implemented by businesses entering new markets as a method for efficiently allocating limited resources. Often, alliances are established to allow one party to leverage their business or technological expertise by combining it with some other parties more intimate knowledge of the sectoral, regional or national target market. Today, the prevailing economic environment and the increase in security related non-tariff barriers to trade, makes the argument for a well planned domestic or international strategic alliance much more compelling.

The generally accepted wisdom adopted by Canadian business, arguing in favor of the utilization of strategic alliances in their various forms, is based on two very significant realities. Firstly, there is the recognition of Canada's position in the world of international trade. Notwithstanding the existence of corporate behemoths such as BCE and Bombardier, many Canadian businesses focus on smaller niche, ancillary or support oriented positions in the larger marketplace. These smaller businesses are well positioned to obtain maximum benefit from a strategic alliance.

Secondly, given Canada's high tax, low productivity growth environment, an efficient allocation of limited resources and a strategic awareness of tax reduction strategies again argues in favor of strategic alliance participation. In a practical or pragmatic sense, the efficient allocation of resource consideration, may keep research and development, design and management oriented tasks in Canada, while concurrently encouraging management to shift the manufacturing component of the strategic alliance's business to such jurisdiction which provides the enviable competitive advantage (i.e. lower labour costs, proximity to resources, lower relative income tax rates, etc.).

## The Planning Matrix Where to Begin

Whenever a cooperative arrangement is being contemplated, a clear understanding of the core business relationship between the participants is a fundamental first step. In this regard, each participant must understand the scope of the new business venture, the nature and value of each participants contributions, the delineation and ongoing responsibility for management and control of the new venture, as well as the ownership of new technology or modified existing technology.

Added to these threshold questions, are a number of primary administrative matters which must be considered by the prospective participants, such as restrictions on the transfer of a participant's interest in the new venture to a third party, rights or restrictions on the participants individually competing with the new venture and finally, consideration of applicable dispute resolution methods.

In addition to the above noted core business issues that must be considered, certain legal issues must also be addressed. Depending on the structure ultimately adopted, these issues may include:

- Local foreign investment, joint venture and agency laws and regulations;
- Trade regulations regarding duties, export / import requirements and security regulations;
- Technology protection and mandatory technology transfer laws;
- Income, capital gains, withholding and excise tax laws and applicable tax treaties;
- Competition and anti-trust laws;
- Governing laws and enforceability of judicial and arbitral awards.

Without exception, the prospective participants in any alliance must, at the outset, consider both the core business and related legal issues, when analyzing the merits of the proposed alliance. This planning matrix will establish whether there is a compelling business purpose, and ultimately, a satisfactory legal environment for the proposed alliance.

### Refining the Strategic Alliance's Objectives

In pursuing the strategic alliance, there are two primary objectives or benefits that may flow to the participants. These are best understood as the maximization of the return on research and development without significant additional financial exposure or expenditure and the enhancement of the likelihood of developing a successful venture through the utilization of local knowledge of the domestic business environment. The efficiency that can be realized by entering into such an alliance can substantially increase the individual participant's internal return on investment, in that revenue realized from the alliance will require little additional expenditure and may be derived from a market that would have otherwise been ignored or undeveloped. In addition to managing the economic and financial risk, other forms of less tangible risk to the alliance must be addressed and managed.

### Limiting Relationship Risk

By way of background, large companies historically embraced joint ventures to share the risk of large projects, but the motivation of small, medium and large companies today are more diverse. Today, alliances are seen as a way to help companies manage a variety of issues in addition to the traditional concept of economic or direct financial risk. We need not emphasize that a poor structure or partner choice can doom an alliance from the start, nor that insufficient attention to post-deal alliance management can ruin a promising relationship. Still, it may be useful to summarize how companies can manage alliance relationship risk:

- Avoid competition: the risk of conflict is high in alliances between rivals;
- Define the scope carefully: Even among companies that are not direct rivals, good fences make good neighbors;
- Do not ignore governance: careful structuring of the alliance in advance of the deal and continual adjustment thereafter is essential;
- Do not trust trust: personal chemistry is good and needed, but it is no substitute for monitoring mechanisms, incentives and organizational alignment.
- Success begins at home: without a support system within your own organization, your external alliances are doomed to fail.
- Do not stare at the downside, watch for the upside: Failed alliances do not achieve their objectives, but successful alliances achieve much more than their original goals.

In conclusion, clear business and financial objectives, a proper governance and legal structure and initial and ongoing relationship risk management will effectively enhance the success of any strategic alliance. Attention to these issues will allow business to realize increased return on investment, avoid non-tariff barriers to trade and enjoy reduced incidence of tax through a global taxation strategy for the alliance enterprise.

*In our next issue, we shall examine various forms of strategic alliances.*

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