

# STRATEGIC ALLIANCES

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## DEFINING A STRATEGIC ALLIANCE

Emerging growth companies in search of capital may find that “strategic alliances” offer a good alternative to traditional equity capital sources such as “angel” investors or venture capital firms. What is a “strategic alliance”? While it can take many forms, in essence a strategic alliance is an agreement or joint venture between two (or more) businesses to collaborate and pool resources for mutual benefit. The joint enterprise is called “strategic” when at least one party believes that the joint venture is fundamental to its strategic objectives.

Unlike commonly recognized business entity forms, such as a corporation, partnership or limited liability company, a strategic alliance in and by itself is not a legal form governed by state laws. Take the corporate entity form as an example, if a company that is incorporated in the State of Minnesota does not specifically address certain matters such as preemptive rights in its articles of incorporation, then Minnesota law will fill in the gap and provide for preemptive rights to shareholders. For a strategic alliance, however, it is up to the parties to define the details of their relationship by contract because there is no state or federal law that will per se fill in any blank terms of such alliance.

Frequently, strategic alliances involve an established, mature company (the “Senior Party”) and an early-stage company (the “Junior Party”). The focus of the alliance can involve a wide variety of

subjects, such as research and development, manufacturing, product distribution or licensing. In the biotech industry, a common theme among strategic alliances is for a mature biotech or pharmaceutical company to fund an R&D project that will be carried out primarily by the Junior Party. In return, the Senior Party obtains certain licensing or distribution rights to the product. Many strategic alliances also involve an equity investment by the Senior Party in the Junior Party.

## **BENEFITS OF A STRATEGIC ALLIANCE**

What do companies get out of strategic alliances? What are the benefits? From the **Junior Party's perspective**, strategic alliances can offer a number of benefits, such as:

- access to capital at attractive rates
- obtaining financing for specific R&D projects
- increasing the Junior Party's visibility in its industry and marketplace through affiliation with a more established Senior Party
- access to governmental and regulatory expertise (e.g., the FDA approval process) possessed by the Senior Party
- developing a relationship with one or more potential acquirers

On the other hand, from the **Senior Party's perspective**, there are a number of different benefits to be derived from a strategic alliance, such as:

- access to new technology
- “locking-up” new technology from competitors
- conducting “off balance sheet” R&D
- shortening R&D project cycles
- filling in gaps in product lines
- evaluating a potential acquisition target over an extended time period

## **RISKS OF A STRATEGIC ALLIANCE**

While both parties to a strategic alliance will experience a number of risks, such as the risk of failure, the Junior Party will more often bear a larger number of risks than the Senior Party. The Junior Party may experience a loss of control and independence or even an unintended acquisition by the Senior Party, either through the contractual terms of the alliance or as a result of issuing a significant amount of equity to the Senior Party. For example, the Junior Party may be required by the terms of the agreement to grant to the Senior Party an exclusive license to use the alliance's product for certain applications or in certain geographic markets. The Junior Party may have to relinquish to the Senior Party substantial control of the technology used by the alliance. The risk of failure may also have a greater impact on the Junior Party than on the Senior Party given the relative size and importance of the undertaking to the Junior Party. Finally, care should be taken in structuring the strategic alliance to avoid anti-trust problems or creating an unintended partnership with potential adverse tax consequences to one or both parties.

## KEYS TO A SUCCESSFUL ALLIANCE

The reality is that most strategic alliances do not meet all of the expectations of their participants. Why is this? What distinguishes the successful strategic alliances from the unsuccessful ones? What have companies learned that will help insure a more successful alliance?

Here are some observations companies have identified as keys to a successful strategic alliance:

- Choose a Strategic Partner Carefully. Prepare a list of potential candidates. Find out what experience they have with strategic alliances and joint ventures. Investigate them thoroughly, taking into account their resources, product and service lines, market position, company culture and reputation. Take time to select the right partner—it will be time well spent.
- Select the Right Form of Alliance. Since a strategic alliance may take any form such as a partnership, joint venture or licensing relationship, it is essential for the parties to evaluate their respective needs and goals and select the most suitable form for their alliance. Important factors affecting the selection of the form of alliance include tax planning, accounting, risk management and other related considerations.
- Develop Well-Defined and Mutually Beneficial Goals for the Alliance. It is important to establish the goals and timeframes for the alliance at the outset. This will help avoid misunderstanding or disputes that might arise later. Equally important is that the alliance work for both parties—not just one. If it is not mutually beneficial, then it won't pass the test of time.

- Make Certain there is Multi-Level “Buy-In” and Support for the Alliance at the Senior Party. Frequently the Senior Party is a large company with a large bureaucracy. Having only one advocate at that company—however strong he or she might be—is very risky. There should be “buy-in” for the strategic alliance on multiple levels at the Senior Party for it to succeed over the long term. People come and go—particularly at large companies—and the strategic alliance should not be dependent on the backing of a sole advocate who may leave the organization.
- Develop Key Personal Relationships, Built on Trust, Throughout the Life of the Alliance. Equally important to the business issues involved in the alliance are the people who must work together to make the alliance succeed. Take the time to develop and maintain those relationships as they will likely be key to resolving the inevitable issues that will arise over the course of the alliance.
- Provide for Effective Communications and Management of the Alliance. Most alliances are living relationships that need clear communications and management to develop and thrive. Make sure the lines of communication are open and the responsibilities for managing the project are clearly established from the outset.
- Build in Reasonable “Exit Strategies” for Both Parties. When the strategic alliance is being put together, the parties naturally have great expectations for success. Experience, however, has shown that many alliances don’t meet the parties’ expectations and frequently need to be unwound early. To avoid disputes, the agreement should provide a method for each party to end the alliance under reasonable circumstances.

- Identify Who Owns What Intellectual Property. Inevitably during the course of the strategic alliance one or both parties will expand the use of or develop entirely new intellectual property. For example, the strategic alliance may attempt to patent a product idea brought into the alliance by one party. A good agreement should identify who is contributing intellectual property, how that property may be used by the alliance, and who will own any derivatives of that intellectual property.
- Agree on the Means of Conflict Resolution. No matter how well a strategic alliance is set up and operated, it is also worth the time and effort at the start of the relationship to provide for ways to resolve potential conflicts. The more specific conflict resolution terms are, the better the parties may later rely on such terms to smooth out any obstacles in the due course of the alliance.