# Strategic Partnerships, Alliances Used To Find Ways To Cut Costs

Gregory Bruce, Richard Shermer *Gemini Consulting Morristown, N.J.*

*It isn't enough to strengthen your firm as an individual actor. Every company is part of a collection of firms that influence each other. Growing interdependence is giving these links new importance. Today, you have to use alliances to reach out and shape the forces in your environment....* (Jordan Lewis, "Partnerships For Profit")

In a commoditized industry like oil and gas, building a sustainable source of competitive advantage is difficult at best. By and large, oil and gas companies are packed in a footrace to cut costs, increase efficiency, and gain market share. It is such a tight race that virtually every contender has reorganized, "right-sized," and rationalized to the point that their cost-cutting programs have themselves become a commodity.

Facing this problem, many firms are turning to strategic partnerships and alliances to find new, more-permanent ways to cut costs.

Some firms are using third-party vendors to perform noncore functions at lower costs. Some are outsourcing basic support services, like information systems, that have previously added overhead but not value to their operations. Still others have joined networks of companies to share vendors and services, but without compromising their core capabilities.

Partnerships and alliances offer many new avenues for cutting costs and significant advantages over more traditional approaches.

One of the major benefits of cutting costs through alliances—a complex, relatively new practice that is difficult to master—is that companies that excel in forming and managing alliances can move ahead of the competition and stay there longer than through more internally focused cost-cutting programs.

Nevertheless, to the extent that alliances focus on cost-cutting alone, the advantages are destined to be temporary. The more important, long-term advantage of mastering the art of forming and managing alliances is that it provides companies with opportunities to combine capabilities and build enduring, sustainable competitive advantages by creating new businesses.

In this sense, expertise in strategic alliances will be a major source of competitive differentiation in the coming decade and beyond. It is therefore vital that companies understand the critical success factors underlying strategic alliances.

*"Expertise in strategic alliances will be a major source of competitive differentiation in the coming decade and beyond."*

It is even more critical that they understand the enormous long-term opportunities that can be created by developing competence in forming and managing these alliances.

Those firms that take advantage of these opportunities by bundling operations in new ways to create new organizations will be the industry leaders in years to come.

## A strong alliance

With change taking place all around us, one of the greatest difficulties in forming an alliance is knowing where to start.

There are a wide variety and number of possible partners. The options can seem endless.

Adding to the confusion is the multitude of forms an alliance can take. From informal cooperation, to simple contractual agreements with modest mutual commitments, to formal contracts involving explicit long-term commitments, to strategic networks that may involve many firms—every alliance is unique.

Yet successful alliances do have a few things in common: alignment of purpose, joint senior-management commitment, mutual trust, and clear roles and responsibilities for everyone involved.

While this is by no means an exhaustive list, these success factors usually prove to be the most critical, as is demonstrated by the following case study.

## Alignment of purpose

About 18 months ago, facing low crude prices, shrinking profit margins, and increasing competition, the district managers of six majors in the same Canadian operating area began to rethink their adversarial relationship.

Acknowledging that the traditional win-lose mindset was hurting them all, they agreed to share reservoir management practices, drilling methods, maintenance procedures, management of vendor services, and accounting practices. Their aim was to leverage this shared knowledge and experience into improved profitability at home and greater competitive strength abroad.

At the outset, they agreed on their mutual purpose, allowing senior managers to build commitment to the partnership while maintaining the proper perspective when resolving disputes.

As one executive involved in forming the alliance commented, "One of the most difficult challenges the alliance faced in the beginning was keeping team members committed. It is so easy to back out and stick with the way things have always been.

"The steering committee executives, who oversee the alliance, had to share a common win-win philosophical belief and sense of purpose in order to achieve synergy."

## Management commitment

This type of win-win attitude at the senior management level is an absolute necessity if an alliance is to endure.

Rather than approaching problems with a "What's in it for my company?" attitude, senior executives must work with their counterparts from

other member companies to develop win-win strategies that benefit all. There must be a complete commitment to jointly risking, sharing, and winning as a unit.

This kind of commitment at the senior level impacts the entire organization, enhancing the creation of a cultural shift toward greater cooperation and teamwork from all involved.

Said one executive team member, "Operators who in the past had been rewarded for being good watchdogs over vendors' activities and charges had to develop a different mindset when they joined the alliance teams."

Now they focus not just on cutting costs but also on developing new ways of cooperating to improve the profitability of every firm involved.

## Mutual trust

Developing and maintaining a high level of cooperation requires an equally high level of mutual trust.

The degree of intimacy and credibility developed between partners determines how the alliance will weather high-risk, low-gain periods that are inevitable in the early stages as well as over the long haul.

One of the keys to developing both intimacy and credibility is open information sharing (within the bounds of legality and the terms of the alliance).

As one manager in the alliance explained, "We found that if we really wanted the partnership to work, we had to set the tone...to be the first to demonstrate just what we meant by 'willingness to share.' So, we just laid out our books on the table and showed them what our costs and margins were.

"This really set the tone for the kind of relationship we wanted and made the partners more comfortable in meeting that same level of candor."

This high level of trust, however, does not imply the need for full disclosure. Each firm protects its interests and respects the trade secrets of the others.

For example, one company found that a horizontal drilling technique was particularly cost-effective in a specific field. Another partner was adept at heavy oil recovery. Yet another was proficient at keeping maintenance costs to a minimum.

Each company retained its unique competencies, choosing to share only non-proprietary practices that benefited everyone involved.

## Clear roles, responsibilities

Integral to maintaining alignment of purpose, retaining senior-level commitment, and establishing a solid basis in trust is for each partner, and each person involved in managing the alliance, to have clear roles and responsibilities that are set out within a well-defined accountability framework.

In such a complex situation, it is not enough just to enumerate responsibilities and assign names to them. A team structure is an absolute necessity.

In this case, an executive steering team, consisting of senior managers and executives from each member firm, oversees the strategic direction of the alliance and makes final decisions on the nature and structure of joint initiatives.

Below the executive steering team is a cross-company, cross-functional core team, which serves as the operational arm of the alliance. This team, in turn, manages and sets the direction for a number of subteams that focus on specific target areas such as reservoir management, well bore productivity, drilling, utility costs, and the like.

Responsibilities and accountabilities are clearly delineated, both at the team and individual levels. In addition, a clear communications path spells out who needs to be consulted and who needs to be informed in all major decision processes.

Though laying out this framework may at first seem tedious, and may even appear to some as bureaucratic, the detailed planning has an enormous payout. It avoids confusion, eliminates unnecessary conflict, and fosters cooperation, trust, and understanding among team members.

## Relationships

Relationships are the glue that holds an alliance together.

Alignment of purpose, joint senior-management commitment, mutual trust, and clear roles and responsibilities are the four factors most critical to the success of a strategic alliance or partnership. Common to all of them, however, is an even more fundamental and more important success factor—people skills.

People, after all, make commitments, choose to be open and honest, establish trust, and carry out their responsibilities. It is up to each member in the partnership to understand a partner's perspective, to be sure his or her concerns are heard, and to work problems out productively.

That is why relationship-building skills should be a factor in selecting team members for an alliance.

Alliances and partnerships are like a marriage: Perfect matches happen only in Hollywood. In business, no two firms make a perfect match. Each firm must satisfy its basic requirements and adjust to the needs of its partners.

The operating alliance in Canada is working because people are making it work. Each firm is acting in its own interests, but the members of the joint teams focus on making the alliance work as a whole.

Consequently, the six firms are optimizing the value of their in-the-ground assets by sharing in the best available reservoir management practices.

They are reducing utility costs by benchmarking against each other's best practices.

They are improving well bore productivity by coordinating vendor services and sharing equipment.

They are eliminating duplicate or redundant supervisory and accounting roles when working with vendors.

And they are doing all of this without giving up trade secrets or entering a cartel that might be subject to antitrust litigation.

## The antitrust issue

Unfortunately, the degree to which oil and gas firms can cooperate to mutual benefit is severely limited by antitrust law.

This is especially true in North America, and specifically in the U.S., where a significant anti-oil industry bias exits and the threat of antitrust litigation is very real.

Complicating the issue is lack of clarity in the law itself.

Therefore, careful attention must be paid to any issues that may involve antitrust laws.

The Canadian alliance has avoided any problem of this type by being careful not to share profit or pricing information in any way. In any case, the input of top-notch legal experts is a must.

## Focusing on core strengths

The Canadian alliance is just one example of a highly effective and innovative approach to cost-cutting.

When focus is placed on cost-cutting alone, however, the benefits are usually short-lived. Other companies learn of the alliance, they benchmark it, and then enter alliances of their own.

Soon, the competitive advantage is lost.

To maintain long-term competitive advantage through strategic alliances, a company must remain focused on its

unique set of core strengths.

Companies that focus on a few core strengths outperform others and more readily know when a partnership is needed and beneficial. They know where to allocate resources within the company. They know what to trade with others and what to hold dear. Faced with rapid change, they have a better chance of long term viability.

An alliance between Dow Chemical and Schlumberger is a good example.

Dow's oil field services subsidiary, Dowell, could effectively manage the business during the boom phase of the highly cyclical oil business. Specialized oil field service companies like Schlumberger, on the other hand, were much more adept during times of lower price. So, instead of spending months or years attempting to develop the needed management expertise themselves, Dow moved the unit into a joint venture with Schlumberger.

Dow realized the gain from selling 50% of Dowell to Schlumberger and continues to participate in a growth business. In fact, Schlumberger's management input has carried the expertise well past what Dow could have done acting alone.

Schlumberger grew its core business, while gaining a partner with the strong technical background needed to help it maintain its leadership position in oil field services. It is a win-win situation.

## New businesses

In many cases, companies that focus on their core strengths discover pathways to creating entirely new businesses by forming alliances.

For example, in attempting to grow the natural gas segment of its business, a major oil and gas company found that it needed to place greater focus on customer relations, satisfaction, and communications. To better understand its customers' needs, it broke down its market into distinct customer segments looking for similar benefits.

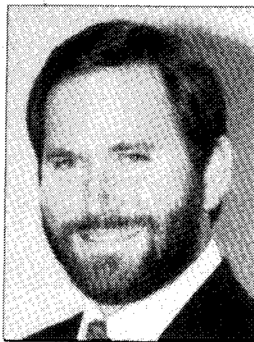
By carefully evaluating each market segment, company managers were able to look at new ways to focus their firm's competencies on meeting customer needs. They formulated a plan to increase profits by helping major fuel users cut energy costs.

They approached companies using massive amounts of coal or electricity (chemical manufacturers, heavy industries like steel and aluminum, etc.) and offered to help them convert to natural gas. Essentially, the sales pitch went like this: "If you will convert to natural gas, we will help you with the conversion, install a natural gas unit or units, absorb some of the costs, guarantee a constant fuel supply, and even manage all operations relating to the energy supply for you. You will save money by cutting out the middlemen (the pipeline company and local utility) and reducing operating costs. We will profit by selling you the gas directly and managing your energy operations."

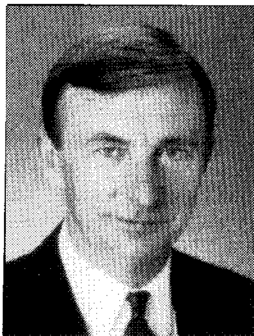
The opportunities to profit from this kind of alliance are virtually limitless.

Products and services can be bundled in new ways to serve the needs of distinct customer segments.

## The Authors



*Bruce*



*Shermer*

*Gregory Bruce is a senior consultant with Gemini Consulting, a global management consulting firm. During the past 7 years he has handled projects for a wide variety of clients, including oil and gas companies. His areas of expertise include organization effectiveness, business reengineering, executive and management development, total quality management, and customer service. Bruce holds an MS from California State University and a BA from the University of California.*

*Richard Shermer is a vice-president with Gemini Consulting. He has more than 13 years of consulting experience. In the past 7 years he has specialized in issues affecting the oil and gas industry. His current work includes reengineering, restructuring, revitalization, and organization-wide transformation. Shermer holds an MBA from Georgia State University and a BS from the University of Bridgeport.*

## Leveraging core strength

The key to success is to leverage your firm's core strength and to ally with firms who need the benefits of those strengths.

Some services add value to a company. Others are a necessary evil that contribute to overhead. In the first case, the services are elements of the core business. In the second, they are not.

When a company produces a service that others can produce more effectively (including transaction costs), it sacrifices competitive advantage. Through alliances, companies can profit by selling their core strengths in one service sector while buying competency from others to acquire noncore services more cost-effectively.

Oil companies are realizing, for example, that effective trading of crudes, intermediates, and finished products can add value of up to 25¢/bbl of crude to their revenue streams. To capitalize on this opportunity, many are now trying to build up their trading capability internally.

The problem is, they are pitting themselves against an established and highly competent industry of professional traders.

Suppose, instead, that a company was to form an alliance with an established trading firm, farming out trading activities to the benefit of both companies.

The company would save the time and cost required to build a trading organization, state-of-the-art trading information systems, and so forth. In other words, instead of trying to build a new competence in what is already a highly competitive industry, why not leverage the ability of other firms who already have that competence?

## Competitive pressures

If the myriad of opportunities that alliances can create is not incentive enough to form them, simple competitive pressures should clinch the argument.

A company can no longer measure its strengths against individual opponents; it must consider how readily its position might be surpassed by others through alliances of their own.

Firms can build strengths with an exceptionally wide set of partners—customers, suppliers, distributors, universities, firms in other industries, even competitors.

By using alliances, firms can grow existing businesses and invent new ones to achieve sustainable competitive advantage. ▪