



Finding the Right Path

Most companies default to the same approach for executing each new strategy. Here's a framework for your journey.

by **Laurence Capron** and **Will Mitchell**

Executing a new strategy nearly always involves acquiring new resources and capabilities. Since firms can't possibly get everything they need through internal development, it seems reasonable in theory to expect that they'll often turn to licensing agreements, alliances, and M&A as well.

Surprisingly, however, the typical firm relies overwhelmingly on one chief way of acquiring resources. In a 10-year global study of 162 telecom companies, we found that only one-third actively use all the methods available to them. Some still develop almost all resources in-house; others focus on licensing or joint ventures; others are M&A specialists. When a firm does add a string to its bow, it's usually just one: for example, M&A to complement internal development. What's more, when asked to explain why they struggle to build new resources and capabilities, few of the managers in our sample seemed to suspect that it's because they're doggedly applying the wrong approach. More than half flagged implementation as the primary cause of problems—in particular a lack of people and skills (67%) and a poor ability to integrate acquired businesses (50%).

By blaming implementation rather than looking at corporate-development strategy, companies leave a lot of value on the table. Our study demonstrates conclusively that firms using all the resource acquisition methods outperform those with a narrow approach. Specifically, firms acquiring resources in multiple ways are 46% more likely to survive over a five-year period than those relying mainly on alliances, 26% more likely than those focusing on M&A, and 12% more likely than those sticking with internal development. It's also worth noting that 54% of managers who haven't paid close attention to the tactics they've used report a high failure rate in resource acquisition, compared with only 20% of those who have looked at the full range of options and made careful choices about which ones to explore.

📖 [Choosing the Right Way to Acquire Resources \(Located at the end of this article\)](#)

Here, we provide a framework to help you become a more strategic decision maker when acquiring resources. We outline three questions you'll need to consider, in sequence, to select the best tactics for the situations you face. In deciding whether to develop existing resources internally, ask yourself if they are relevant to your new needs. If not, it makes sense to pursue a contract or some other arrangement with an external provider. Figure out which way to go by gauging whether all parties have the same understanding of the resources' value. Unless everyone is in agreement, a contract won't work—and you must then sort out what depth and scope of relationship you want so you can choose between engaging in a strategic partnership and making an outright acquisition. (See the exhibit “Finding Your Way to the Resources You Need.”)

📄 Finding Your Way to the Resources You Need (Located at the end of this article)

Our framework builds on our formal research over the past decade and on extensive discussions with managers at established and emerging firms in multiple product and service industries throughout the world. By following this approach to acquiring new resources, you can prime your company for growth.

Question 1: Do You Already Have Relevant Resources?

Developing new resources internally is faster and more effective than acquiring them from external parties when your firm's existing resources are similar to the ones you need and when you outshine competitors in the targeted area. Obviously, this means that most incremental advances are best undertaken in-house. But internal development can jump-start major initiatives, as well. The Israeli pharmaceutical firm Teva, for instance, has begun producing proprietary drugs in addition to its generics by building on existing research skills, both within its labs and through its long-term relationships with academic scientists. Similarly, Neuland Laboratories in India has used its established technical and production base to expand beyond commodity production of active pharmaceutical ingredients and create a contract research and manufacturing organization.

Even when developed internally, new resources and capabilities that threaten to make current ones obsolete will meet with resistance from anyone invested in the old practices, culture, and processes. People may even shun the development of new resources in order to preserve existing values and retain power. As one of the managers in our study pointed out, this has happened in many telecom companies,

where voice traffic departments have been loath to relinquish power to data traffic departments: “In some firms, investments and resource allocations [in] data technologies have been postponed or limited due to this internal competition.”

For this reason, having technical or commercial knowledge that seems functionally relevant isn’t enough to enter a new business. Firms that require different organizational models often fare better if they import new systems rather than adapt what they have. When market pressures (notably in the case of acquisitions) provide momentum, the firm can integrate the new resources with some degree of buy-in from employees and other stakeholders.

Let’s look at the British medical-imaging pioneer EMI and the Indian IT-consulting firm Infosys. EMI attempted to develop a new-generation CT scanner internally when its first device began to face competition. But its efforts were derailed by internal conflicts over resource use, technical trade-offs within its multiple labs, and disagreements among marketing personnel. In retrospect, the company would have been better off identifying and obtaining technology outside the firm. Indeed, it could have turned to the established X-ray equipment maker Picker, which was lagging in the market despite its strong technical capabilities and seeking a partner or even a buyer.

Infosys, by contrast, in-licensed new software technology when it began to offer health-sector services, even though the new services called for tech-development skills similar to those applied in its existing business. The company chose an external source because health care consulting required a substantially different organizational structure. By entering a licensing agreement, it created an immediate presence in the new market segment, bypassing the organizational conflict that would have arisen if the company had attempted simply to adapt its existing offering.

One caveat: Conflict isn’t always something to avoid. You may be able to use it to generate insights that will help you build stronger resources. Be selective, though, because even productive conflict takes substantial time and effort to manage. If internal debates will yield benefits that you couldn’t obtain from external sources, use them—but bring them to a close after the insights emerge.

Also, choosing between internal and external approaches is not a once-and-for-all decision. Smart companies revisit the question all the time as they build their competitive positioning in new businesses. When General Electric entered the CT scan business, for instance, it licensed technology from the early entrant Disco because GE believed that its existing radiography skills provided an inadequate knowledge base to

thrive in the new market. But after GE had expanded that base, it continued with internal development of highly successful CT instruments.

Question 2: Do You and Your Provider Have a Shared Understanding of Value?

If internal development doesn't seem sufficient, a contract such as a licensing agreement may be a sensible route, because it's the simplest way of obtaining resources externally. Pharmaceutical firms, for instance, commonly license the rights to register and market other companies' drugs in particular geographic markets.

However, purchase contracts work only when the parties craft a transparent agreement. They fail when partners don't start with a shared understanding of the resources' value. If one side knows less about that value than the other, it will be reluctant to negotiate a contract for fear of being taken advantage of. Bosch, a German automotive and industrial technology company, considered using a purchase contract to obtain air-conditioning technology from the Japanese firm Denso but decided not to, because Denso had far more knowledge about the value of the resources.

It's even more common to struggle with assessing a contract's value because the exchange of resources has unquantifiable effects. The former Swedish drug company Astra and the U.S. company Merck explored using a simple license to introduce Astra's anti-ulcer drug Prilosec to the U.S. but quickly realized how complicated that would be: They'd need to conduct extended clinical tests and create a new form of pharmaceutical marketing in the U.S., all of which was difficult to reduce to a dollar amount for a license.

When the present or future value of the new resources is elusive, the two parties will struggle to agree on terms and to enforce them to both sides' satisfaction. Coordination will become time-consuming and costly over the long run. Such problems will be attenuated or amplified depending upon the skills of the firm looking for resources. As one manager explained to us: "The more data skills you have, the less intangible this know-how becomes. The more qualitative insights and feelings you have, the more you reduce the risk of not commanding the intangible aspects of the technology you buy." In other words, you need to possess certain competencies before you can acquire a technology effectively.

If you lack those competencies, you must consider whether to engage in some kind of broader alliance with an external provider. Alliances can take many forms, ranging from R&D and marketing partnerships to freestanding joint ventures. They allow firms to

create governance mechanisms that protect the partners from opportunistic behavior. Such mechanisms are often imperfect but provide greater security than arm's-length purchase contracts, and they can establish systems for coordinating ongoing exchanges between the partners as the value of the resource transfer becomes clear. For instance, Astra and Merck commercialized Prilosec in the U.S. through a joint venture, AstraMerck. The partnership accomplished what a licensing agreement couldn't: It established a framework for transferring technical knowledge needed for clinical trials, developing a new approach to retailing in the U.S. gastrointestinal medical market, specifying the financial commitments and rights of each partner, and coordinating and adapting activities over time.

Alliances are most effective when relatively few people and organizational units from each party need to work together to coordinate the joint activities. That was the case in the AstraMerck venture. Similarly, General Electric's aerospace business and the French firm Snecma have maintained a long-term aircraft engine venture, CFM, that rests largely on independent activities by the two partners. Little contact is required to coordinate technical and marketing activities in different geographic markets.

A classic example of an alliance that failed because it was too broad in scope: the attempt by Renault and Volvo to integrate their development and marketing efforts while remaining independent companies. The carmakers created a complex set of governance and management groups to coordinate activities. Their joint work managed to produce a few vehicle offerings but quickly foundered as conflicts arose between the firms. The alliance was far too complex for two independent, presumably equal parties to manage. Renault learned its lesson, though. It insisted on taking the strategic lead in its alliance with Nissan, essentially acquiring control of the Japanese company.

Question 3: How Deeply Involved Do You Have to Be with Your Partner?

Suppose that a partnership won't take you far enough toward your goals—or that generating the resources you want will require the involvement of many people and organizational units. Corporate acquisition might be your best alternative, especially if the relationship between your firm and the resource provider would involve highly strategic assets.

For instance, when trying to find new uses for the active ingredient in the erectile-dysfunction drug Cialis, Eli Lilly decided to purchase cocreator ICOS rather than continue with the firms' partnership. It became clear that the new development efforts

would call for too much coordination over too long a time period for the alliance to keep working effectively.

 In Practice: Eli Lilly (Located at the end of this article)

Of course, business acquisitions are a crude means of obtaining specific resources. They are often costly and disruptive for the merging firms. But they do allow the resource-seeking company to control coordination of targeted and current resources, form a more stable knowledge platform for future developments than alliances would offer, and gather more encompassing resources than discrete licenses would provide. Johnson & Johnson, for instance, has long followed a strategy of buying businesses and then, over time, reconfiguring and integrating the targets with the company's other business units. In this way, J&J has created and commercialized many important products, from Tylenol to drug-coated stents.

M&A needs to be the final choice in the decision sequence because acquiring and integrating your target firm requires so many financial and managerial resources. Keep in mind that overreliance on acquisitions adds to your overall risk and may stretch your M&A integration capabilities too thin. In some cases, a difficult alliance may be preferable to one acquisition too many.

Firms using M&A regularly must be disciplined about selling off the resources they do not need, lest they become overloaded with excess baggage. J&J sheds businesses when it has extracted what it wants. General Electric divests as often as it purchases, after reconfiguring its targets.

It's not hard to see why firms tend to focus on just one mode of resource acquisition. Each approach calls for different selection skills and implementation capabilities, which in turn call for different cultures and organizational structures, and these all take time to build. Although sticking with one mode may work in the short term, the long-term risk is that the company will end up doing the wrong things really well, lagging more broadly capable competitors, and, quite likely, becoming targets themselves.

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Choosing the Right Way to Acquire Resources

Read the Executive Summary

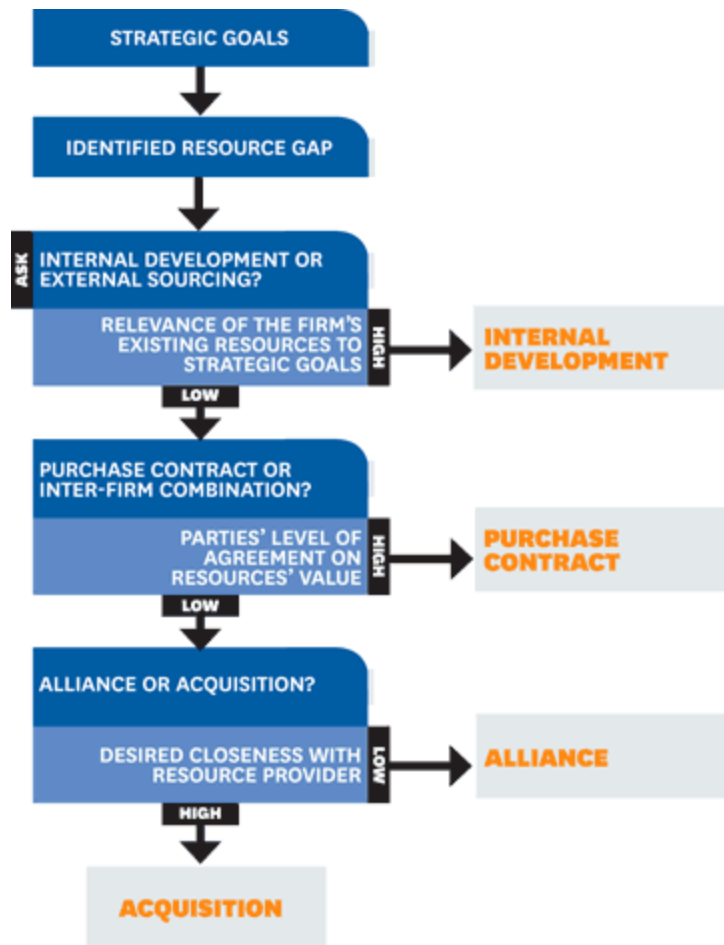
When deciding whether to develop resources internally or obtain them through purchase contracts, alliances, or acquisitions, you'll need to weigh three criteria: the relevance of existing resources to the organization's new strategic needs, the level of shared understanding with third parties (such as potential licensing partners) about the value of resources they will provide, and the desired depth and scope of relationships with those outside organizations.

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Finding Your Way to the Resources You Need

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Go after new resources in the simplest way that will satisfy your strategic goals. For instance, when deciding whether to develop them internally or externally, tweak the ones you already have if they're highly relevant to what you seek. Business acquisition is your most complex option; reserve it for when it really pays to have a close relationship with your provider.



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In Practice: Eli Lilly

Read the Executive Summary

Good corporate development involves cultivating the full range of resource-acquisition capabilities: nurturing internal development, negotiating contracts, managing partnerships, and buying other businesses.

Take Eli Lilly. Several thousand people are engaged in an extensive set of *internal development* projects at Lilly Research Laboratories in the U.S., China, Singapore, Spain, and elsewhere. The company decides whether to invest in such projects by determining which ones will build on its existing capabilities. Around 80% of its major projects focus on three core therapeutic categories: cancer, diabetes, and neurological disorders.

Lilly also actively pursues *purchase contracts*. Over the past two decades, it has secured approximately 200 in-licensing agreements. These confer rights to compounds, products, delivery technologies and devices, development and production processes, software, and geographic markets. Lilly uses basic licenses only when it can negotiate focused agreements to cover the primary contingencies.

But when development and commercialization relationships are somewhat complex, the company typically forms *alliances*, ranging from stand-alone joint ventures to cross-site collaborative partnerships. Lilly created the Office of Alliance Management to help figure out when partnerships make sense and to oversee the ones the firm chooses to pursue. The company now uses alliances to develop products and technologies that draw on the partner organizations' combined capabilities. It has undertaken more than a hundred such partnerships during the past 20 years.

Lilly relies on *M&A* when relationships between independent partners would be too intricate to manage. It has an active acquisition-evaluation team that includes senior corporate leaders. The company has acquired around a dozen firms in the past 20 years, for more than \$14 billion. In 2007, for instance, Lilly paid more than \$2 billion for ICOS, its partner in the development of Cialis. (Almost half of Lilly's acquisitions involve prior partners.) The reason for the acquisition? The relationship between Lilly and ICOS had evolved so that joint activities needed substantial integration, partly to commercialize and develop new dosages of Cialis and partly to investigate additional uses for its active ingredient, such as treating pulmonary arterial hypertension.

The ability to go after resources in the right ways and effectively implement its choices underlies Lilly's successful growth and transformation.

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