Strategic Agreements, Key to the Future of the Internet
Eduard Guiu
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On the day of the merger agreement between AOL and Time-Warner, the hug which Steve Case gave Gerald Levin questioned the nickname of "Alliances On-Line" used to describe AOL. This nickname came about due to the numerous alliances (Tel-Save, Microsoft, Netscape, Cisneros in Latin America, Bertelsmann in Europe, Sony in video consoles) which allowed AOL to lead the multimedia sector. But today, with a different economic and media environment, are strategic alliances still the best vehicle in the Internet world?

A recent study published by PwC indicates that 77 percent of technology companies have some kind of strategic alliance. Moreover, the same companies have an average of seven strategic agreements. So we can see the current validity of a phenomenon which is getting faster and which has had an annual growth of 103 percent over the last five years. There are several causes which explain this turnaround in vertical integration. The defining and definitive characteristic of the Internet is, on the one hand, its speed, and, on the other, its incipient ubiquity. This technological environment evolves quickly and is determinant in the decision making process. And it is here where positioning based on strategic alliances acquires all its logic, since it has the following virtues: a quick geographical input, the possibility to maximise the productivity of the content. Equally there is the possibility of approach through multiple agreements which imply a relatively low cost compared to an acquisition strategy.

Unlike alliances, acquisitions, apart from their economic cost, imply organisational costs through reorganisation, internal tensions and cultural differences. This last point is vital, since if many seem to agree that "the New Economy is dead", it appears that this agreement is also unanimous when distinguishing some specific characteristics of the digital economy. Firstly, an important initial cost, which cannot normally be recovered. Secondly, an almost inexistent marginal cost and, finally, network economies. These characteristics of the information economy establish that, once the initial struggle for a share of the market is over, the latter centres on a dominant producer and allows the other players the possibility to leave this market as the most profitable option.

An example of this can be found in the domination of Windows as the PC operating system. Some define these markets as decantation markets. Markets in which the most important thing is to be the standard, and the standard is that there is a leader. This is one of the keys to the digital economy: to acquire critical size in order to become the standard. And once this is done, all that is left is to manage the hegemony of the market. It is thus understandable that many companies strive to reach agreements in order to develop markets.
Developing a market requires innovation, or, in other words, resources which are drained from the areas considered non-strategic. This logic leads to outsourcing (subcontracting of services) and to a race to concentrate on what one does best, forming alliances with other companies for other activities. This is the theory, what happens in practice? In practice, the companies which participate in alliances offer better results than those which do not ally themselves. They have almost twice as many staff, with an average of 1,559 employees. On the other hand, the companies immersed in alliances forecast revenue growth of 28 percent, compared to 19 percent for those which are not.

**Evolution**

This is clearly reflected on the stock exchange: the evolution of the values which have carried out alliances is better than the evolution of those which have carried out a merger, since many mergers end up destroying value. Hence, it will be difficult to forget that of the ten major merger-takeovers which took place in the year 2000, seven correspond to technology and media sector companies which were intimately tired to the Internet. A series of mergers which moved 465,170 million euros (77.3 billion pesetas): the same as the sum of the Gross Domestic Products of Portugal, Greece and Ireland.

"Which makes more sense in order to compete on the Internet: an alliance or a merger?"

**Antonio Vázquez, Director, PricewaterhouseCoopers**

A priori, an alliance is not better than a merger, nor vice versa. The content of the agreement is much more important than the formal instrument through which it is articulated. The most important thing is to know that you are choosing a good travelling companion. In the Internet world, alliances are popular because they are usually between very young companies with limited human and financial resources which imperiously need to extend their sphere of action. The natural option then comes about to reach agreements with other companies in the sector in order to combine their market offers or to access a large number of customers more quickly. On the whole, they are alliances which are reached quickly since they do not imply any important additional economic effort. Mergers are more complex since the range of undertakings is often greater and implies internal transformations in the operative structures of the companies, transformations which are almost impossible to undo. For this reason alliances are more frequent on the Internet: they are reached in less time and have less impact on the participating organisations.

**África Ariño, Professor of IESE**

The context of competition on the Internet places us in a highly uncertain environment in which it is difficult to forecast which strategic assets will be relevant in order to compete in the future. Which technology will be dominant in the next few years? What will be the key content? Whilst this and other uncertainties continue to exist, it is interesting to maintain different options open with regard to the future. The carrying out of a merger means gambling a priori on one asset or another. Luck is necessary in order for these assets to become the key ones. If they are not key, it will be
difficult to reverse the situation, and one may even run the risk of ending up outside the market. On the other hand, by maintaining a portfolio of strategic alliances we can divide our possibilities amongst several options. The difference between some competitors and others will be determined by their ability to exercise the most appropriate option at the correct moment. The result is that mergers produce a chain reaction, and the last in choosing shall end up with the least attractive option.