The Control-Trust Dilemma

Finding the Right Balance Makes It Easier to Arrive at an Effective Alliance Design

By Ard-Pieter de Man

COMPANIES CAN ADOPT ONE OF two basic approaches when designing their alliances: the control view and the trust view. Figure 1 summarizes the two views by reviewing the assumptions behind each, how they define the key challenge for alliance design, and their effect on the prescriptions provided for how alliances should be designed.

The Control View: Taming Opportunism

The control view makes the assumption that partners in an alliance join the alliance because of their self-interest. Therefore, they will see the alliance as a vehicle to promote their own good, without much regard for their partner's interests. The most important challenge in designing alliances is to create safeguards against opportunistic behavior. This view of alliances was epitomized by a controller of a pharmaceutical company, who described his job in an internal alliance conference as, "I am here to protect us from our partners."

Opportunism in alliances may come in different forms. Often, such actions are small, such as investing slightly less time than the partner does, thus shifting some of the burden to the partner. Sometimes such actions are significant, as in the case of the Danone and Wahaha joint venture. The two partners jointly brought a Danone drink on the market in China. Wahaha, however, took the Danone recipe and also started to secretly produce the drink under its own brand. This view of alliances underlines American writer Ambrose Bierce's definition of an alliance in international politics from his notorious *Devil's Dictionary* as "the union of two thieves who have their hands so deeply inserted in each other's pockets that they cannot separately plunder a third." The possibility that a partner will engage in opportunistic behavior and free-riding based on self-interest defines the control view of strategic alliances.

This view leads to an emphasis on using formal mechanisms in alliance design. The first element is defining commonly agreed-on targets with a partner to ensure that both partners are on the same page regarding what they want to achieve. Making these targets measurable is the first safeguard against conflicts of interest. Clear definition of targets is important, and an extensive planning and control system that measures deviations from the plan, reports progress, and highlights areas for improvement directly follows the target-setting process. Targets may also be set for the inputs that both partners have to deliver to the alliance to ensure that investments are reasonably shared.

The focus on targets immediately raises the question of how the benefits will be shared once a target is achieved. Control-based alliances tend to have detailed value appropriation mechanisms in place, clarifying exactly which revenues and costs belong to whom. This clarification is achieved by the use of many detailed rules to govern the alliance. Elaborate contracts are implemented to cover as many eventualities as possible. An alliance may be open-ended by definition, but the control view sees incomplete contracts as a negative. The contractual space needs to be reduced as much as possible to ensure that—in case of a conflict—the solution to that conflict is completely clear. Senior management up to the board level needs to deal with any remaining issues during the course of the lifetime of the alliance. Therefore, senior management is closely connected to the alliance and provides it with active guidance. If necessary, they will even intervene in alliance operations to ensure that the company's interests are well looked after.

FIGURE 1:
The control and the trust approach to alliance design

	CONTROL	TRUST
Alliance assumption	Partners look out for their own self-interests	Partners benefit from a common interest
	Conflicts of interest are likely to arise	Joint growth and development ensure long-term alignment
Alliance design challenge	Prevent opportunism	Build social capital
View on alliance design	Target driven	Vision driven
	Value appropriation	Value creation
	Rule based; detailed contracts	Principle based; norms and values
	Extrinsic motivation	Intrinsic motivation
	Strong senior management control	Senior management as coach

In short, [control-based] alliances highly rely on extrinsic motivation: sticks and carrots guide the alliance in the right direction, not the personal responsibility that someone feels to contribute to it.

To stimulate both sides to collaborate, their targets are connected to bonuses and payoffs based on alliance performance. Thus, control thinking extends to the individuals who comprise the alliance. People are rewarded when they behave in accordance with alliance targets. In short, alliances highly rely on extrinsic motivation: sticks and carrots guide the alliance in the right direction, not the personal responsibility that someone feels to contribute to it. Structures and systems are in the lead.

This type of thinking also has an effect on the level of the individuals working in alliances. Instead of attempting to align their behavior using targets and bonuses, the trust approach seeks to create a psychological contract with an individual.

The Trust View: Building Social Capital

Whereas the control view departs from the self-interest of partners to join an alliance, the starting point for the trust view is common interest. Although these are two sides of the same coin, the implications for alliance design are profound. The shift in focus from conflict prevention to joint growth entails a completely different view of alliance design. As long as partners are able to identify new opportunities for growth and development, partners' interests will be aligned and the collaboration should be stable. To continually identify these new opportunities, companies must get to know each other, be willing to share their ideas and insights openly, and foster a dynamic culture in the alliance. Doing so requires a high level of social capital; that is, people need to know and trust one another. In the trust view, the challenge is to design an alliance that fosters the social bonds between organizations that are needed to build that social capital.

One way to build these bonds is by developing a joint vision for the alliance. Rather than setting narrow targets, the concept is that companies discuss a broader set of issues. Developing the vision for an alliance demands that organizations exchange their views on long-term developments in their market and how the alliance fits into those views. These discussions enhance mutual understanding and provide greater certainty to a partner's intentions, thus reducing the chance that a partner takes unexpected actions.

"Well, honestly, Doc… I'm not sure you can help me with my trust issues."

The emphasis on growth and development also leads to an emphasis on value creation. By learning and innovating, an alliance can continue to add value to its partners. The well-known distinction between sharing and growing the pie applies. In the control view, the emphasis is on sharing the pie; in the trust view, the emphasis is on growing it. If the partners can ensure that the pie continues to grow, a natural incentive exists for partners to stay in the alliance and to avoid behaving opportunistically and killing the goose that lays the golden eggs. Sufficient value is created for everybody to earn a living.

Because too many rules stifle innovation and creativity, trust-based alliances do not define detailed regulations for what should happen under certain circumstances. Instead, they focus on behavior, such as how the partners should behave when something happens that requires their joint attention. In the design of alliances, such an approach leads to an emphasis on norms and values that support mutual adjustment. An increasing number of alliances implement codes of conduct to that effect. Instead of laying out detailed rules, the concept is that an alliance is more flexible when it is based on certain principles that dictate how partners deal with one another, rather than attempting to cover every possible option in a lengthy contract.

This type of thinking also has an effect on the level of the individuals working in alliances. Instead of attempting to align their behavior using targets and bonuses, the trust approach seeks to create a psychological contract with an individual. Through an appealing vision of what the alliance can mean in its market, employees are positively motivated to contribute. Fun, recognition, and meaningful work tie the partner companies together through their employees. An example is the Future Store Initiative, in which 50 partners collaborated to build a supermarket of the future. The vision was appealing for all involved. The collaboration made room for a variety of new ideas and experiments, which generated energy in the partnering companies and their employees. A memorandum of understanding of only two pages was signed. The trust-based mechanisms of joint vision, value creation, and intrinsic motivation took care of the rest.

If an alliance succeeds in building social capital in this way, elaborate planning and control processes are not needed. When both sides of an alliance automatically do what is in their joint and individual interests, the alliance should run smoothly. Senior management involvement can be limited to a coaching role. For example, they can help remove barriers to the alliance or think along with alliance managers about next steps.

In short, the trust approach builds on the informal elements of alliance design. It is able to do so given the emphasis on growth and development that should guarantee that the alliance is not only beneficial to the partners at its inception, but also continues to add value over time.

Balancing Control and Trust

Obviously, the previous description is somewhat black and white in nature. Many shades of gray exist in between. However, that all alliances end up in the middle is certainly not true. In fact, some alliances clearly depart from one perspective and have completely different alliance designs than when the opposite point of departure is taken.

Both alliance types can be successful. Control is not necessarily better than trust or vice versa. Some people have an instinctive preference for one or the other. Accountants and lawyers tend to like the control approach; entrepreneurs usually have a preference for the trust approach. However, the real issue is to find the right design in the right situation. Thinking that everyone will always be intrinsically motivated to contribute to an alliance is just as naïve as believing that having a good contract in place will in itself ensure the success of the alliance. The point is to custom design an alliance.

Control and trust may strengthen each other. A discussion about all of the issues that may call for greater control can help strengthen the understanding between the partners. Clarity on each other's perspective regarding the alliance may help build trust. Trust may make it easier to share concerns and, as a result, formal rules may be agreed on to alleviate these concerns. In this way, trust may strengthen control. The concepts of control and trust may be intuitively clear, but their practical application is less straightforward.

Each approach has its limits. Although having a high level of trust may sound ideal, the downside may be that the attention paid to the goals of the alliance may diminish when a partnership becomes too intimate. Groupthink may lead alliance partners to ignore or downplay changes in the environment, putting the alliance at risk. A formal control mechanism ensures that alliance partners ask the right questions about their business and help maintain their focus on the goals. In contrast, placing too much emphasis on control may undermine employees' identification with the alliance and the mutual adjustments necessary for effective alliance operations. Processes, procedures, and contracts do not make an alliance. People need to be willing to invest in the alliance, which requires that they form a psychological bond with it. When people identify with the goals of the alliance, the alliance will operate more smoothly.

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Each approach clearly has its limits. An overly heavy emphasis on control will reduce flexibility and creativity in an alliance. It may induce people to focus on the rules instead of the goals. Moreover, the costs of governing the alliance will be high. In contrast, significant emphasis on trust may lead to a loss of focus and lower operational efficiency, and may provide no explicit mechanism to correct free-riding and opportunism. In an alliance that aims to create economies of scale, trust may be ineffective. In alliances aimed at innovation, control will be counterproductive. Therefore, one of the most fundamental questions that needs to be answered when designing an alliance is: What is the right balance between control and trust given the specific aims this alliance seeks to achieve?

Based on detailed case studies of more than a dozen alliances, the general guidelines are easy to identify. More control is necessary when alliance size increases and the partner-related risk is higher (e.g., when collaborating with a competitor). When business risk is high, as in a fast-changing environment, trust is called for because detailed contracts are counterproductive in such a situation. In practice, however, companies face a mix of these elements. In that case, fine-tuning the alliance by taking into account all elements of alliance design is necessary. These include clarity on the strategic imperatives of the

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alliance, formal and informal building blocks, alignment with internal stakeholders, and a view on how to manage alliance dynamics. A detailed discussion of these five elements is beyond the scope of this article. The full version of *Alliances: An Executive Guide to Designing Successful Strategic Partnerships* contains detailed checklists and practical examples of all of these elements. The challenge for alliance managers is to combine these building blocks to create the right level of trust and control and thereby avoid common mistakes in designing alliances (see Figure 2).

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FIGURE 2:
Common mistakes in designing alliances

Lumping lust: adding goals to an alliance, leading to a loss of direction
51 percent fever: the belief that a majority gives control
Set in stone: keeping to an agreement that is past its sell-by date
Inbox indigestion: communicating through emails and letters, instead of at face-to-face meetings
Lack of a joint design: leaving the work of designing the alliance to one of the partners, to a third party, or to deal-makers
JV junkies: having a preference for joint ventures even if not the optimal form
Expertise arrogance: believing that one knows better, even in the area of one's partner's expertise
Equity addiction: using equity stakes to create commitment
Internal incentives: forgetting to adapt internal incentives to fit the alliance
Shaky steering committees: nominating people to the alliance steering committee or alliance board who do not have a stake in the alliance
Committee confusion: creating a plethora of committees to deal with any conceivable problem
A mess for less: selecting a lower-cost governance structure or a faster process, resulting in a structure that does not meet the alliance's needs
Myopic management: focusing on a governance structure that works well today but is not future-proof