FORGING VERTICAL STRATEGIC ALLIANCES

by Erna van Duren, Wayne Howard, and Helen McKay

Buyers and suppliers usually compete for the best deal. But many firms have benefited by collaborating instead of competing. Even in the Canadian agrifood sector, characterized by regulations that pit buyers against suppliers (for several commodities, direct sales from producers to processors are not allowed; negotiation, confrontation, and arbitration by marketing boards are the norm), progressive firms have forged beneficial vertical strategic alliances. Here we look at four successful vertical alliances. Each of these alliances depends on (1) trust, (2) a dedication to the partner, and (3) a mutual commitment to remain independent—all principles which other businesses might follow to improve their own profitability.

Campbell Soup in Canada and Ball Packaging

After the Canada-U.S. Trade Agreement was signed, Campbell Soup in Canada changed its relationships with several suppliers to generate cost savings and become competitive with its U.S. operations. Although Campbell Soup Canada and Ball Packaging had done business for over sixty years, before the Canada-U.S. Trade Agreement neither party used the relationship to its maximum advantage. Campbell simply bought cans from Ball, and Ball simply sold them, even though cans accounted for roughly 20 percent of Campbell's purchases and Campbell cans accounted for about the same proportion of Ball's food industry sales.

Now, Campbell and Ball deal with each other very differently. Their new business relationship relies on openness and trust.

On a day-to-day basis, Campbell continuously reports any expected fluctuations in its manufacturing schedules to Ball. Since Campbell no longer carries an inventory of cans, it must trust Ball to manufacture the necessary cans and deliver them in time to meet Campbell's production schedules.

Ball now provides all Campbell's technical support for depalletizing, can-handing and can-sealing. Ball people work in Campbell plants when needed, and on a scheduled basis to provide advice and lessons for productivity improvements. Ball's laboratories also handle more of the problems that arise in Campbell's plants.

Ball and Campbell jointly design products and packages. A joint task force from the two companies' procurement, operations, engineering, and consulting departments considers new can designs and their adaptability. Through their joint efforts, cans now use less material, and more universal, cost-effective enamels.

McDonald's in Canada and Caravelle Foods

McDonald's, the world's largest quick-service chain, provides high-quality food and exceptional customer service.

McDonald's has used a system of dedicated suppliers for nearly two decades. These independent suppliers sell only to McDonald's.

TRUST

The independence of McDonald's and its suppliers contributes to McDonald's success: independent suppliers maintain quality or they lose the business, and McDonald's can focus its expertise on food service. Caravelle Foods, a dedicated supplier, provides McDonald's Canada with beef products.

Caravelle and McDonald's have worked together on nearly all aspects of their business for nearly two decades. Information about new technology, McDonald's menu promotions, and new products flows freely in both directions. McDonald's informs

Caravelle of anything that could affect production and inventory. The firms jointly develop new products. McDonald's and Caravelle share the understanding that anything that increases retail sales benefits both companies. Not surprisingly, Caravelle's test kitchens are identical to kitchens in McDonald's restaurants.

McDonald's uses open-book costing with its suppliers. Suppliers pass on any cost increases with an agreed-upon fair profit margin. Automatic cost pass-through reduces the temptation to cut corners and reduce quality. McDonald's feels that suppliers should maintain an adequate and predictable profit, both to maintain current quality and to encourage investment in new technology for higher quality and cost savings in the longer run.

DEDICATION

The McDonald's-Caravelle relationship is very close, but they are independent firms with no joint equity. In fact, Caravelle built its plants to supply McDonald's without a formal contract. Caravelle recently built a $12 million plant based on a verbal request from McDonald's.

McCain Foods and UFL Foods Inc.

McCain Foods is a multinational, Canadian-based food company, and its recent introduction of battered french fry products illustrates the advantage of collaboration with suppliers.

McCain's initiated its collaborative relationship with UFL, a Canadian food technology, innovation, and ingredients company. McCain's needed timely, technical expertise to penetrate the U.S. market with a new battered french fry product, as well as to develop a corresponding Canadian market. Without a formal contract, UFL technical people worked hand in hand with marketing, technical, and engineering staff at McCain's. McCain's openly provided key strategic, cost, and technical information needed to penetrate the U.S. market. UFL staff effectively used this information to develop a tasty, low-cost batter for a battered french fry product. Jointly, McCain's and UFL developed a new $40 million plant to export to the U.S. within a very short time. Together they are also committed to reducing costs, so that McCain's can cut prices as the battered french fry evolves from a differentiated novelty to a food service commodity.

The Kellogg Company in Canada, Thompson, Cargill, and southwestern Ontario corn farmers

Kellogg's is synonymous with golden corn flakes. To achieve the golden flakes image, Kellogg's in Canada developed forward-looking collaborative arrangements with grain elevators, which in turn offered contracts to local farmers to supply corn with the required characteristics.

The collaborative arrangement between Kellogg's in Canada, the grain elevators operated by W.G. Thompson and Sons and Cargill's Specialty Crops Division, and corn farmers in southwestern Ontario were developed purposefully and consciously to increase international competitiveness. In the early 1980s, Kellogg's became more selective about the type of corn it wanted for its corn flakes. It was willing to pay a premium for specific corn varieties, but only two grain elevators in southwestern Ontario were willing and able to meet Kellogg's requirements and source the corn locally.

The two grain elevator companies, Thompson and Cargill, coordinate all aspects of corn handling for Kellogg's, including price hedging and monitoring on-farm practices. The companies coordinate scheduling and deliveries on a weekly or even a daily basis. They are beginning work on a fully integrated electronic information system for paperless invoicing and instantaneous sharing of quality standards and other important information.

Kellogg's also works with local corn producers. Each summer it invites them to tour the London, Ontario plant to help them understand the importance of growing the appropriate type of corn, and drying it according to Kellogg's specifications. Kellogg's also monitors their farmers' grain crop for early indications of grain quality. In the summer of 1992, when rain devastated the Ontario corn crop, Kellogg's was able to source corn elsewhere. Early decisions based on quality indicators allowed the farmers to sell in alternative markets for a better-than-average price.

The Case Studies

The strategic management and economics literature report that many firms benefit from strategic alliances, and that successful vertical strategic alliances are based upon trust, dedication, and independence. To see how these principles applied in the Canadian agrifood sector, and to promote "best practices" for the sector, the Canadian Agri-Food Competitiveness Council commissioned the cases reported in this article. The council selected the cases and obtained the cooperation of the participants. (Of course, the authors are responsible for all errors and omissions.)

Each case followed a similar format. The business literature and annual reports provided background information about each company. We interviewed the CEO and relevant vice president at each firm about their vertical strategic alliance—the dimensions of the alliance (e.g., the duration, the number of activities integrated, legal structure, etc.), *ex ante* and current expectations about the alliance, and critical success factors in an alliance. We taped each interview and sent a draft of the case to the company to check for accuracy and obtain a release. Further details are available from the authors.

Advantages outweigh disadvantages

In the cases we studied, the advantages of vertical strategic alliances included survival as a corporate entity, reduced transactions costs, reduced manufacturing costs, and improved quality to meet specific performance targets. In some cases volume discounts and the learning that occurred because of the strategic alliance allowed for further indirect cost savings and productivity improvements

Most participants involved in the alliances felt no existing disadvantages, but potential drawbacks included awkwardness in dealing with potential suppliers, reduced access to new technology not available from the current partner, and problems if the partner goes out of business or wants to end the relationship.

Principles for developing vertical strategic alliances

Based on our case studies we suggest that trust, dedication to the partner, and mutual commitment to remaining independent are key ingredients to a successful vertical strategic alliance.

- *Trust.* Trust is *the* essential ingredient. Indeed, trust critically contributed to the success of each of the strategic alliances reported in the case studies. Trust facilitates discussion, increases the chance that business decisions in the two organizations will be aligned, and reduces surprises. Trust encompasses access to the same information, particularly about the final consumer, and contributes significantly to a mutual understanding of expectations.

  Trust requires competency. The skills and expertise which the partners bring to the relationship lay the groundwork for the partners to meet the expectations of the relationship. But a commitment to do whatever it takes often enables partners to actually come through and meet each other's expectations.

  Trust requires openness and honesty. All the managers involved in the alliances studied indicated the critical importance of openness and honesty. This advice seems obvious. But most firms carefully guard information, and becoming open and honest can be a significant challenge.
- *Dedication to the partner.* A supplier must be completely dedicated to satisfying the buyer's wishes: delivery on demand, quality as requested, etc. Buyers, similarly, must not shop for the lowest-cost supplier and must share strategic information.
- *Mutual commitment to remaining independent organizations.* Both organizations involved in the vertical strategic alliance must commit to remaining independent. The importance of this principle is particularly compelling from the buyer's perspective. In every case we studied, the buyer recognized that the supplier had expertise which the buyer did not wish to have in-house. Quality standards and other performance criteria were easier to maintain through collaboration rather than through transactions with a wholly-owned subsidiary. Remaining independent signals the companies' intention to work together rather than compete.

Vertical strategic alliances are within every firm's reach

Canadian regulations and market structures create incentives for buyers and suppliers to work against each other. Yet, as shown here, agribusiness firms that want to develop vertical strategic alliances have done so. They followed the principals of trust, dedication to their partner's wishes, and a commitment to remain independent to achieve profitable alliances. Following these principals, businesses outside Canada should find alliances even more successful. ◘

■ For more information

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