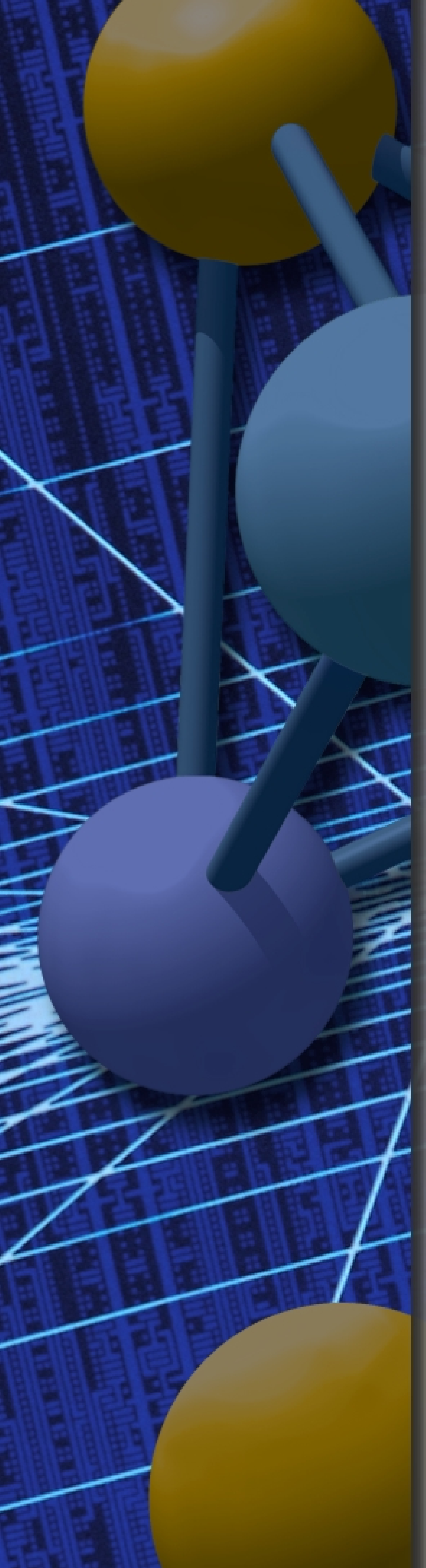


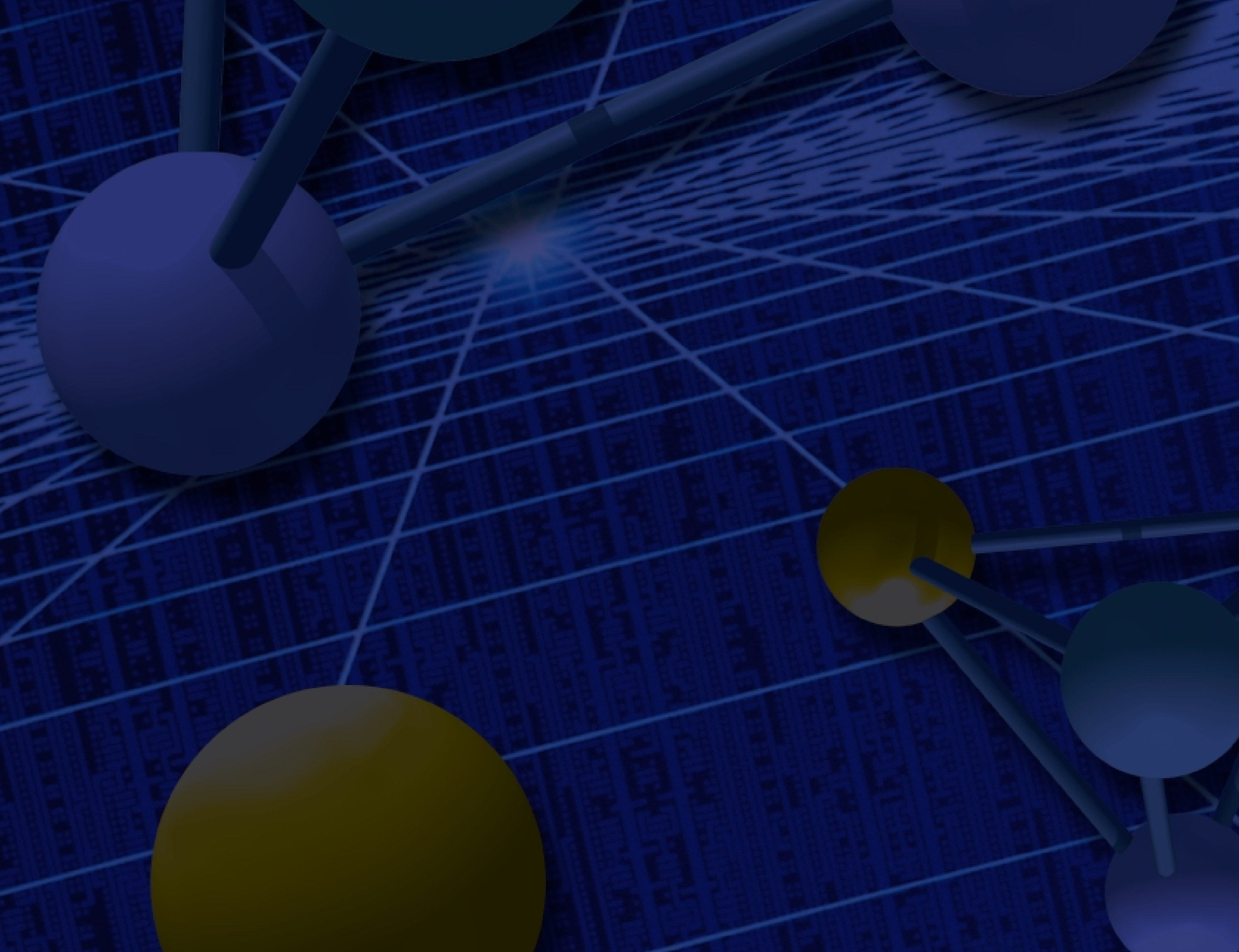
Deloitte Research

The High-Tech Industry and the RELATIONSHIP PORTFOLIO

A strategic approach to dynamic partnering

A high technology viewpoint by Deloitte Research

The demands of the networked economy mandate a radical change in organization and management mindset. As technology advancements and increased globalization lead to more informed and demanding consumers and investors, companies must find ways to be more flexible and innovative than ever. Leading companies are realizing that they cannot provide the world-class solutions customers demand strictly on their own. More and more frequently, successful players are looking for partners. These companies now face the challenge of how to manage, and even how to think strategically about a profusion of global partners. Companies that develop, build, and manage a portfolio of capability-focused relationships that allow them to collaborate innovatively will emerge as winners in this new environment.



The High Tech Difference:
Speed and Flexibility as a Priority

Partnering has always been intrinsic to the success of the high tech industry. The organizational agility that comes with partnering allows these companies to better respond to changing customer demands or shifts in the marketplace. Rather than having to scale up or scale down operations, through partnering, high tech firms are able to enter or exit relationships or even reconfigure the value chain.

More than any other industry, high tech firms routinely form relationships, exchange capabilities, and balance the forces of multiple alliances. To form these interdependencies in any other industry, firms would need an army of external lawyers to write massive contracts stipulating actions for all possible scenarios. High tech firms are built on speed and flexibility and, as such, high levels of protection and risk aversion simply are not part of their DNA. Instead, while partnering key functions to outside providers, most successful high tech firms focus on protecting the basic elements of their competitive position, such as their intellectual property, their engineering talent (knowledge workers), and their sources of supply and manufacturing.

The Challenge:
Managing Risk Amid Complexity

While many high tech firms have eagerly embraced the idea of partnerships and of extending the enterprise through relationships, networks of relationships in the industry are complex and multi-faceted. Many high tech firms operate in a decentralized fashion and are organized in business units representing products or markets. In the resulting network of relationships, thinking about a company as a single member in a portfolio of relationships may be too simplistic.

Consider this example: IBM recently signed a $16 billion, seven-year contract to supply components to Dell Computer. On one level, a division of IBM is a strategic supplier of equipment to Dell. On another level, IBM's personal computer group competes directly with Dell's main business of desktop and laptop computers. Potentially, Dell Computer could also be outsourcing its help desk support, a best-in-class capability, to another division of IBM.

In this example, IBM and Dell have multiple and interdependent relationships, rather than one single relationship. This complexity creates significant strategic issues and poses unique challenges for each member of the relationship. For instance:

- Is the value of receiving components and technology from IBM greater than the competitive risk of IBM and Dell selling against each other in the marketplace?
- If Dell is a significant customer of components and technology for one division of IBM, can Dell put pressure on another division of IBM to offer a lower cost for their help desk support?
- If IBM supplies technology and components, and these components go on allocation due to shortages, should this IBM division supply these components to IBM first, and to Dell second?

This example is hardly unique in the high tech sector. A closer look at some of the leading high tech firms such as Hewlett-Packard, Siemens, Philips, Microsoft, Lucent, and Cisco reveals that they are indeed very complex, multi-divisional organizations with hundreds of relationships with other firms for capability and capacity. In a very real sense, all of these large firms are competitors on some level, and yet highly reliant on each other in a high tech "ecosystem."

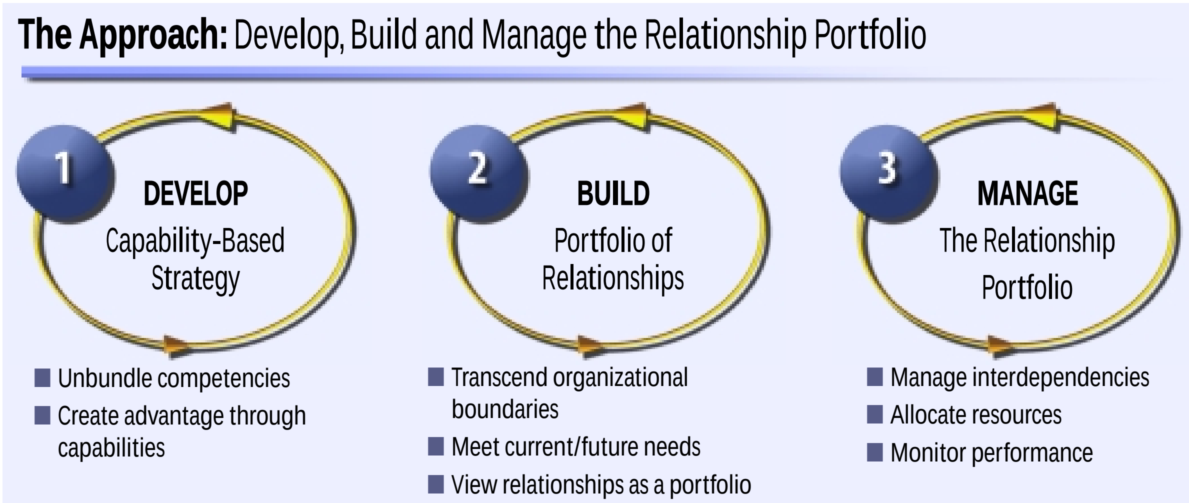
The Solution:
Adopting the Relationship Portfolio

As is evident from the IBM-Dell example, high tech firms still face numerous challenges when it comes to managing their complex capability-focused relationships. While high tech firms thrive on speed and flexibility, they are also increasingly challenged by it. Companies whose markets are in the midst of rapid technological advances have to face the serious impact of suppliers, customers and partners on their networks. Rapid advances in information technology and increases in globalization have created an environment in which survival depends on businesses being more flexible and innovative than ever before. With these conditions, rising customer expectations have exceeded the ability of high tech firms to respond to customer demands anytime, anywhere. Converging markets and the fact that success in the industry is a moving target will require winning companies to extract the very highest value from a broad network of relationships.

High tech firms trying to survive are challenged to manage their partnering process intelligently in order to meet the demands of flexibility and innovation. As strategic relationships become more important and more prevalent along the value chain, high tech companies must take a structured approach to managing the set of relationships: we call it *intelligent partnering*.

Using this approach, companies must move quickly to establish an enterprise perspective of their relationships and manage them as a portfolio. Typically, high tech firms operate in a decentralized fashion, focusing on products or markets, equating centralized control with inefficient and slow processes. However, when a high tech company takes an enterprise view of its relationships, it makes informed decisions more quickly, operates with greater flexibility, and is able to achieve new competitive positions rapidly and with agility. Greater visibility allows seemingly unrelated capabilities to be combined into innovative applications, creating value for the company, its partners and its customers.

Adopting a relationship portfolio (RP) approach also allows a company to reconfigure capabilities and relationships rapidly to meet the growing need for flexibility. Individual relationships can be enhanced or de-emphasized as necessary, with a complete understanding of the implications of each decision. By developing a portfolio of relationships, each in various stages of development and each addressing different links in a firm's value chain, a company can remain flexible with respect to how integrated or modular its value chain is. Companies must not only strive to enhance the effectiveness of new and existing relationships, but also "option" future partner capabilities through relationships. As competitive pressures evolve, a company can further integrate its value chain or outsource certain capabilities without committing itself irreversibly to a particular course. This portfolio approach offers a new flexible framework through which companies can pool expertise and talent, enter new markets, share financial risk, and get products and services to market faster.



SOURCE: DELOITTE RESEARCH

The RP firm sees products and services as "bundles" of underlying capabilities. One company cannot perform every required capability at world-class levels. When a company begins to think of itself in terms of unbundled capabilities, managers can begin to understand how those capabilities are used throughout the company and how they can be leveraged across corporate boundaries. These bundles have multiple potential applications, depending on the other capabilities with which they are bundled. The result is a strategy based on world-class capabilities with an understanding of those the company can perform itself and those that it cannot.

In spite of last year's sharp downturn in the semiconductor sector, ARM Holdings, the U.K.-based microchip designer, has remained surprisingly resilient in the embedded chip market. Rather than produce chips, the company continually updates its core chip designs and patents the chip technology to third-party IT companies worldwide in a range of fast-moving applications, from next-generation mobile phones to digital TVs. In year 2000 alone, ARM's core designs were used in the production of over 400 million chips. Without any costly factories to run, ARM relies primarily on its R&D-intensive workforce to create innovative designs, and attract customers and partners across numerous industries.

These semiconductor companies are part of a decades-long specialization that's been taking place in the world of microelectronics. Early on, the typical semiconductor company had to do everything itself: design and manufacture its products, and build the tools used in manufacturing. Then, in the 1960s, independent tool companies arose. In the 1970s, companies were formed to automate the process of semiconductor design. The 1980s brought so-called fabless semiconductor companies, which design and sell integrated circuits actually fabricated by others. Next in line was the growth of the "unbundled" intellectual-property companies, like ARM, which designed circuits for others to manufacture and sell under their own labels or to blend with other designs into a combination chip.

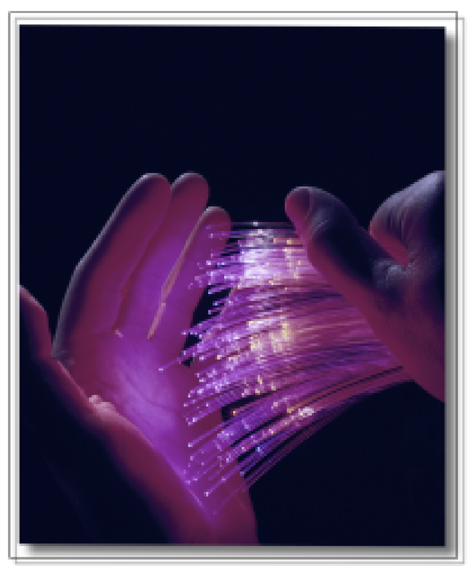
Just as high tech companies have recently adopted an enterprise view of their customers, so too must they be able to take an enterprise view of their extended relationship partners. Creating this view will require firms to understand their own capabilities, their degree of dependence, and tolerance for risk. It will also require them to develop a set of business rules that will allow them to trade off benefits against risk. For instance, 50 percent of Lotus' alliances have no formal agreements, stressing the company's preference for speed, but none of the alliances are integral to the future survival of the organization, which underscores Lotus' risk tolerance parameters.

Companies should use strategic relationships to access or exploit capabilities. The result is a value chain extending far beyond the organization's traditional boundaries. However, when building a portfolio of relationships, not only is it important to select appropriate partners, but high tech firms must also consider each relationship in the context of the portfolio as a whole. This means that companies must acquire and balance relationships across the full spectrum of customers, suppliers and partners. Companies that do so will be able to deliver the greatest value to the customer and will have the greatest chance for success.

Achieving this balance requires a technical infrastructure to connect the vast array of relationships into a real-time value network. Creating this infrastructure brings additional challenges. Some companies excel either at the "front end" (customer relationship management) or the "back end " (supply chain management) of the relationship spectrum, most companies struggle with both. However, a few manufacturers integrate the two dimensions successfully, by leveraging Internet technologies to maximize the value-creation process across the extended spectrum of partners. By differentiating the way they treat each and every customer, by coordinating resources throughout the supply chain, organizations have achieved remarkable gains in profitability.

In this sense, high tech firms maintain and actively cultivate a potentially large number of diverse relationships so that they can compete tomorrow as effectively as today. The RP approach offers this capability because it provides relationships in various stages of development. RP is about evolving relationships; not merely "long-term partnering" but a recognition of the changing nature of the environment and the need to develop relationships now that will serve well in the future. High tech firms that have embraced this concept are uniquely positioned to compete — in both the present and the future.

The Corning Glass network of relationships in fiber optics, for example, evolved over time: An initial portfolio was used to overcome technical hurdles in commercializing the technology, and a second portfolio of users and manufacturers was used to bring the technology to market. Finally, in 1999, Corning exercised one of their relationship "options," acquiring Siemen's share of Siecor, the leading optical cable company. Just as the portfolio is more important than an individual deal, the evolution of relationships over time is more important than the initial deal.



Many high tech firms have realized that this approach offers a significant opportunity to capture value, not just in managing the individual relationships, but also in managing the set of relationships as a portfolio. Doing so successfully means taking any interdependencies among strategic relationships seriously, and tracking their impact on the rest of the portfolio, allocating firm resources strategically, reviewing performance regularly, and acting accordingly

As one step toward managing relationships as a portfolio, some high tech companies have begun to view their relationships in different tiers of strategic priority. With hundreds and even thousands of alliances, segmenting relationships allows a company to serve each level with the appropriate resources. For example, Oracle has over 11,000 relationships at the business partner level and only four or five at the top strategic level. A company's most strategic relationships tend to cross multiple operating groups and extend from exchanges of capabilities to go-to-market relationships. Implementing a tiered structure sets priorities among partnerships and, if performance measures were determined at the beginning of the partnership, sets an evaluation basis for each group. High tech firms should evaluate top-tier relationships on a continuous basis, not just annually, to see whether the relationship continues to add value to the rest of the portfolio of relationships.

Conclusion

As early adopters of partnerships and relationships, high tech firms continue to develop thriving extended enterprises that function as part of a high tech industry "ecosystem." The sheer number of relationships that are in place, and the rapid patterns of change introduce a high degree of complexity to the management of relationships to customers, suppliers and industry partners.

Successful companies are rethinking the way they do business. Unbundling capabilities and organizing them around a relationship strategy, managing relationships from an enterprise perspective, and leveraging Internet technologies to maximize the value-creation process across the portfolio are the first steps in successfully leading the extended enterprise in the networked economy. As the high tech industry continues to transform rapidly amidst market and technological uncertainty, the winners will be those who navigate this rapidly changing environment successfully by managing their portfolio of relationships competently.

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