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The Dark Side of Alliances: Lessons from Volvo–Renault

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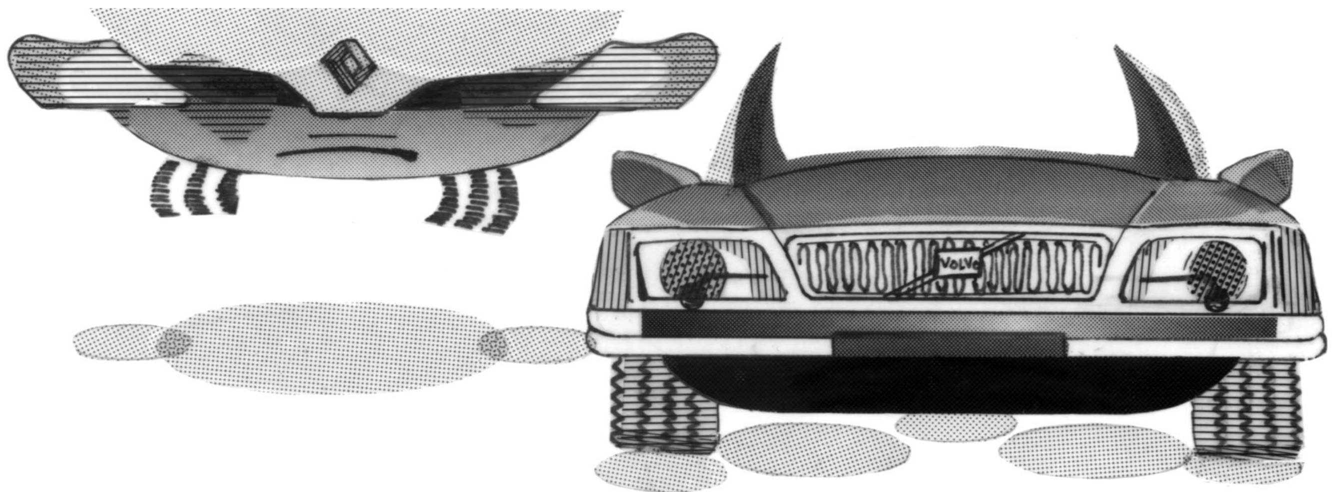

This article explores sources of failure in strategic alliances drawing on field research into one of the most prominent alliance collapses in recent years. The alliance of Volvo and Renault married the two largest enterprises in their respective countries for economic objectives that virtually all industry experts applauded. Three years after its founding, the allies split apart in a bruising argument that left observers reassessing the future of alliances and of European integration. We believe that an explanation of the paradox of 'good motive–unhappy outcome' here is to be found in the 'dark side' of alliances that invites managers to make fatal errors. We identify six factors that undermined the Volvo–Renault alliance: misalignment of senior and operating managers, path dependence, alliance recontracting, leadership style, cultural differences, and time. Alliances are vulnerable to these and other errors. Lessons about them are relevant to all alliance managers and senior executives of corporate allies. **© 1998 Published by Elsevier Science Ltd. All rights reserved**

The strategic alliance towers over the corporate landscape of the mid-1990s. These innovative organizational structures stretch our vision for inter-firm collaboration. In the view of Quinn (1992) and Gomes-Casseres (1994), alliances herald the arrival of the networked or 'intelligent' enterprise, a disaggregated organization concentrated around a core set of knowledge or skills. The rising tide of alliances[1] announced each year suggests a boom in organizational invention and experimentation. The motives and high expectations for alliances form a steady mantra: to gain production efficiencies and the resultant lower costs; to expedite access to technology, markets, and/or customers; to promote organizational learning; to expand strategic competencies;

and to launch a strategic response to a much larger, or more nimble, competitor (see, for example, Powell, 1987 and Lorange and Roos, 1993) These and other motives represent the bright side of alliances.

In the midst of this euphoria it is stunning to find that the track record for alliance success is rather low, with some estimates stating that more than 60% of all alliances fail.[2] Some executives explain that many alliances are formed to promote corporate *development* and that what is nominally a failed alliance is really a very valuable acquisition of knowledge or expertise. Others argue that alliances are similar to taking options on the future. Like an R & D project, failure is inherently part of the process and should be expected.

To be sure, alliance success is often tough to measure. Organizations learn at different rates and one partner might be a slow learner. Certainly, this is the case at NUMMI; GM has not learned as quickly as Toyota has. Or, the intended goal of the alliance is not achieved but one partner reaps windfall profits by virtue of its brief, albeit profitable, association. For example, executives at AT&T point to the millions gained in their sale of Olivetti stock and their subsequent order for telecommunications equipment from the Italian PTT as measures of alliance success, although by all external accounts the AT&T–Olivetti alliance never accomplished its intended goals. For many more firms, the gains are illusory and such education can be quite expensive. Executives who wish to avoid the dustbin of failed alliances must begin by understanding the causes of failure and their possible remedies.

Our own research highlights six key points of vulnerability for alliances which should be the focus for special attention by executives of corporations and managers of alliances. We illustrate these vulnerabilities through an in-depth case study of the failed strategic alliance between AB Volvo and Renault S.A. Our study draws on 20 interviews in Europe and the United States of senior executives at Volvo and Renault, as well as knowledgeable observers in finance and business journalism who followed the alliance closely.

The Volvo–Renault alliance is an exemplar for senior executives. First, it was one of the largest and most prominent alliances in Europe. The two companies were the largest enterprises in their respective homelands. The combination of Swedish and French giants seemed to model the future of European business integration and could have symbolized the best intentions of pan-European cooperation. The alliance promised to shift the strategic paradigm in Europe, creating a muscular world-class competitor out of two smaller producers. For Volvo particularly the alliance was seen as its key to survival. Auto industry experts questioned Volvo's go-it-alone strategy. The industrial motives for the alliance were impeccable: indeed, to this day they remain unchallenged. And finally, the alliance consummated the efforts and outlook of two business leaders who were praised in the highest terms: 'visionary,' 'charismatic,' and 'deeply respected.' The ultimate demise of this alliance starkly illuminates the darker side of these combinations, embracing special issues of strategy, leadership, culture and control.

Founding the Alliance

In 1990 Volvo and Renault agreed to establish a strategic alliance through a complicated scheme of cross-share holdings, joint production and R&D agreements, and supervisory boards. The allies knew each other well through 20 years of industrial cooperation. In 1971 they initiated a cross-supply agreement involving the swapping of gasoline engines for gearboxes. Renault invested in Volvo shares in 1980 (and sold them in 1985, during Renault's close-call with bankruptcy). Volvo's Executive Chairman, Pehr Gyllenhammar, approached Renault's CEO, Raymond Lévy, in 1986 with a proposal for Volvo to purchase Renault's truck manufacturing business. The purchase would have solidified Volvo's lead in the European truck market. Lévy demurred then, but in 1989 opened discussions with Gyllenhammar for a more far-ranging alliance. Lévy drew a parallel between the Volvo–Renault partnership and the founding of the Royal Dutch Shell Group: as the Dutch and British organizations came together in a marriage of equals, so would Volvo and Renault. The timing of these discussions was important: both allies were financially healthy. By the end of 1989, Renault could solidly assert that it had recovered from its distress of the mid-1980s, and could point to its successful new products, *Clio, Espace,* and *Renault 25* as indicators of a promising future. Volvo, too, could look back on several years of dramatic prosperity, fueled largely by its sales growth in North America.

The strategic alliance founded in 1990 was motivated by two primary considerations. First was the desire to exploit sizable potential synergies in joint product development, purchasing, quality and manufacturing. Volvo and Renault estimated that the undiscounted value of scale economies available through the alliance would amount to Swedish Kronor (SEK) 14 billion between the years 1991 and 2000. The second was to combine complementary firms in order to 'create a firm of sufficient size, breadth and depth as to be able to compete effectively in the global industry.' As Figure 1 shows, a fusion of Volvo and Renault was part of a longer-term process consolidation in the automobile industry within Europe. Finally, the sharing of key competencies of each firm might lead to other, less tangible, benefits. The two firms had complementary competencies in market positions, geographic regions, and core competencies, as illustrated in Table 1. However, that

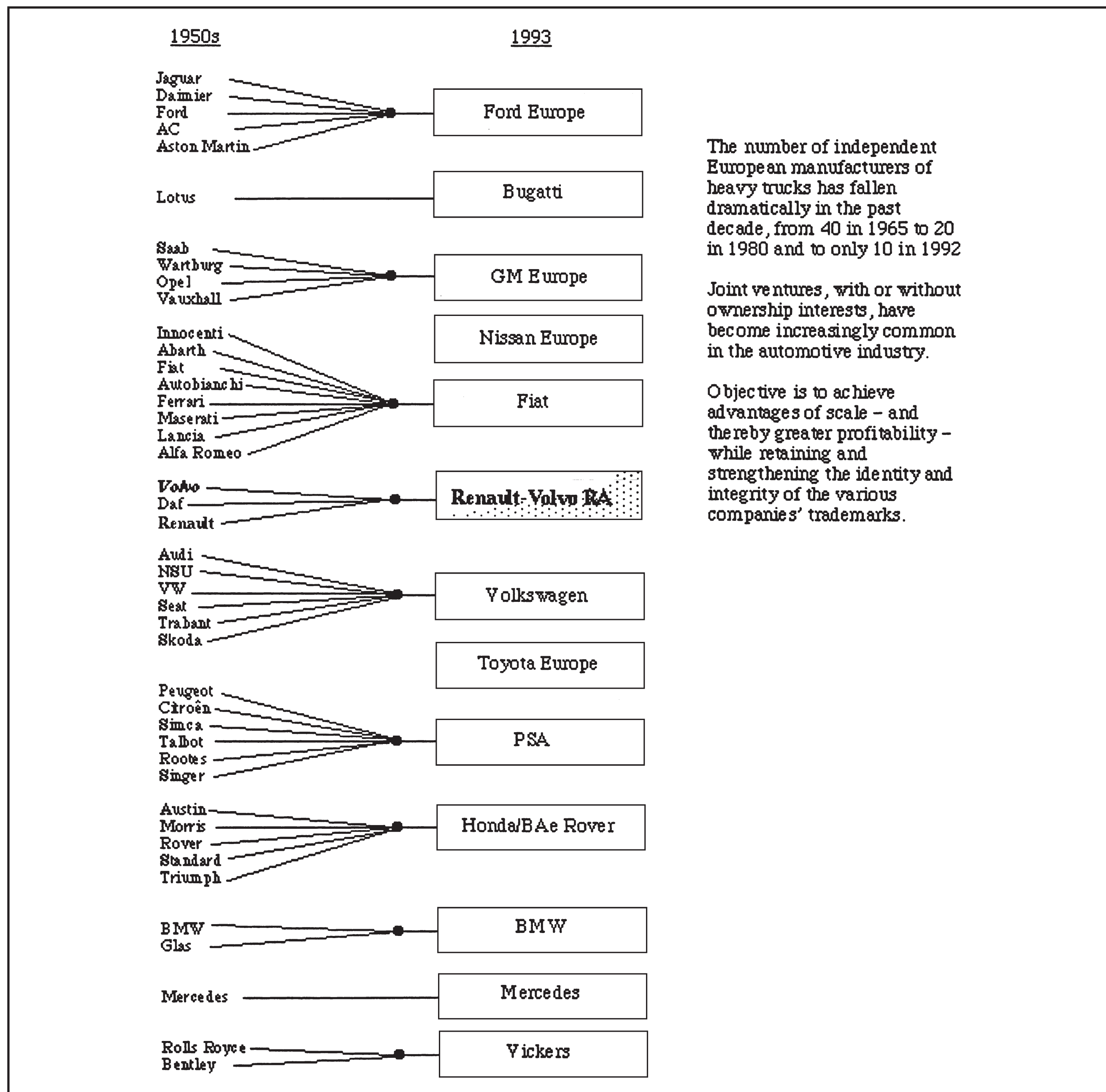

Figure 1 Changing Competitive Structure of Industry.

Table 1 Elements of Difference and Complementarity between Volvo and Renault

	Volvo	Renault
Home country/region	Swedish; Scandinavian; Anglo-Saxon	French; Latin; Continental European
Language	Swedish; (English dominant second language)	French
Ownership	Investor-owned	State-owned
Size/position	Small niche-player in cars. Dominant in heavy trucks	Large, broad product line player. Weak in heavy trucks
Core values and competencies	Safety Engineering	Styling Cost management
Management structure	Decentralized; easy flow of information	Centralized; formal flow of information
Market orientation	Scandinavia, North America, Asia	Continental Europe

table also shows the huge challenge facing the partners: bridging the cultural gulf between both firms.

A schematic diagram of the alliance is given in Figure 2. Key features of the alliance terms were:

- Substantial **cross-share holdings** by each firm in the other, and a poison pill to discourage any attempt to unwind the alliance. Renault and Volvo would hold shares in each other's parent company, thus permitting their CEOs to sit on each other's board of directors. Though cross-shareholdings are unusual in alliances within North America, they are relatively common in Continental Europe. Cross shareholdings were expressions of *strategic intent* of Renault and Volvo to co-mingle their automotive businesses. At one level, one might view this cross shareholding as an 'exchange of hostages' to signal also the joint and mutual commitment of both partners to the future success of their business venture. Through these cross-sharing holdings the ability to untangle the two businesses became quite cumbersome. Given this, one might expect that both sides would work doubly hard to sustain the alliance. The poison pill is not shown in Figure 2, but its terms were complicated, and its impact material. The pill was to impose sizable costs on either party seeking to terminate the alliance. Three years later, Volvo paid Renault SEK 5.2 billion under the terms of the pill. The ownership and control aspects of the alliance created a *path dependency* for the two partners that later would narrow the range of possible responses to unanticipated problems.
- **Equality**. This was evident in the equal division of management appointments to the joint operating committees, the creation of two alliance headquarters (Paris and Gothenburg), and in the choice of neither company's native language as the official tongue of the alliance (English was to be the official language). This equality is remarkable in view of the fact that Renault was several times larger than Volvo in cars, and somewhat smaller in trucks. It is important to note that in the alliance relative size matters little — partners retained an equal voice in the management of the alliance.
- **Comprehensiveness**. Management of the alliance entailed a structure of 21 committees. In order to realize the anticipated alliance synergies it would be necessary to engage each organization many layers deep. While parallel organizations and steering committees are common in Europe and North America, such complexity tends to be a European phenomenon. Again, such complex structures contribute to increasing the switching costs

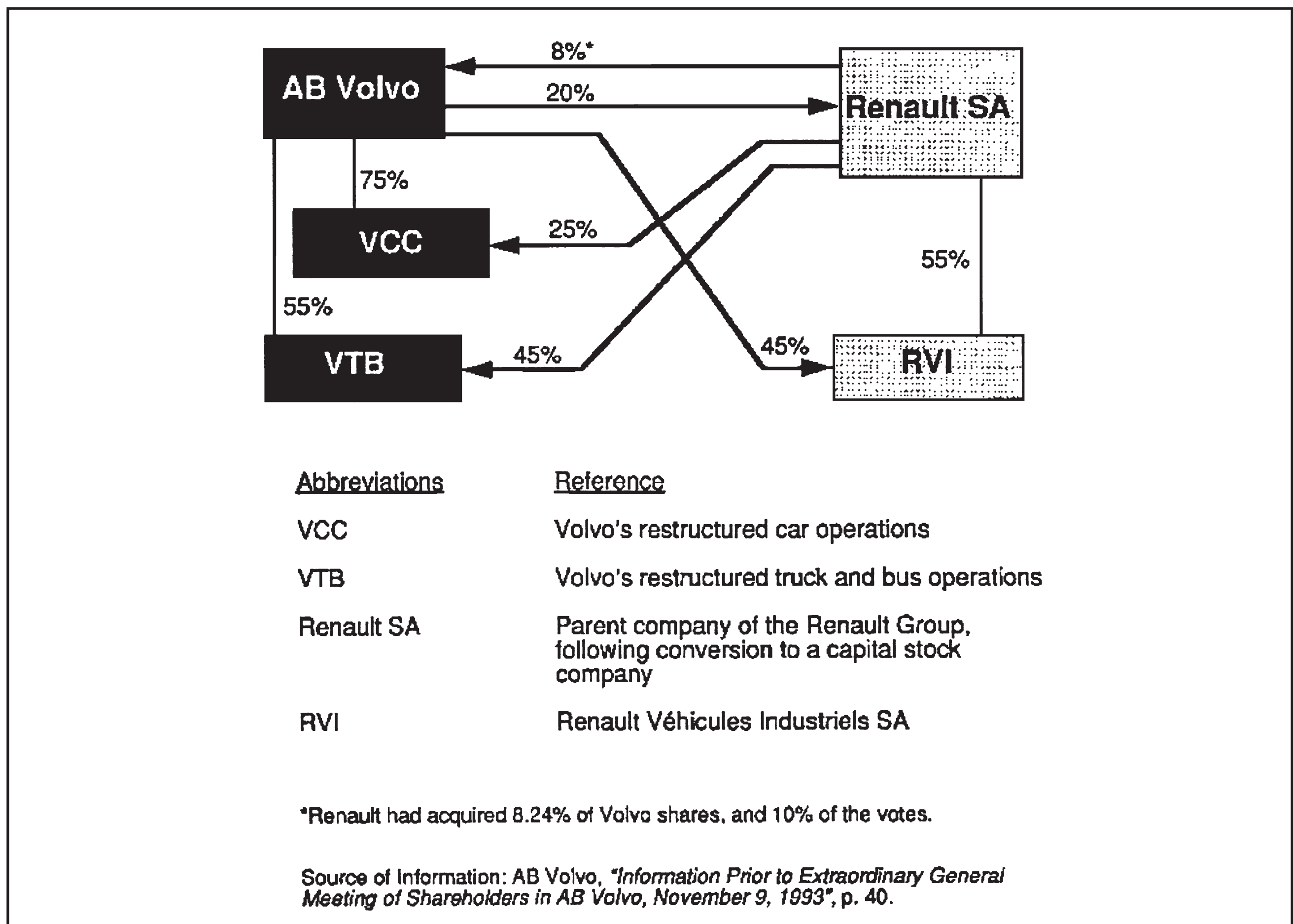

Figure 2 Structure of Strategic Alliance and Cross-share Holdings as of September 1993.

and can lead to a heightened sense of joint commitment. It is not clear that there was any alternative: unlike an *acquisition* of Volvo by Renault, the larger firm could not simply appoint middle- and junior-level managers in Volvo and command them to change the organization. Volvo and Renault needed to engage each other and *jointly* realize the synergies. Such engagement required tight coordination as well as a joint vision of the future. These committees were viewed as the vehicle by which coordination, and cooperation, could be enhanced.

❖ **Brand integrity, operational focus**. The alliance would not entail a combination of the brand names and dealer networks. Rather, it was mainly a creature of the operational side of the two firms: purchasing, manufacturing, and components development. Both firms would gain from the upstream synergies of the alliance but would be free to pursue their downstream options separately. Other alliance research (Doz, 1988) suggests that conflicts tend to arise when partners who cooperate upstream then compete downstream. Yet, Table 1 demonstrates the complementary nature of the partners' markets and products; thereby minimizing potential conflict.

In February 1991 Gyllenhammar asserted that the focus of the alliance was 'cooperation,' not ownership. He said, 'the hierarchical structure will become outdated' in the future, as more firms adopt the cooperative structure typified by this alliance. The alliance afforded a less structured set of linkages between the two firms, at a number of different levels and across a number of different functions. Management believed that such flexibility was needed to ensure mutual growth and heightened cooperation. However, flexibility suffered under the complex committee structure and the cooperation between equals slowed decision making and subtly contributed to a growing sense of frustration at the operational level.

Health of the Alliance, 1991–93

Our interviews revealed a remarkable split in perceptions on the success of the alliance: along Swedish–French lines, and within Volvo, between headquarters and operational executives. Senior executives of both Volvo and Renault indicated that the alliance was healthy and successful. In 1993, Gyllenhammar said, 'When the alliance was made, we had many observers who thought it was complicated, difficult, heavy, and how could it work with a committee structure between two major manufacturers? We can safely say today the alliance has been a success. It developed much better than skeptics thought and better than we had hoped.'

By 1993, the components exchange had worked well. Yet, this exchange had a long history of success. Purchasing had begun to realize economies, but would take more time to achieve full potential. However, these economies were never fully quantified and the amount of the full financial benefits remained rather vague. This lack of specificity can be compared to other alliances in which partners are quick to document the gains made and the savings achieved. For example, early in their alliance, KLM and Northwest airlines were able to point to $23 million in savings attributed to economies in purchasing and maintenance. Such gains are often viewed as the 'low hanging fruit' of the alliance. Quality efforts between Volvo and Renault had made some headway. The two firms could look to successes such as the development of a new family of rear-axle drives, and the establishment of a joint venture for manufacturing buses in France. The language difference was still a concern, though the French had made strides in mastering English. However, some newspaper accounts reported that Renault engineers reverted to speaking French in moments of conflict, and that some Swedes perceived that as a means of excluding them.

Many observers believed that by 1993 the alliance had exploited the easy gains, and that more difficult challenges lay ahead. Operational executives at Volvo expressed dissatisfaction with the alliance. Our interviews revealed two projects that exemplified these challenges:

❖ **P4 Project**. The effort to develop a new common platform for a high-end executive car occupied 200–300 engineers. For the French and the Swedes, the design of a flagship-model car summoned forth the greatest skills and strongest feelings. Among car people, emotions run high when new models are conceived and designed. The French were proud of styling and cost containment skills behind the successful new models introduced in recent years. The Swedes were especially proud of the engineering and safety embedded in the Volvo cars — indeed, engineering was the 'real heart of Volvo,' as one executive told us. Volvo's newest model, the 850, had taken eight years and SEK 7 billion to launch. Renault worried that Volvo's engineering gains came at great expense. Certainly, the delays and cost over-runs are far in excess of the Japanese auto makers who represent 'best in class.' Models built on the P4 platform were to be launched in 1997. The French proposed that the P4 be a front-wheel drive car; the Swedish engineers strongly wanted it to be rear-wheel drive, similar to the Mercedes-Benz S-class, and the BMW 500 and 700 series cars. A front-wheel drive design would require the engine to be transverse-mounted which raised other problems. For instance, Volvo produced a modern six-cylinder in-line engine, powerful enough to drive an executive car, and which met both European and American emission standards. But it was too long to be mounted transversely. Renault could supply its

own V6 engine, which was short enough to be mounted transversely, but could not meet American emission standards, where Volvo had a material market presence. One solution was to buy a V6 engine from Mitsubishi with whom Volvo already had a joint venture, but this was unpopular with the French. Finally, computer-simulated crash tests revealed the platform to be too light: the engine could be pushed into the passenger compartment. The safety-conscious Volvo engineers insisted on strengthening (i.e., increasing the weight of) the platform; Renault engineers were concerned about weight, cost, and development time. With a launch planned for 1997, the final commitment on the platform would be needed in six months.

“The suspicion among the Swedes was that the French fought because of power-seeking”

❖ **Truck production**. Questions about truck production illustrated the need for making hard decisions to rationalize the efforts of the two firms. Truck buyers were much more sophisticated than car buyers and perceived Volvo engines as being higher quality than Renault engines. Since the price of Volvo trucks was higher than comparable Renault trucks, it might be possible to acquire a Volvo engine and engineering for less money, by buying a Renault truck. Volvo's solution was to propose that Volvo assume responsibility for all production in heavy trucks — where Volvo ranked second in world production — and that Renault assume responsibility for production of medium and light trucks where it had good volume. Renault resisted, pointing out that *it* had a very strong heavy truck position in France. Observers sensed that Renault's truck operation was afraid of being swallowed by Volvo, and that Volvo feared losing, or diluting, both its brand identity and consumer franchise.

A leading business journalist in Sweden, Sven-Ivan Sundqvist, told us, ‘They would have fights on these committees that were technically about some operating matter. But the suspicion among the Swedes was that the French fought because of power-seeking.’ Michel de Virville, Executive Vice President of Renault said, ‘To run an alliance by committees takes time, and time as everyone knows, is money.’

With a 50:50 control arrangement, both sides had the power to veto decisions. There was concern that with an equal voice decision making would stall and time would be wasted as the partners attempted to reach consensus on key business issues. Many of these decisions were very sensitive. On the industrial side, they could affect the allocation of production, and jobs, between Sweden and France. Renault, a state-owned enterprise, was especially sensitive to the loss of jobs. In the area of new model development, the two firms were protective of their respective brand identities. But real cost savings lay with both eliminating redundancy and replacing a product completely; it would be difficult to obtain large savings with old products in the system. Compromises on product design would tend to erode savings. Without a dominant partner, it was believed that compromise would result in sub-optimal decisions and a potential loss in agility. In contrast with this view, Corning, a recognized alliance expert, views equal control as a positive force since partners are compelled to work harder to achieve their espoused mutual gains. Corning appears to be driven less by issues of power and control, and is more focused on fostering commitment and trust. Equal commitment acts to lessen the likelihood that one partner will act in his own self-interest to the detriment of his partner. Commitment holds opportunistic behavior in check.

Gyllenhammar and Louis Schweitzer (Renault's CEO beginning in 1992) believed that the first two years of the alliance had proved its wisdom, but were impatient with the pace of joint work and integration. He and Gyllenhammar viewed merger as one obvious solution. Other research (Chesbrough and Teece, 1996 and Deeds and Hill, 1996) suggests that when one is concerned about speed and control an alliance might not be the most efficient organizational mechanism and that a merger might prove more effective. It appears that the term ‘effective’ is used to mean control in that in a merger one partner typically retains a dominant position.

Transforming the Alliance Through Full Merger

Gyllenhammar and Schweitzer claimed that merger had always been the ultimate aim of the strategic alliance established between Volvo and Renault. Other interviewees disagreed on this point. For a non-trivial segment of Volvo employees, the notion that the alliance was merely the first step toward merger may have come as a surprise. Almost concurrent with the merger talks, the French conservative party gained power in March 1993, the new Minister of Industry told Schweitzer and his senior management team to prepare for privatization. Renault would probably be privatized late in 1994. Privatization would have an immediate effect on the value of Renault's market value which determines the exchange value of stock upon which the merger is based.

Gyllenhammar and Schweitzer believed that it was

now or never: if the two firms were to wait until the privatization process were complete, the economic opportunity might have passed. If it is true that progress within the alliance was beginning to stall, then the solution to merge would have assumed some urgency and dictated a consummation before Renault was privatized, rather than in 18–21 months. Senior Management's belief was that through a merger cooperative sentiments give way to a more hierarchical structure — decision making can move faster. Although a merger appeared to be the obvious solution, management's obsession with time and the need to move fast presented a number of unforeseen problems. Nonetheless, serious merger talks between Volvo and Renault began[3] in April 1993.

In August, the press published surprising financial results for the two firms. Volvo's second-quarter earnings surged fourfold in the second quarter, and the firm reported a return to profitability for the first half. This dramatic turnaround reflected a resurgence of the North American auto market. In contrast, Renault reported pretax profit in the first half of 1993, down 87% from the previous year. The firm blamed the earnings decline on lower sales in anaemic European car markets. As the economic fortunes of the partners reversed, the question of privatization took on even greater importance for Volvo share holders — their concern for the market value of Renault's shares became paramount.

On September 6, 1993, the Chairmen of Volvo and Renault announced the terms by which their auto and truck manufacturing businesses would merge. Schweitzer said, 'To achieve economies you need speed and determination. This is easier to achieve through single management than through partners who are in complete agreement.' It is important to note that neither Schweitzer nor Gyllenhammar acknowledged the symptoms of a serious illness that surfaced at the alliance's operational levels.

Gyllenhammar called a special meeting of the shareholders for November 6, 1993 to obtain their approval. He was confident that approval would be obtained. Viewing this as mainly a discussion between Volvo's shareholders and board of directors, Schweitzer declined to take an active role unless asked. Following the announcement, the two leaders commenced a 'road show' to present the proposal to the financial community in Europe and North America, and to their respective organizations. Blinded by his vision of the future, Gyllenhammar woefully underestimated the resistance that sprung for a number of key stakeholders.

The proposed merger would create Renault–Volvo RVA to be owned 65% by the French Government, and 35% by AB Volvo. The *pro forma* 1992 sales of this group would have ranked the firm sixth in size in the worldwide auto industry. The firm would employ 200,000 persons, and be headquartered in Boulogne-Billancourt, a suburb of Paris, and the location of Renault headquarters. Figure 3 gives a diagram of the ownership and governance structure of Renault–Volvo RVA.

RVA would be directed by a Management Board under the supervision of a Supervisory Board. The Supervisory Board would have extended powers and would be called upon to decide on major financial issues. To be nominated Chairman of the Supervisory Board would be Pehr Gyllenhammar. The Management Board would be responsible for the operation of Renault–Volvo RVA. The French Government would nominate Louis Schweitzer as the Chairman of the Management Board and CEO of RVA.

The Government announced that it intended to privatize Renault in 1994, and that it would sell its shares principally to a *noyaux durs* (literally, 'hard nuts,' i.e., a hard core) of investors. Leading candidates for this hard core included Matra (a French industrial and automotive manufacturer), and French financial groups with ties to the French Government, such as Société Générale, Groupe Suez, and Crédit Agricole.

Gyllenhammar and Schweitzer pointed to three main reasons for the merger. The first was competitive advantage. The combined firm would rank second in world production of trucks after Daimler-Benz, and sixth in world production of passenger cars.

Second, the CEOs sought to exploit operating efficiencies in procurement, research and development, and production. Volvo explained that these economies would amount to an additional[4] SEK 16.4 billion (FF12 billion) on an undiscounted basis between 1994 and 2000. However, these figures were not substantiated by public announcements of specific savings achieved during the time of the alliance. Moreover, it wasn't clear that these two gains could

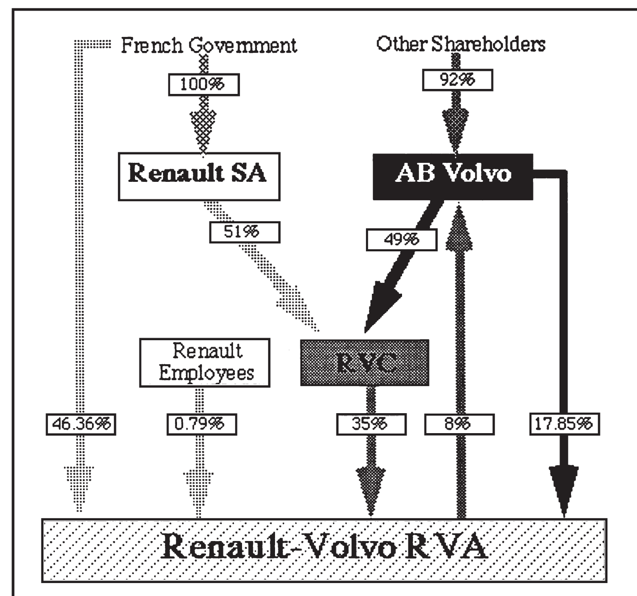

Figure 3 Proposed Structure of Ownership of Renault–Volvo RVA, Post-merger.

not have been achieved through the alliance. In fact, these reasons were stated previously as rationale for the alliance in 1991.

Third, Gyllenhammar and Schweitzer wanted to achieve substantial financial strength to meet future capital requirements, estimated in Volvo's case to amount to between SEK 5 and eight billion. The Renault truck operation would require substantial additional capital as well. Sören Gyll, Volvo's president and CEO, wrote, 'Without the merger with Renault, securing the long-term survival of Volvo would have required major infusions of capital. Combined with Renault, a large, sound and financially sustainable automotive operation is created, which becomes an important cornerstone in the new Volvo.'[5] Volvo's car operations, which reported substantial profits in the 1980s, have lost money since 1990 mainly due to lower sales volume in North America. This resulted in increasing debt.

The support in Sweden for the proposed merger evaporated between September 6 and December 1,[6] 1993. The proposal touched a nationalistic nerve, just at a time when a severe recession and the integration of Sweden into the European Community were prominent issues — a recent poll had revealed that only 30% of the population supported Swedish membership in the EC. Interestingly, neither the 50% purchase of Saab by GM nor the mergers between Nobel and Akzo, the Dutch chemical giant, and Asea AB and the Swiss company Brown Boveri created the same excitement and nationalistic feelings. However, to a large degree, Volvo *is* the national symbol of Sweden.

> *“If you want to win, you must go faster. The advantage of a complete merger is simplicity and speed.”*

In addition, some observers believed that media opposition (and opposition by other groups) masked hostility to Pehr Gyllenhammar. Gyllenhammar was perceived as a flamboyant personality, given to making complex merger proposals that were politically — but not always economically — advantageous. Finally, the investment community voiced doubts about the projected merger synergies, fears about handing control to the government of France, and eventually optimism about Volvo's ability to survive on its own.[7] The most prominent index of the erosion of support for the combination was the dramatic fall in Volvo's share price.

Other stakeholders in Volvo rebelled as well. On October 26, a committee representing 5000 white collar workers announced that its members would vote their shares against the merger proposal. Also, 900 civil engineers within the company called for the merger to be postponed. This opposition was significant for two reasons. First, the traditional implicit contract between management and workers in Swedish business society gave workers considerable influence. Second, the workers' opposition shed light on rumors that alliance projects between Volvo and Renault had not gone smoothly. The rumors suggested that alliance coordinating teams had reached an impasse on important decisions (e.g., truck production and the P4 projects).

Opposition among the media, investors, and Volvo unions seemed to legitimize a skeptical reconsideration of the merger within Volvo's managerial ranks. The disarray fanned fears of domination by Renault. For instance, Volvo dealers in North America expressed strong concerns that the merger would dilute Volvo's strong brand franchise there, where Renault was viewed comparatively poorly. Under the alliance, control of the joint activities had been 50:50; managers believed that with the merger, control would tilt 65:35 to Renault and the French government. Given France's recent handling of strikes at Air France, fears surfaced regarding France's possible lack of concern for Volvo and its Swedish work force.[8] At the same time, Volvo's dramatic profit improvement in late 1993 prompted some executives to conclude that Volvo did not necessarily need a merger to survive. Others agreed that the privatization and golden share issues created too much uncertainty about the control of RVA.

On the evening of November 30, Sören Gyll convened at his home a special meeting of Volvo's senior divisional managers to discuss the merger. The next day, 25 managers signed a letter to Gyll urging the board of directors to drop the merger proposal. Gyll met with Gyllenhammar, who had just returned from a business trip out of the country, to say that he would recommend to the board of directors meeting the next day that the merger proposal be withdrawn.

In a stunning reversal on December 2, 1993, the directors of AB Volvo withdrew their recommendation of a merger between Renault and Volvo's automotive businesses. Gyllenhammar later said that the board responded to pressure that was 'intense and coming from all sides....it was natural to cave in.' He and four other directors resigned immediately. The next day, Gyllenhammar sold his family's share holdings in Volvo, and charged that the opponents to the merger had turned their backs on Europe, that the alliance would dissolve, and that Volvo was a 'wounded company.'

At a special meeting in January 1994, the shareholders elected a new board of directors. At that time, Sören Gyll announced a change in strategy for the firm, toward refocusing on the core automotive businesses. The new strategy entailed a commitment to

sell all non-core assets by 1996. With the expected capital gains on these sales plus a possible share offering the company would reduce its debt outstanding. Gyll alluded to the possibility for new alliances in the future, but said that these would be narrowly-focused cooperative ventures in a wide range of areas.

On February 17, 1994, Renault and Volvo announced the dissolution of the strategic alliance. This was expensive for Volvo as it entailed a payment to Renault under the poison pill, a partial repurchase of Renault's interest in Volvo, and a write-off of goodwill. All joint projects were terminated, except for an agreement to exchange engines and gearboxes between the two firms (the same arrangement in force since 1971).

The CEO's letter to the shareholders in the Volvo *Annual Report* for 1993 (published March 9, 1994) is poignant:

> 'The automotive operations must have our full attention... the inner stability of the group must now be restored. It is important to convey knowledge and understanding of the company's current orientation and status to all interested parties. Candidness and clarity must characterize our operations.'

Looking back on the series of events, Raymond H. Lévy, an architect of the Renault–Volvo alliance, quoted Shakespeare's *Julius Caesar* to describe his sense of the opportunity that had passed when the merger proposal was defeated:

There is a tide in the affairs of men
Which, taken at the flood, leads onto fortune;
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
On such a full sea are we now afloat,
And we must take the current when it serves,
Or lose our ventures.

Some Lessons

Alliances generate adversity. The relevant focus for senior managers should be *how to respond*. Carrying forward the P4 project, and resolving the difficult questions surrounding integration of the two truck businesses have numerous analogies in other alliances. (One need only look to British Airways–USAir, British Telecom–MCI, and Global One, to mention a few, for other recent alliances.) But in attempting to make sense of the Volvo–Renault collapse our interviewees repeatedly referred to *process errors*. These errors arose from the failure to understand six classic points of vulnerability which can undermine well-intentioned management efforts. These points represent the 'dark side' of alliances which we believe warrant careful attention by both alliance managers and senior managers.

Lesson 1: Alliances Demand Alignment, But Breed Misalignment.

Alliances depend crucially upon common agreement about mission, ideals, economics, and even culture. This common agreement should be actionable: as problems arise, players in the alliance should share a common point of view on remedies. Alignment is needed at both the strategic and operational levels. Volvo and Renault appeared to be aligned only at the most senior levels of both organizations. Our interviews reveal a *fundamental lack of alignment* between the French and Swedes, senior and middle-management, and senior management versus other stakeholders such as investors. To achieve alignment between separate and distinct organizations challenges even the most accomplished managers; to operate blindly under an assumption of alignment is to court disaster.

To illustrate the action implications of alignment, we distinguish between the *core business* and the *relationship among the allies*. Either or both can be strong or weak. As problems arise in the alliance, the actions an executive takes should depend on the locus of the problem. Table 2 illustrates that the action one could take to resolve alliance problems differs substantially in focus, depending on the perceived challenge.

Our interviews revealed a significant *misalignment* on the nature of the problems facing the alliance. As a result of the misalignment, agreement about action-taking dissolved, as did the alliance. Again, referring to the Table, Pehr Gyllenhammar and the managers of Renault were in the 'fix the business' cell. Public speeches, our interviews, and the merger prospectus emphasized that the alliance was well, but that the automotive industry was generally in such turmoil that a radical redesign of the Volvo–Renault relationship was required. Louis Schweitzer said, 'If you want to win, you must go faster. The advantage of a complete merger is simplicity and speed. Agreement between the two companies does not go as fast as managing a single group. Speed is of the essence. We must go beyond the limits of cooperation to date.' (Done, 1993).

For example, it was Gyllenhammar's view, stated publicly at the time, and privately with us in an interview, that the alliance was operating satisfactorily, but that Volvo's car business was doomed in the long run without a sizable partner. Gyllenhammar discounted the severity of alliance problems in the P4 project, in the trucks segment, and generally in the language and cultural differences between the two allies. Instead, he asserted that changes in the strategic environment in automobiles would adversely affect the company. Focusing on macro events, Gyl-

Table 2 Tailor the Management Approach to the Condition of Alliance and Business

		Business is...	
		Strong	Weak
Alliance relationship is......	Strong	*Continue to manage* Look for additional opportunities	*Fix the business* Focus on strategy, profitability, value creation, timing and agility. Emphasize control, speed and determination. *Pehr Gyllenhammar* *Louis Schweitzer*
	Weak	*Fix the relationship*. Focus on organization, culture and leadership. Take time. Emphasize teamwork and cooperation. *Volvo operating managers*	*Exit*

Source: AB Volvo, information prior to extraordinary general meeting of shareholders in AB Volvo, November 9, 1993, p. 43.

lenhammar was in the northeast quadrant of our table, 'fix the business.' The merger was aimed at just that: enhancing the strategic and operational standing of the alliance's automotive business.

Ironically, Gyllenhammar emphasized in his public presentations that 'the whole [Volvo] organization is behind this merger.' In reality, Volvo operational managers, white-collar workers, and stockholders were in the 'fix the relationship' camp. As Volvo began to recover financially from the effects of the recession in North America, it became increasingly apparent that the tiny automotive manufacturer could not only survive but prosper. The basic business was healthy; the alliance, not the business, needed fixing. Raymond Lévy appeared to acknowledge this when he alluded to the timing of a merger proposal: in 1992, Volvo was at the nadir of its business cycle. Certainly 'fix the business' would have been an appropriate response at that time. But by 1993 conditions had changed. The misalignment in perceiving the nature of the problems facing the alliance led to very different agendas for action. Gyllenhammar favored a speedy, decisive transformation of the alliance, casting it along Continental European lines.[9] This error in judgment led to a singular focus on *fixing the business* while ignoring a fundamental flaw in the alliance — the strained relationships among managers who resided outside of the executive suite.

Evidence supporting the explanation of misalignment was given by several interviewees. Raymond Lévy told us that 'neither Volvo nor Renault management tried hard enough to penetrate the minds of the Volvo shareholders to explain why Volvo alone would not be happy forever, and why Volvo with Renault could be happy in some equitable relationship.' François Schwartz, Deputy Chief Financial Officer at Renault said, 'Rather than shareholders, we were not able to explain to *management* their interest in the merger.' It is essential to bring the reality of these opportunities and challenges to the middle managers who are responsible for implementation (Yoshino and Rangan, 1995). Gyllenhammar was referred to as aloof, a hard manager, almost regal in his dealings with lower level managers. Such a personality does not naturally attend to, nor readily acknowledge, the process skills needed to *fix the relationship*. Such a personality might ignore a key alliance tenet: people are key to the alliance process! One must attend to relationship issues from the outset as they become the safety net that protects the alliances through the rough times.

Lesson 2: Beware of Path Dependency

Alliances create path dependency, both real and imagined. This raises switching costs and can invite irrational behavior. Path dependence is commitment to a stream of decisions and outcomes. For instance, to travel from New York to Boston, one chooses among flying, driving, or taking the train — once embarked on the trip, it is costly to change: one is path dependent. Path dependence may amplify potentially-dangerous kinds of behavior that are well-known to managers, and are the focus of increasing interest in academia. These behaviors include:

Endowment effect or status quo bias. Decision makers often prefer to stick to the current strategy rather than switch to a more attractive alternative. Thaler (1992) describes the common manifestation of this in laboratory experiments: people demand much more to part with an object than they would be willing to pay to buy it.

Escalation of commitments. Northcraft and Wolf (1984) suggest that 'The decision maker may, in the face of negative feedback, feel the need to

> reaffirm the wisdom of the time and money already sunk in the project. Further commitment of resources somehow "justifies" the initial decision, or at least provides further opportunities for it to be proven correct.' (p. 226)

The difficulty of departing from the path of alliance is implied in the article by Bleeke and Ernst (1995) who warn that alliances are often only preludes to a sale.

The rigid structure of the alliance (including cross-shareholdings and a poison pill) increased Volvo's dependence on the path of strategic alliance and made escalation of Volvo's commitment (i.e., through merger) a more tractable solution to the challenges encountered in the alliance. In retrospect, merger was not the natural course to pursue given the problems that surfaced during the alliances. Logic would dictate that one would address, and hopefully resolve, the relationship-related problems. Rather, momentum carried senior management forward to a merger. It is interesting to note that a merger could not 'fix' the emergent, relationship problems. The symptoms might vanish but the underlying illness would remain.

Lesson 3: Tinkering with the Alliance Contract is Tempting, But Highly Risky

Because alliances are founded on *cooperation and collaboration*, they are formed with difficulty, and are easily strained. As conditions change, the alliance must adapt. This may prompt the allies to tinker with their cooperative agreement. But tinkering risks shattering the fragile (and often unwritten) terms of the alliance. Where the contract is revised at stress-points in the alliance's existence, the risk of collapse rises higher. To understand why this is, consider that alliances are learning organizations and that they tend to amplify the learning disabilities of the respective allies. Revising the contract of cooperation sharpens these disabilities. The objective of alliance managers should be to protect the spirit and vision of the alliance while, at the same time, adjusting the scope of the 'contract' to reflect the changing environment. Simply, alliances cannot be fixed at one point in time. The agreement that ties the partners must be viewed as a living document that adapts to change while maintaining the core ideals upon which the alliance was first conceived. To tamper at the core risks damaging the central premise of the alliance, calling into question its reason for being, and questioning the foundation upon which the initial agreement was built. One should not attempt to change the fundamental rules of engagement — i.e., the alliance spirit.

Regardless of the disagreement about problems and solutions, Gyllenhammar's merger proposal promised turmoil within Volvo because it would dramatically alter the nature of a relationship among partners who had been *equal* allies. Elements of the change are apparent in Table 3. As the exhibit suggests, the merger proposal was a radical revision of the terms by which the Swedes and French would collaborate — virtually all interviewees acknowledged that the complexity of the proposal made it difficult to understand and easy to fear. Volvo dealers (particularly those in North America) doubted that the brands would remain separate in the minds of the consumers, and worried that the Volvo brand would become tainted by the memory of Renault's retreat from North America in 1986. Our interviews with Volvo executives and large investors revealed that the proposal undermined the appearance of partnership and created an appearance of domination and submission. Executives and employees resented the shift in power. Volvo's own board required several weeks to absorb fully the implications of the golden share, hard core investors, and privatization — all of these tilted the control toward France even more than the 35/65 division of shares suggested. Volvo's large shareholders feared the power balance: Renault's owner, the government of France, was one of the most interventionist in Europe. It must be underscored that Volvo is viewed as one of the crown jewels of Swedish industry and for it to fall into French hands alarmed the Stockholm community.

Table 3 How the Proposed Merger would change the 'Contract' between the Two Strategic Allies

	Alliance	Merger
Brands and dealer networks	Separate	Separate
Headquarters	Paris and Gothenburg	Paris
Language	English	?
Ownership	50:50 Control. Cross share holdings of minority interests	65% France 35% Volvo
Special control features	Poison pill held by both allies	*Held by France only*: Golden Share Noyau Dur Privatization
Internal governance	21 Committees	Management Board. Supervisory Board

Source: AB Volvo, information prior to extraordinary general meeting of shareholders in AB Volvo, November 9, 1993, p. 43.

Bleeke and Ernst argue that asymmetry in bargaining power is a major destabilizing force in alliances. These asymmetries may stem from differences in *initial* strengths and weaknesses, from conflict in overlapping products and markets, and from changes in strengths over time. Stability is probably greatest in alliances among *complementary equals*. To change the fundamental terms of the alliance agreement in which partners were accorded equal voice seriously altered the alliance dynamics. The shift in control embedded in the merger terms was destabilizing. Several interviewees agreed that the merger proposal provoked a reconsideration of Volvo's future by Volvo employees. Sundqvist told us, 'As opposition to the merger mounted, inner feelings were allowed to grow among Volvo managers. When former managers expressed their opposition, the current managers' feelings emerged too.'

Asymmetry in this alliance relates also to the question of equity and trust. Blau (1984) cautions that while fair rates of exchange for costs and benefits are important, equity is necessary for establishing a norm of fair dealing. Beyond the golden share, the change in ownership percentages raised questions in the Swedish press about control over one of its national treasures and whether the merger was fair to Swedish people. Gyllenhammar plainly miscalculated the reaction to the proposed merger. He sought to create no buy-in to the concept of merger before he announced it. And following the announcement he presented it as a *fait accompli*.

Lesson 4: Alliances Invite Leadership by Fiat; But They *need* a Coach, Guide and Visionary

What could explain the misalignment of perceptions and the miscalculation about recontracting? Many observers believed that Gyllenhammar had grown removed from his own organization and its alliance with Renault. Raymond Lévy told us,

> 'When we were working on the alliance proposal, we had a meeting of 200 of the top managers of Volvo and Renault. At the close of that meeting, Pehr Gyllenhammar said to his managers, 'Those who aren't in agreement with this plan have one thing to do: jump ship.' I thought that was wonderful. It indicated that Volvo had a powerful, strong man at its helm. I found later that this was deeply resented at Volvo as an expression of dictatorship.'

The business journalist, Sundqvist, said,

> 'He was an emperor. What does it mean to be an emperor? It means somebody who does not listen. [Gyllenhammar] built an ivory tower. Vicious is too strong a word, but people around him did not want to oppose him... Watch out for leaders who grow out of proportion to their companies.'

Lars-Erik Forsgårdh, President of the Swedish Small Shareholders' Association, and a leader in the opposition to the merger, told us, '[Gyllenhammar] had too many admirers in the board [of directors].' The irony is that our interviews also revealed that Gyllenhammar is an exceptionally visionary, charismatic, and intelligent individual.

Research suggests that alliances require a *special kind of leadership*, perhaps different from the kind required to lead large corporations — indeed, each of the cells in the matrix described above requires a different kind of manager. Modern theory (see, for instance, Kotter, 1988 and Bennis and Nanus, 1985) on leadership holds that the tasks of the leader are to *create vision* and to *create agreement between the internal organization and external stakeholders*. Virtually everyone agreed that Gyllenhammar was a visionary CEO. But vision alone is not sufficient for leaders of corporate transformation. Increasingly we see that the other necessary attribute is the ability to build *buy-in, involvement, and participation*. Other research (Spekman *et al*., 1996a) shows that trust, credibility and honesty are key alliance management skills. These alliance management skills make it easy for the leader to mingle with his or her organization. If done right, the momentum for organizational transformation wells up from within the organization itself, rather than being handed-down by an autocrat. In this sense, the effective leader is a follower, a listener, a coach, and a cheerleader. As Lao Tzu said, 'To lead, one must follow.' It is evident that Gyllenhammar was never comfortable in these roles; often he was described as elitist and aloof. Indeed, he may never have had to learn followership, since at a young age he was appointed CEO of Skandia Insurance by his father, and then of Volvo by his father-in-law. Gyllenhammar's aloofness was perhaps his fatal flaw. Rather than distancing himself from his own managers, he needed to immerse himself.[10] We observe that in corporate transformations leaders must be prepared to transform *themselves* just as they are transforming their institutions.

A team of Darden researchers (Spekman *et al*., 1996b) have examined the role requirements of alliance managers as the alliance progresses through its life cycle. Early stage alliance skills that help create and set the vision for the alliance are often different from the skills needed to transform that vision to a viable and tangible alliance strategy that attempts to blend the partners. The research suggests that strong alliance management skills must exist simultaneously at the strategic, operational, and interpersonal level. Also, Kanter has highlighted the need for senior managers to translate the potential benefits of the partnership into reality (Moss Kanter, 1994). She warns that often they worry more about controlling the relationship than about nurturing it. Strategic advantage just does not happen because senior managers say it exists, it must be managed proactively.

The orientation of Gyllenhammar and Schweitzer on high level strategy, rather than to process related

issues directly contributed to the failure of the alliance and then the proposed merger. Although both senior managers had a shared vision of what the new auto giant could accomplish, the benefits were developed at a very abstract level. One example of the degree of abstraction was Gyllenhammar's vision that the merger would help integrate Sweden into the larger European community, creating a united Europe. A second example is the vision that Volvo and Renault would complement each other's market coverage. But in North America, this complementarity might work against the combined businesses: the US Volvo dealer network was very concerned with Renault's reputation for poor quality and its impact on Volvo's brand image there.

In communicating with markets and investors, the CEO should assume that he is dealing with sophisticates. Gyllenhammar vastly underestimated his investors, and paid a severe penalty for doing so. The negative reaction of investors was not random violence, but rather the inexorable justice that financial markets exact for the destruction of market value. Markets have long memories. Sooner or later investors settle their scores. A good business leader attends to relations with investors and other external stakeholders as carefully as he or she attends to internal relations.

The two leaders plainly failed in speaking to concerns of key stakeholders: risks were not fully acknowledged, nor were the expected gains fully explained. Open communication is a hallmark of successful alliances. One must be sensitive to the information needs of key constituents and must attempt to craft a response that addresses these concerns. Clearly, neither leader understood fully the extent to which key stakeholders from all quarters had fundamental concerns about all aspects of the merger.

Lesson 5: Blending Businesses Might Appear Easy, Blending Cultures is Not.

In the first quarter of 1996, the value of merger activity in Europe jumped 22% from a year ago to $71 billion (Javetski, 1996). We are witnessing consolidation across all business sectors with a great flurry of activity among airline, banking, telecommunications, and pharmaceutical companies. We can easily understand the business rationale for these mergers as a response to global competitive forces. However, based on our observations from the failed merger between Renault and Volvo caution is advised. One must attend to differences in culture (language, values, customs, and national traditions) on both a corporate and a country level. The French and the Swedes were highly conscious of their differences: attitudes towards work, behavior at lunch and breaks, working hours and the like. Interestingly, earlier research conducted at the University of Uppsala in Sweden reported that Swedish managers were more comfortable working with Germans and British than they were with the French and managers from southern Europe (Håkansson and Wootz, 1975). Although Mr. Gyllenhammar was frequently described as a Francophile, it was clear that his ease with the French was shared by many of the Volvo managers, and might have both limited his ability to sense the tension that was building at the operational level during the alliance and led him to discount the opposition that was building in Sweden.

It would appear that executives at both Volvo and Renault were open to learning that was task related but had thought little about the perceptions and stereotypes that each held about the other or about managing cultural diversity and establishing a set of alliance values that placed currency in the cultural differences of the two partners. Alliances consist of people working together, finding a common ground on which to build the value that first brought the firms together. Cultural differences matter; inattention to the importance of cultural differences will only accelerate problems.

Lesson 6: Time is a Double-Edged Sword

During our interviews, executives on both sides viewed time as the enemy and spoke of the importance of moving quickly to the merger. Yet, in complex alliances that cross national boundaries longer, rather than shorter, periods of time might be needed to establish a web of interpersonal ties among key managers, to build a more accepting environment for cultural differences, and to nurture the trust and commitment that are essential alliance ingredients. Had the merger moved quickly, we believe that many fundamental flaws would have remained. As Europe moves to consolidate its industries in response to global threats, some nationalistic response by governments is expected; however, we have shown that cultural differences must be acknowledged, managed, and hopefully leveraged.

Research (Spekman *et al.*, 1996b) has shown that large, very complex alliances take time for trust to emerge. Often three to four years pass before the alliance is 'up and running.' Here, waiting might have provided time to remediate operational tensions and resolve relationship problems. However, waiting also allowed resistance to build and provided an opportunity for those opposed to the deal to solidify their positions. To a great extent, senior management was damned for waiting and would have been damned had they not.

Conclusion: the 'Dark Side' and its Implications for Senior Managers

The 'dark side' of strategic alliances may be summed up in three sayings well-known to gamblers and cynics:

You can't win. The odds of the game seem to be stacked: something like 60% of alliances fail.

You can't break even. Endowment effects, the tendency to escalate commitments, costs of organizational integration, imply that the investment of time and money will be greater than anticipated.

You can't get out of the game. Alliances create path dependency. The risks and costs of adjusting the alliance contract discourage making creative modifications that solve fundamental problems. Dennis Overbye (1991) has used the same metaphor to argue the difficulty of proving scientific results in physics and astronomy.

This downbeat assessment of alliances should serve as a cautionary warning to the casual architects and managers of alliances. In studying the failure of the Volvo–Renault strategic alliance, one is struck by how much of it is explained *at the interfaces* of human behavior: nations, cultures, allies, owners vs managers, and senior managers vs operating managers. The irony is that the trend of organizational design in corporations is toward the networked or 'boundaryless' firm-designs which will serve to heighten the significance of these interfaces.

We remain optimistic, however, that thoughtful managers can create successful alliances through careful attention to the elements highlighted in the case of Volvo and Renault. Remembering that failure is built into the alliance process, we have attempted to present an argument that highlights problems **that can be** solved. There is no magic formula, the successful management of alliances takes time and effort. They take considerably more time than one can imagine. If one begins with the premise that alliance management deals with both the management of the business *and* the relationship, we have shown through the Volvo–Renault alliance several areas of concern. Through a comprehensive exposition of their failure we have presented the opportunity for others to learn. Success comes to those who learn!

Acknowledgements

This research is based upon 20 field interviews with individuals at both Volvo and Renault, as well as knowledgeable journalists and finance professionals. Some of these have requested anonymity, a request respected herein. Others were willing to speak for the record and are identified in the text of the article. To all, we extend our deep thanks for their time and candor in illuminating the case. Also, we gratefully acknowledge the financial assistance of the Darden Partnership Program, and the University of Virginia Darden School Foundation.

Notes

1. Securities Data Company (Newark, NJ) estimates the annual growth rate in number of alliances at 25%.
2. Failure rates of 60–70% are cited in various studies. See Harrigan (1988), Levine and Byrne (1986), and Savona (1992).
3. Actually, merger discussions had been held in 1992. But action on those discussions had been tabled in the absence of a privatization bill from the French parliament.
4. Gyllenhammar announced that the projected merger synergies were over and above projected alliance synergies of SEK 41 billion for the years 1994–2000.
5. Information Prior to Extraordinary General Meeting of Shareholders in AB Volvo, November 9, 1993, AB Volvo, p. 6.
6. Volvo share prices declined 22 per cent against the Swedish Stock Market average between the announcement and early November. For a detailed analysis of the financial aspects of the merger, see Bruner (1998).
7. In early November, Volvo inadvertently reported buoyant 9-month profitability. The news helped galvanize the opposition: Volvo could survive on its own. Renault, more heavily positioned in Europe than in North America, was still reporting deepening losses as the recession worsened in the European automotive industry.
8. Air France, a state-owned enterprise, had lost money consistently during the 1980s, and was kept afloat by large subsidies from the French government. When the European Commission insisted that the subsidies end, Bernard Attali was appointed chairman of Air France with the mandate to cut costs, restructure the firm, and restore it to profitability. Employees resisted Attali's restructuring program, ultimately striking for two weeks to protest. Attali was fired by the government for his handling of the unions and his tough-minded restructuring program.
9. The classic model toward which several interviewees pointed was the combination of Asea (Swedish) and Brown-Boverie (Swiss) into a single global engineering firm managed through a holding company owned by its Swedish and Swiss parents. Also, Daimler-Benz has a two-tier structure of management and supervisory boards, consistent with those outlined in the proposed merger.
10. Indeed, his mode of departure, the coup d'état, is characteristic of the exit of departures. See Sonnenfeld (1988).

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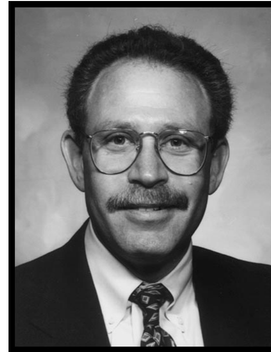

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