THE NEXT INDUSTRIAL

Collaboration in the Multi-com

REVOLUTION *pany Enterprise*

By Janis L. Nordstrom

The Industrial Revolution of the late 18th and early 19th centuries ushered in new manufacturing processes, marking a major turning point in history that influenced almost every aspect of daily life. Innovations in waterpower, machine tools, chemical manufacturing, and iron production contributed to this period of unprecedented sustained economic growth. Today, we stand on the threshold of the next industrial revolution—next-generation manufacturing—where collaboration breeds innovation, thriving in the unconventional environment of multi-company enterprises.

To Compete: Collaborate

No longer merely an industry buzzword, collaboration is becoming a practical tool for innovation. Companies of all natures and sizes, including competitors, are using collaborative methods and structures to address new customer requirements with agility and intelligence. The multi-company enterprise—an alliance where two or more often very different companies with complementary strengths come together for a period to create something that neither would have been able to create on its own—stands at the forefront of the revolution, driving innovation. Old guidelines that in the past prevented such alliances from happening are being tossed aside, and the results are exciting on several fronts.

"In this new era of 'cooperate to compete,' we sometimes refer to a multi-company enterprise as 'co-opetition,'" says Foley & Lardner LLP attorney Joe Ziebert, who has guided avionics companies through the process. "For example, a subsystem you created may be going into another supplier's system for a manufacturer. At the same time, you're making a competing system that you'd like the manufacturer to buy. But you look past the competition part, realizing that the projects are generally so large that you'll get a good piece of it if you cooperate with your competitor. You'll thrive and provide innovation through co-opetition. Automotive and avionics suppliers run into this frequently."

A multi-company enterprise begins with a purpose, vision, business strategy, and a specific project goal in mind. In some cases, major manufacturers or other companies with particular knowledge, financial resources, or the ability to commercialize product will team up with inventors, technology companies, independent laboratories, universities, and/or others that are deft at discovery and development to achieve innovations that might not be feasible, or even possible, on their own. Advances in automotive, healthcare, avionics, homeland security, utilities, communications, and more can be attributed to multi-company enterprises. In other cases, such as Ziebert suggests, collaboration becomes a practical matter of cooperating with your competition in order to stay in the game and thrive.

More precisely, a multi-company enterprise is not necessarily about merging similar skill sets. In fact, more often than not, one party may be supplying information and the other supplying technology. How they marry those two skill sets to come up with something new and useful is at the heart of the multi-company enterprise and innovation. Such collaborative alliances

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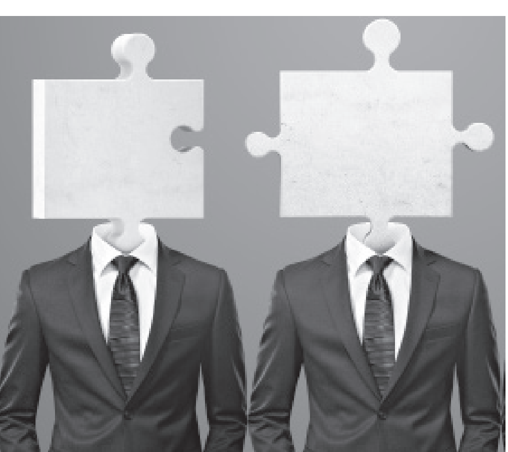

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take on several forms, described below. But the advantages and outcomes are similar—even revolutionary.

A Nimble and Cost-Effective Platform

Multi-company enterprises provide a nimble and efficient platform to achieve a desired outcome or innovation. In many cases, the customer—the manufacturer or distributor of the end product—drives the quest for an alliance that will produce a specific technology or piece of information. Sometimes the alliance is formed because one or the other company's research and development team cannot provide a needed piece of the equation efficiently or economically on its own. In either case, the collaboration involves a project that typically has a beginning and an end, though rarely some alliances may turn into something more long term.

"It is easier to form an alliance for a set project than it is to create a separate entity such as a joint venture to accomplish the same goal. You get there more quickly," says Andy Rawlins, a Foley attorney who frequently helps set up multi-company enterprises. "Auto companies highlight the way this works. Where a company has a weakness in certain technology but a strong market position, it can maximize an outside technology company's strengths to improve its offerings to the ultimate consumer. On-board, Internet-based communications and entertainment systems in cars are one example."

In other cases, a multi-company enterprise alliance may be created to obtain access to information. To illustrate, let's imagine a multi-company enterprise formed between a widget manufacturer and a coverings and coatings company.

ABC Widgets has a lot of information about what customers need in the widget field through constant customer feedback. The company also conducts extensive market research to stay on top of trends and maintains a reliable set of data. But it doesn't have the in-house technology capability to efficiently create new coatings that respond to customer requests. During an executive meeting with its R&D team, the company learns that Acme Company, an applied chemical manufacturer, may have the needed solution in a new composite coating.

Acme does indeed have a new coating ready for market, based on four years of research, but the company lacks crucial information—such as where and how this coating technology is needed—in order to make it profitable.

The two companies meet, agreeing to form a multi-company alliance. The ABC/Acme alliance will focus on the further development and commercialization of the coating in the widget industry, specifically. In their agreement, ABC gets rights to the new product for its widget customers—product it could not develop on its own—and Acme will retain all rights for the new coating in every market application outside the widget business, where ABC Widget Company has no interest. For Acme, it gets needed information—what does ABC know about the market that it can use? Acme is fairly certain that there are at least five other areas where it can apply its discovery and maximize its profit.

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At the end of a project alliance, although each party has given up something, both walk away thinking, "I'm glad I did this." Both companies know that they were better off doing it than not doing it. And that's what you're aiming for when establishing a multi-company enterprise.

"In events leading up to an alliance, there's always a point when this happens—the benefit of collaboration is seen as greater than the cost of not doing it," says Rawlins. "That's when agreement takes shape. It is rare that two parties can't arrive at that point."

What's in the Box?

The critical piece of the multi-company enterprise is an open mind. Companies cannot be stuck in old attitudes ("I own all the rights to everything I do with my product"). Innovative companies will understand that creating advantage will not come by adhering to outdated guidelines on exclusivity. Rather, they will look to find common ground—who needs to own what or have a license to what—in order to thrive and profit from the innovation they create through collaboration. Defining that upfront is imperative.

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"In structuring business enterprises today, there are few examples of the classic joint venture—a separate corporate entity in the legal sense," says Richard Kaufman, a corporate finance and life sciences attorney based in Foley's San Diego office, where he has facilitated dozens of multi-company enterprises in the biotech and pharmaceutical industries. "The need for separate staffing and bricks and mortar is usually a deterrent for the joint venture. The MCE [multi-company enterprise], where each party has an interest in different parts of the outcome, is a nimble solution. In some cases, it can also be an excellent financing option—a way to provide capital for smaller innovator companies."

For example, an innovator company on one side of town makes a discovery or conceives an invention but doesn't have the infrastructure or capital for large-scale clinical development, manufacturing, or commercialization. But on the other side of town, there sits a major pharmaceutical company whose strength is bringing products to market; however, the long discovery and development cycle—sometimes 15 years or more—remains its nemesis. An alliance on a project basis can make a huge difference in its ability to bring innovative products to market.

Essentially, the innovator company looks to the pharmaceutical company for cash, clinical development, and commercialization, while the pharma company looks to the innovator company for innovative products to take forward. Everyone plays a part and everyone gets something to offset their needs. The same holds true in almost all other industries that are using multi-company enterprises to advance innovation.

Hand-off Versus Side-by-side

At its core a multi-company enterprise is a business strategy. It can come as a result of a customer request, a period of flat sales, a drive to differentiate, or a dozen other business cases. To address those needs, MCEs generally take the form of two successful models: the hand-off and the side-by-side.

In the hand-off model, the innovator company might take its research and development to the point where it reaches its limit, likely in both capital and expertise. At that point, it might approach a major partner to complete the process of development and commercialization. In exchange, the partner might pay royalties to the innovator company based on net sales when the product is delivered to market, as well as a cash payment or a license fee paid up front to the innovator in exchange for development and commercialization rights to the new product. Success may bring additional payments after milestones are achieved. These remunerations are always spelled out in the contractual documents, along with intellectual property rights and other pertinent details, such as mechanisms related to decision-making and resolving disputes. Sometimes the innovator company has joint decision-making power, but it is more common that the ultimate decisions in the hand-off model belong to and are the responsibility of the development and commercialization partner who is paying the bills.

The side-by-side model involves a more symbiotic relationship: The two companies need one another on a day-to-day basis, each having assigned tasks and each contributing in parallel to deliver the product. In this model, typically the innovator company is not positioned to bring a product to market so, in order to continue its march toward the market, it partners up. For larger entities, it is often difficult to innovate on a schedule. But they do know that products are the result of discoveries and realize that innovator companies are more agile and quicker at achieving them. Discovery, development, and market commercialization are a continuum. Therefore, they choose to work side by side to become an equal source of the ultimate product opportunities.

Assembling the Multi-Company Enterprise

The multi-company enterprise can spring from anywhere along the food chain. The impetus may come from the customer (e.g., the original equipment manufacturer), the supplier, a competitor, an inventor, the R&D department, or a combination of the above. Collaboration happens at a number of different levels in a number of different ways. It is a never-ending dance that can involve buyers, sellers, colleagues, consultants, in-house research and development teams, attorneys, and, in some cases, even bankers.

Attorneys are usually happy to put people in touch with each other if they know those who might have complementary interests—when it makes sense. More often, though, collaborations grow organically or are made through intentional business development outreach. Most industries have associations, and both inventor companies and OEMs attend the same meetings and conferences, where people from both sides troll the industry pond hoping to hook something. Smaller companies might engage business development consultants to leverage their contacts on their behalf. Major companies frequently have a staff devoted to finding opportunities. When the transaction involves an acquisition, bankers may be involved. However the talks begin, the alliance takes shape when the agreements take form.

One of the biggest pitfalls in multi-company enterprises occurs when parties underestimate the potential for failure. While agreements should always include provisions for obligations and ownership of intellectual property, product and other items, they should also provide for conse-

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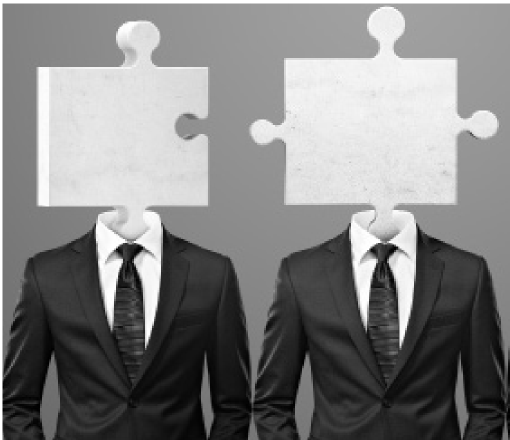


quences when a project fails to produce the expected product or outcome.

"The failure rate for MCEs in the biotech and pharmaceutical industries is extremely high," says Kaufman. "Many times events beyond the parties' control come into play, such as FDA approval. It's important to have provisions that address such instances."

Interestingly, with the high number of failures in the biotech/pharma playing field, one would expect there to be a considerable amount of litigation. Kaufman finds the opposite to be true.

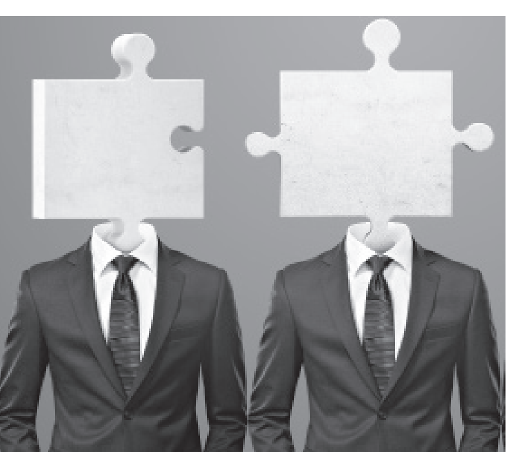
"The biotech/pharma industry has historically not been litigious. Of course, sometimes there are patent lawsuits, but we don't see a lot of breach-of-contract cases. Technically speaking, most multi-enterprise contracts have arbitration agreements. But in practice, companies and inventors in that area prepare for the worst, and are generally comfortable with the risk. That's an important part of planning and an important consideration when choosing an innovation partner. How much is each party willing to risk? How much are you willing to risk?"

He adds that closing loopholes on the front end is very important. But, in most cases, once you get to the negotiation and agreement stages, you are working with people who know how to solve their differences. In every MCE contract there should be a clause that provides a mechanism for resolving disputes, says Kaufman. "Preferably an internal one."

Who Is a Good Candidate for Multi-Company Enterprise?

Manufacturers, suppliers, inventors, distributors, and everyone in commerce operate under contracts of one kind or another. The multi-company enterprise is essentially a contract, arguably one with a unique—likely revolutionary—purpose. When historians look back at the "Next Industrial Revolution," it is highly likely that they will say it happened because companies found innovation through collaboration. They will write that visionary companies arrived at new uses for natural resources, technology, chemicals, medicines, and production processes that contributed to unprecedented sustained economic growth through the creation of symbiotic alliances that allowed them to innovate.

Companies of all sizes, industries, geographies, and purposes have strengths and weaknesses. The best candidates for the multi-company enterprise are those that recognize and acknowledge them, and have the courage to change their course. The path to innovation is lined with strategic collaboration. M



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