

## Emerging Risks Spur Strategic Alliances in Manufacturing and Automotive Industries

To remain competitive, today's manufacturers and automotive companies must produce more at a faster pace. These companies must evolve their production processes — and even their business models — while grappling with costly technological advances and vast labor shortages.

This pressure is leading many in the industry to form strategic alliances — sometimes with competitors — to keep pace with heightened customer expectations. Doing so, however, comes with its own set of challenges, making risk management and insurance critical components of these arrangements.

### A Changing Landscape

Manufacturing and automotive companies are facing digital disruptions that have forced them to transform production processes to better meet customer demands, including delivering more product variety and shortening production cycles. Robotics, 3D printing, nanotechnology, and blockchain are just a few of the digital solutions allowing manufacturers to adjust to changing customer needs.

Automakers, in particular, have been challenged to adapt. Not only are they expected to go to market with new and improved models at an unprecedented rate, they are now attempting to solve for driverless cars and are fighting for space in the rideshare market to diversify their business. It's likely that none of this would be possible without 3D prototyping, connected factories, or the tech-driven shared economy fueling the rideshare marketplace.



At the same time, technology is increasing competition, creating demand for more skilled labor and presenting evolving privacy, security, and safety issues. Adding to these challenges is the integration of new technology into manufacturing processes, which can be costly and complex; solutions can quickly become outdated, and updating one network or system often requires altering others so they are compatible.

Manufacturers face great risk from what is often deemed the “fourth industrial revolution.” They are susceptible to intellectual property theft by cyber hackers, business interruption from system shutdowns, and financial losses and reputation damage from hefty development costs for products that do not meet revenue expectations.

## Teaming Up for Better Results

These mounting risks are leading manufacturers and automotive companies to form strategic alliances, which are formal partnerships whereby two independent companies remain separate entities but share resources or collaborate on projects for their mutual benefit.

Such strategic alliances often involve intertwining supply chains, technology, production locations, and/or finances. For instance, some automakers share technology and facilities to develop autonomous driving systems and electric vehicle platforms, while many food and beverage manufacturers share distribution networks and facilities to expand their reach.

These alliances can be beneficial, allowing collaborating companies to:

- **Improve product development:** Two minds are better than one. When two similar or complementary companies collaborate, they can bring different resources to bear, which can lead to real transformation. Rather than creating “separate but equal” standard products, they can unite to create truly innovative products that will move the needle for both companies.
- **Reduce costs:** Innovation is not cheap, but it can cost less in a strategic alliance. The aligned parties can split the cost of procuring or implementing new technology and share facilities, which can reduce redundant capital expenditures for expensive technology and equipment at separate locations, and benefit from economies of scale along their supply chains. Ultimately, if a collaborative project fails, it usually costs less than if the parties were going it alone.
- **Enter new markets and grow more easily:** Strategic alliances can speed up research, development, and production of new products and up the momentum on distribution of

longstanding products debuting in new markets. Collaborating parties can piggyback off one another’s already established production or distribution platforms in specific locations. As such, companies are able to overcome production barriers and local cultural and operational obstacles that would otherwise hamper speed to market.

## Performing Your Due Diligence

Ultimately, strategic alliances can produce better outcomes at a lower cost, taking companies from barely surviving to thriving in today’s competitive marketplace. However, such partnerships are not without potential challenges. In fact, not properly managing a strategic alliance could actually increase your risk.

Unfortunately, strategic alliances often fail. Nearly half of the respondents to a 2014 study on strategic alliances by the CMO Council and Business Performance Innovation Network reported strategic alliance failure rates of 60% or more.

Recently, two major automakers partnered to trade one’s hybrid technology for the other’s access to a particular geographical territory. Both parties failed to agree upon terms and deliver on their promises. This not only resulted in a failed alliance, but also prompted international arbitration.

Meanwhile, two large telecommunications manufacturers jointly acquired a portion of another smaller telecom company and made a significant investment in a burgeoning industry. But the industry never took off because consumers were not interested, and the alliance failed within just one year of their agreement.

These examples highlight how strategic alliances can be difficult to manage, despite their potential value. However, with adequate due diligence and proper planning, potential partners can avoid common missteps and instead find allies with compatible business cultures, aligned objectives and strategies, and agreeable terms regarding their operational business arrangements and how profit pools will be shared.

Due diligence should go beyond high-level company culture and business strategy research, taking into account potential partners’ risk management and insurance programs as risk and insurance can become especially murky in strategic alliances. For instance, which company’s insurance responds first in the event of a claim? Even if the answer to that question is straightforward, how will partners manage through the frustration or financial burden if one party seems to shoulder disproportionately more risk?

When considering a strategic alliance, organizations should take the following steps to conduct effective risk and insurance due diligence:

- Evaluate a potential partner’s approach to risk management, loss control, and claims management.
- Review insurance policies to identify any gaps in coverage.
- Determine the extent to which deductibles or retentions will affect the quality of earnings.
- Assess the adequacy of provisions for self-funded losses on the balance sheet.
- Examine property schedules and create a risk map to determine if shared equipment, processes, and activities, would occur at inherently risky locations.
- Identify potential areas of exposure or hidden liabilities.
- For cross-border alliances, consider any unique in-country risk management and insurance requirements.
- Assess — qualitatively and quantitatively — a potential partner’s risk profile, including benchmarking insurance programs and reviewing financial security of current and historical insurers.
- Develop pro-forma insurance cost projections with respect to a partner’s total cost of risk.
- Quantify historical liabilities (for example, from self-insured programs) and identify any insurance-related one-off costs that could affect an alliance.

Acquiring such information can be much more manageable with access to data and analytics and modeling tools. Guidance from insurance advisors with expertise in manufacturing, strategic alliances or similar arrangements, and any new geographic territories being explored for an alliance can substantially ease this process. And while it may seem like a significant undertaking, risk and insurance due diligence can reduce uncertainty and help prevent surprises. It can also help obtain a clear picture of the value of the liabilities and assets being shared — potentially enhancing strategic alliance agreements, operational costs, and corporate governance.

Technology and digitization continue to disrupt manufacturing and automotive industries. Amidst such industry dynamics, strategic alliances may be one of the few ways manufacturers and automotive companies can keep up with the demands to expand product offerings while shrinking production timelines. And while adapting a strategic alliance business model might involve some growing pains, it can also result in real transformation for the manufacturing and automotive industry, helping these companies thrive in an ever-changing environment.



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