The dangers of misaligned product co-development contracts and how they can derail innovation in high-tech firms

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Researchers from Mansoura University and University of Guelph published a new *Journal of Marketing* study that examines how misaligned contracts can erode innovation outcomes of high-tech firms. The study, titled "[Collaborating to Innovate: Balancing Strategy Dividend and Transactional Efficiencies](#)," is authored by Nehal Elhelaly and Sourav Ray.

When a giant multinational like Unilever partners with one of its major suppliers, such as the industrial enzyme-producer Novozyme, the collaboration can fast-track [innovation](#) and improve business performance. Such a partnership between a firm and a supplier brings together knowledge, technologies, and other resources to create a product, service, or solution—and industry reports indicate that up to 85% of firms believe these collaborations are an effective means of innovation.

This broader impact of product co-development collaboration is aptly captured in the following public statement by the multinational pharmaceutical company Bristol-Myers Squibb: "As critical drivers of our strategy, external innovation and partnering have brought significant commercial success and pipeline growth. Twelve of our company's twenty blockbuster medicines are derived from collaborations. In addition, more than sixty percent of our current development pipeline is externally sourced bringing significant external innovation to complement our internal capabilities and innovation."

However, such collaborations also expose the firm to various transactional hazards such as knowledge spillovers and opportunism. The danger looms large when a firm fails to consider its positioning strategy and functional capabilities when crafting innovation collaboration contracts with its suppliers. This creates a barrier to a firm's ability to generate sustained dividends from its broader marketing strategy.

Strategic decisions taken by firms are based on the presumed value generated from the implementation of the decisions and the presumed costs incurred in the process.

Elhelaly explains that, "as important as innovation co-developments are to a firm's broader marketing strategy, managers should ask themselves an important question: Will such contracts help sustain any strategy dividend? The strategy dividend can be whittled away if there is no fit between a firm's strategic positioning, functional capabilities, and the governance modes of co-development."

The downsides of joint venture partnerships

Consider, for example, industry observations that Joint Venture (JV) partnerships can help firms navigate economic downturns. Economic downturns impose a need for cost efficiencies, and JVs can be useful because of presumed close coordination between the two entities.

Yet, as the study's hypotheses and results show, this economic dividend can only be realized when firms have high technological capabilities. The researchers estimate that for firms with similar efficiency orientations, their technological capabilities are associated with an increase of 5.2% in innovation performance for JVs, but not for technology licensing contracts and joint development agreements.

On the other hand, estimates show that strong marketing capabilities in the same situation are associated with a decrease of 17.9% in innovation performance for JVs. Additionally, marketing capabilities seem to be more benign for joint development agreements in high differentiation-oriented firms. For such firms, marketing capabilities are associated with an increase of 7.8% in innovation performance for joint development agreements.

One of the study's central themes is that the idea of fit in co-development collaborations comes with underlying notions of misalignment costs that need to be recognized. "While mapping the bases of misalignment," says Ray, "we highlight the keystone role of the firm's positioning strategy in innovation collaborations. Strategy frames how a firm deploys its resources and focuses its energies. So, a misalignment will naturally manifest in inefficiency, perhaps one that will emerge over time. As our empirical results bear out, misalignment between collaboration contracts, capabilities, and strategy significantly erodes innovation outcomes."

The study offers three key takeaways:

1. For better innovation outcomes, firms need to select the collaboration form that motivates their partners to share know-how and expertise and facilitate efficient knowledge transfers. At the same time, firms must also pay attention to protecting their valuable knowledge and skills from opportunistic appropriation and ensure effective use of their deployed resources.
2. Firms need to build the "right" functional capability to yield the most benefit from innovation collaborations. For instance, a firm needs to invest in building marketing capabilities if it is driven by high differentiation and consider more arms-length arrangements such as joint development agreements with suppliers. In contrast, firms driven by efficiency considerations are better off developing their technological capabilities when considering a joint venture.
3. Firms must resist blindly copying the practices of other firms, regardless of the appearance of "industry best practices." Considering the firm's positioning strategy along with its capabilities is crucial to designing effective contracts. Thus, blanket prescriptions for one or the other types of contracts (e.g., joint ventures during downturns) may be misdirected.

More information: Nehal Elhelaly et al, Collaborating to Innovate: Balancing Strategy Dividend and Transactional Efficiencies, *Journal of Marketing* (2023). DOI: 10.1177/00222429231222269

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