Why is Foxconn's Alliance with Sharp a Problem for Sony and Apple?

Foxconn and Sharp just announced an alliance that involves a purchase of Sharp shares by Foxconn, sales of LCD screens from Sharp to Foxconn, and Foxconn access to Sharp LCD technology.

It is a clear case of firms seeking to overcome their weaknesses: Foxconn LCD technology is not up to Sharp standards, and Sharp is a high-cost player with difficulty selling its screens. There are many ways such an alliance could fail, including the obvious one that it does not really reduce Sharp's production costs in the short run, and it is unclear how well the combined entity can keep up with the technology and build more efficient production capacity in the long run. But any project can fail, and this alliance has a good rationale when analyzed in isolation.

What if we see it in connection with other alliances that these firms have? This is a step that many forget, but it is important because the alliances of firms become a broader network where the relation of two firms can decide how they relate to other firms. So Sharp already has an alliance with Sony in exactly the same business – LCDs. Seeing Sharp tie up with Foxconn obviously suggests to Sony that Sharp is less interested in the Sharp-Sony alliance than before, and Sony can predict a number of problems following that decision. Sony has already announced that it will not invest further in that alliance, and it may exercise its right to make Sharp buy out its equity stake. This is a reaction that Sharp executives should anticipate: it is hard to maintain alliances with two firms that are rivals in the same market. But it is likely that they did anticipate this reaction and joined the new alliance regardless, expecting Sony to pull out. In research with Hitoshi Mitsuhashi and Joel Baum I found that firms in alliances also kept an eye out for other opportunities, and switched to alliance partners that fit their needs better. Alliances are practical solutions to problems, not necessarily lengthy commitments.

The problem for Apple is of a different kind. Both Sharp and Foxconn supply LCD displays to them. I have previously written about Apple's move toward spreading its purchases across multiple suppliers (Power and Temptation). This could be a risk management strategy, but it could also be a way to make them compete. If it is a way to make them compete, it is already starting to backfire, because a Foxconn-Sharp alliance is going to be a more difficult negotiating partner than Foxconn and Sharp acting independently.

The Foxconn-Sharp alliance has effects across many layers. It lets them transact more easily than before, and provides needed resources for both firms. It may re-arrange other alliances in the LCD industry, notably the Sony-Sharp relation. And finally it has implications for their customers, who may now be seeing a bigger and more assertive supplier. Alliances are complicated because they have so many effects, but in this one it looks like Sharp and Foxconn are maneuvering well.

Greve, Henrich R., Hitoshi Mitsuhashi, and Joel A. C. Baum. Forthcoming. "Greener pastures: Outside options and strategic alliance withdrawal." Organization Science forthcoming. Juro Osawa and Daisuke Wakabayashi. Foxconn Buys Into Sharp. Wall Street Journal, March 27 2012.