KPMG

Joint Venture Advisory Practice

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Avoiding Blind Spots when Measuring a Joint Venture's Performance

After months of challenging negotiations, the joint venture (JV) terms have been agreed on and documented. But the work does not end here. Now comes the question of "How do I measure the performance of my new JV?"

While the traditional measure of performance is usually profit, the key strategic goals of JVs are not always monetary. Sometimes, JVs are set up as an agreement to share research, knowledge or certain intellectual property -- as in the case of a JV that was established to combine the R&D efforts of two specialist businesses. If traditional financial returns within the business unit are measured, the JV appears to cost more to operate than originally anticipated. There's also the risk of being perceived as non-performing. Whereas in reality, both partners are extremely satisfied as the combination of the two R&D units have produced new technology, which one party would never have developed alone and which is of value to both partners in their businesses outside of the JV. As long as the partners' strategic goals remain aligned and the sharing of created IP has been agreed to beforehand, the JV may actually be viewed as outperforming.

There is no "one-size-fits-all" approach to performance measurement. So it is crucial to understand the importance of non-financial performance measurement when evaluating JVs or alliances. In this issue, we look at situations where financial measurements may fail to achieve a comprehensive performance assessment and suggest certain non-financial measures that can be considered.

When financial measurement is not enough

Some JVs are **not core to the overall business** and are deemed 'immaterial' to the parent. Materiality is usually linked to financial significance. However, if evaluation is solely linked to financial measures, one may overlook the JV's true value. For example, a JV that was established to block a competitor's access to a certain resource/market or to tie up a key distribution channel might be small set up, but hugely valuable strategically.

In cases where JVs are private arrangements, especially **with different financial arrangements between the partners**, using financial measurements alone may not be adequate. It is difficult to compare the performance of one JV against another within a company's portfolio, and even more difficult to find a comparison outside the company's portfolio. This challenge is further exacerbated when comparing a JV which you control vs. one you don't.

There are also instances when JVs can contain **inefficient cost structures**, where the JV has peculiarities in its financial design resulting in certain requirements of one of the partners. For example, a government's requirement for a fixed minimal wage to assist the local employees or a need for seconded employees (normally on an expatriate pay package) to add value to a business or to train and transfer knowledge to the local employees.

Alternative JV non-financial performance considerations

When it comes to the JV non-financial performance considerations, they need to be designed specifically to meet the needs and the risks of the JV that shareholders are trying to manage. We recommend three main areas to begin with:

- Assess the relationship
- Design pre-emptive metrics and solutions
- Assess the environment

Assess the relationship

Trust is the most important item for a JV to succeed, but it's hard to quantify. It is, however, reflected in the strength of the relationship between the JV partners and this can be assessed. Like any relationship, any party that feels oppressed or marginalised, is more likely to react and cause harm to the other party. In a JV, this could spell disruption, trigger cash calls, tie up assets or lead to an excuse for an easy exit.

Design pre-emptive metrics and solutions

JV non-financial metrics can be a pre-emptive to ensure that issues are dealt with on time to protect against unforeseen relationship or local issues. For example, understanding what resources could be attributed to improve the overall value of the JV and increase performance. This is not only about financial investment, but it can be softer things, such as procedure manuals, localising roles to replace rolling off secondees, or sharing access to relevant operational benchmarks. Pre-empting the needs of the business and assisting in the facilitation where able not only improves the business, but also creates a picture of overall performance.

Assess the environment

Shareholders often are quite inward looking when assessing the performance of a JV. For example, in a JV between two resource companies, Company A might assess performance on throughput, operational efficiency and safety, whereas Company B, the operator, may assess utilisation, cost recovery and management to budget. Rarely do companies comprehensively assess the wider environment and manage JVs to optimise performance for other stakeholders. This is not to say optimise at the expense of your own interest, but understand the strategy and pressures of stakeholders and ensure that the JV is in an environment in which it can perform.

Also, JV partners ought to be vigilant to stakeholders outside of the JV, particularly government, when operating in a foreign country. Assessing the JV against wider environmental factors, such as upskilling local workforces or changes in government policy towards industries, are valuable tools when assessing JV performance and risk.

The KPMG Joint Venture Advisory Practice conducts such reviews, whether on a particular joint venture or alliance, on a portfolio of joint ventures or with the operators, with the view to identify joint venture risks, optimize the business and increase shareholder visibility and engagement.

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