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The Trouble with JVs

As companies seek to expand into new territories, joint ventures are becoming an ever more essential part of the business landscape. ***Marc van Grondelle****, Head of Joint Ventures at KPMG, explains the practicalities which business leaders can't afford to overlook*

When boards consider joint ventures they tend to think of a mutually beneficial contract between their company and a government or a large national company, bringing them much needed access to or licences within a host country. They foresee a straightforward arrangement with both sides keeping each other's interests firmly in mind. A well-developed and legally sound Joint Venture Agreement (JVA) underpins this confidence.

Sadly, this scenario commonly proves unrealistic. All too often, joint ventures are forced marriages between two or more parties who misunderstand each other and have widely differing aims. Western companies often lack the expertise needed to make joint ventures work in practice; they over-rely on the JVA, under-resource the venture itself and pay scant attention to any warning signs that trouble lies ahead.

SLIPPERY SLOPE

Take international oil companies, for instance. Typically, these have around 30 to 40 per cent of their portfolios tied up in joint ventures, a percentage that is set to grow to some 70 to 80 per cent over the next five to eight years, as they enter territories in the hope of securing new resources.

Although joint ventures are familiar ground for oil and many other natural resource companies, such operators often struggle to make them work. Cost overruns, schedule delays, compliance issues, renegotiations and value-erosion are common.
Even major transnational energy companies with heavy exposure to joint ventures in their portfolios do not have the skills, resources and specialist expertise to operate with sustained success in the joint venture space. Applying, for example, 'normal' assurance methodologies (which are effective within the company) to a joint venture results in under-detection of those issues likely to erode value. And the absence of intervention skills makes any attempt to enhance performance a costly exercise. In fact, companies with a wide range of sectors often admit they have no expertise in this area.

With such scant top-down knowledge, companies also struggle to find volunteers to staff ventures properly. There is a very strong perception among junior executives and high-potential employees that joint ventures spell trouble when it comes to their career trajectory. There is plenty of anecdotal evidence to show that individuals seconded to joint ventures see their promotion prospects damaged by the experience.

In order to make a joint venture work, the following areas need to be given due consideration:

KNOW WHAT IS EXPECTED OF YOU

Whether you are dealing with governments or corporations, it is essential to understand the motivation of joint venture partners, and actively manage how these motivations change over the years. In the case of governments granting mineral or exploration rights, for instance, commercial companies need to appreciate that their joint venture partner will want to be seen to deliver value to their electorate, whether through equity rights, resources or assistance with infrastructure projects.

Relying on sanctity of contract is less and less applicable globally. This is a principle that holds true for other kinds of joint venture partners. A large state company providing market access will also want something in return and it is crucial to identify what that something is: people or technology, for example.

It is therefore necessary to keep an eye on your partner's expectations of you and any changes in those expectations as time goes on. Prepare to adjust course, and re-negotiate the joint venture, or put defences in place early.

BEWARE CONTRACT KILLERS

Western companies tend to believe that a contract (once set up and signed) will be adhered to. However, that's an assumption that doesn't always hold up when it comes to working in some developing economies. In parts of Asia, Latin America and Russia, for example, the life cycle of contracts tends to be much more short-lived than in Western markets. In the UK, a contract is a contract. In the majority of emerging economies, the contract is the basis for ongoing discussion.

Before going ahead, run challenging scenarios as to how the local joint venture partner(s) may seek to renegotiate and erode value. Play war games and 'what-ifs', using neutral third-party joint venture experts. Then, put defences in place to make your joint venture a hard target and manage these defences continuously as the venture matures.

THE FIRST YEAR IS CRUCIAL

Delays in subsequent years can often be traced back to inadequate resourcing and management inattention during year one. Companies often find that overlooking compliance issues, such as the need to acquire environmental permits or pay local taxes, are omissions that can be held against them later. Likewise, opportunities not taken up in the first year may prove unrecoverable.

It's a case of approaching the first year as you would an acquisition or merger, and planning that first year thoroughly before signing off on the JVA.

Once the plan is in place, check and audit progress rigorously.

REVIEW AND STRENGTHEN

Your joint ventures must be proactively managed. It is important to put early detection mechanisms and specialist trouble shooters in place. That often means audit and assurance arrangements need to be very different from the standard approach, so review existing joint ventures to ensure your position is a strong one and look to remove areas of conflict.

For example, in the former Soviet Union, minor non-compliance with tax or environmental laws are often used to commence joint venture re-negotiation. Strict compliance with key requirements, based on thorough defensive risk assessment, will be key to protecting your joint venture.

RESOURCE YOUR JVS WITH CARE

Companies often under-resource in terms of both the quantity and quality of the personnel they deploy. This is about developing capabilities for the long term and looking at individual joint ventures with a view to identifying management and skill deficits. Key employees will also need adequate backing. ■

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Through his work on the governance and trouble-shooting of complex transnational joint ventures, often from the position of a minority stake holder, he has been personally seconded into joint ventures with Shell, XOM, Total, ENI and other IOC's, as well as a wide range of National Oil Companies.

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