Joint Venture Advisory Practice

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Reviving focus on non-operated joint ventures

Why it makes commercial sense to pay more attention to non-operated joint ventures

A large proportion of joint ventures are non-operated, meaning that while a company may have an equity interest in the joint venture, it does not operate or control the day-to-day operations of the business or asset. This form of business partnership arrangement was pioneered by the oil and gas, natural resources and associated industries, but they are becoming increasingly popular in other sectors as an alternative to joint operations. Especially, in circumstances where one partner has a particular skill and the other does not.

While the non-operator may rely heavily on the performance of the joint venture, it is our experience that many do not spend adequate time protecting their interests. The preference instead is to focus on wholly-owned subsidiaries, forming new ventures or optimizing joint ventures, which they operate. When they do assess the performance of their non-operated joint ventures, they tend to focus on specific aspects and rarely on the overall health of the business or relationship. In this issue we look at the reasons behind this, if this approach makes commercial sense, and the current market trends on these forms of business partnerships.

Non-operators need to pay attention to what they do not control

Large organizations have a tendency to focus on businesses that they can control rather than those they cannot. This stems from how they are typically set up to report success, incentivize people, and manage risk. The more common corporate structures leave the overarching governance to a few people, and they tend to focus on the larger chunks of the corporate pie – parts that can 'really affect performance'. There is a common perception that the effort required to materially affect non-operated joint ventures is greater, to achieve the same result. Naturally, this is not the focus of time poor management. This lack of attention or desire to invest time in what they do not fully control then cascades throughout the organization. With such structures and cultures, it is no surprise that non-operated joint ventures are a part of the business that is often forgotten or receives the least attention.

The disassociation with non-operated businesses are often emotional, rather than rational or economic, and make little commercial sense in isolation. They are often seen as 'their' businesses, 'not our responsibility', or 'not one of ours', whereas it is quite often the case that joint venture agreements give certain rights and abilities to the non-operator that can be used to improve performance. The focus is often on the profit and loss statement, which is more directly affected by consolidated entities, rather than the overall value of other business interests.

Focusing on non-operated businesses makes commercial sense
There are many reasons why corporations should focus on these businesses. They may provide a critical link in the value chain, contain large balance sheet assets, lead to larger opportunities with the other joint venture partners in the future, or they may offer a straightforward opportunity for value accretion. Usually, should the non-operated joint venture fail, it will cause more challenges and value loss outside of the business than within it. For example, failure by a multinational company partnering with a state-owned enterprise can result in a difficult future business environment in that country for a period of time. Or, failure in a joint venture that forms part of the company's supply chain can have a domino effect on the brand, financial performance and reputation, and hold ups for supply above the breakage. As these examples show, it often makes commercial sense to pay attention to what you do not fully control.

Failing joint ventures are often those which find themselves in a position where the world has changed since the joint venture was established, but the agreements have not. Companies reposition strategies, markets move, and countries evolve, yet the operator is trying to manage a business through a set of legal agreements that has become obsolete. What tends to happen in these instances is that people try to 'fix' the issues, one at a time. A little tweak here, a little change there, and all of a sudden there is a mishmash of out-of-contract arrangements to keep things going. A far better approach is to reset the joint venture periodically. Joint venture partners should sit down and readdress the imbalance and optimize structure and governance, in order to give operators the best chance of success.

It would be unjust to claim that all non-operated joint ventures are not in focus. In fact, many are. The issue is how they receive the focus. They often engage with different departments in the company, but this is usually conducted in silos with the specific purpose of that business unit in mind rather than the overall health of the business. For example, the legal department may look at regulatory compliance, the operations team at operational efficiency and compliance, and the finance team at the cost allocation framework or financial performance. It is relatively rare for large corporations to take a holistic perspective and look at the overall health of the business, and that is where we see value leakage.

The importance of non-operated joint ventures is a topic that needs the commitment and support from leaders and managers. Organizations are increasingly building a culture around shareholder value rather than profit and loss accounting, so joint ventures should always be assessed on the basis of the value they deliver beyond the business and used as platforms for ongoing business development opportunities.

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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