Joint Venture Advisory Practice

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Succeeding in joint ventures and alliance creation

Business partnerships, in the form of joint ventures, alliances and other collaborative approaches are increasingly important for many businesses. However, with a high overall failure rate, successful delivery is a common challenge that, when poorly managed, results in value erosion, tarnished business relationships and sometimes even country expulsion.

There are numerous reasons for future underperformance at the deal stage. In this issue, we cover a few common examples.

To detail or not to detail
When forming a new business partnership, the likelihood of success can usually be predicted based on the parties' willingness to delve into the details during the deal stage. Reluctance is understandable as there is often uncertainty with the proposed transaction, and the deal usually involves commercially sensitive information, especially at initial stages of development.

Unfortunately for the health of many joint ventures and alliances, it is at these initial stages when key success factors are agreed. Shareholder split, economic benefit and board of directors composition being three more common examples of these. Further along the transaction when more information is available, it usually comes to light that those earlier decisions are now restrictive and any design will be suboptimal or uneconomic, with impact to at least to one party. This is commonly where deals start to fall over.

There are many examples of joint ventures where companies have signed a contract and plan to 'work out the details later'. These joint ventures and alliances generally perform badly, with little or no alignment over strategy, investment, return expectations and how it will work in practice.

We recommend establishing a deal approach which allows parties to release increasing levels of information as the transaction progresses and milestones are reached. As parties start to see the deal forming, they tend to embrace collaboration, which contributes to the formation of a robust deal.

Robust yet flexible deal approach
More often than not, the reason for not following a robust creation strategy stems from the resistance around investing time or money on something that is not as certain as, say, an M&A transaction, or the fear of offending their future partner by focusing too much on the details. In the worst cases, where the joint venture transaction or transition becomes unsalvageable, companies incur significant monetary and opportunity costs far in excess to what the original investment would have been, so it makes little sense not to setup robust structures in the first place.

Inflexible internal and external deadlines can also play a part, with factors such as reporting dates, competitive pressure or even 'getting it done by Christmas' impacting the robustness of major transactions, which shareholders regret in hindsight. Flexibility allows potential partners to do the right deal, rather than be pressured into doing any deal.

Underestimating the impact of ethnic culture
Another factor that influences the chance of success when forming a new joint venture is culture. Two potential partners from very different social cultures, such as Japan and Indonesia, would have an immediate hurdle to overcome before achieving success, as compared to two Japanese companies. Furthermore, stereotypes from the press or other unrelated businesses transactions also help to create preconceived ideas about another culture, and these are usually deeply rooted in the population. However, with some acceptance and understanding, and willingness to make the partnerships work at a strategic level, this can be relatively straightforward to overcome.

Underestimating the impact of corporate culture
Corporate culture on the other hand is usually more difficult to overcome. The issue stems from the fact that business generally focuses on the competitive mindset – winning that bid, taking that customer, or even getting that promotion. The particular element of joint venture formation which is affected is control. A potential source of tension could stem from both partners' unwillingness to relinquish centralized control (competitive mindset) for one that includes joint decision making (collaborative mindset). This is especially the case when the joint venture is with a natural competitor, and for this reason these joint ventures are the hardest to form and to maintain successfully. This is an anomaly to economic theory, as close competitors should by their very definition be aiming for similar goals and have similar issues, and working on these together ought to be more efficient than working apart.

Over-reliance on the contract
When things start to get tough, it is all too easy to pick up a legal agreement and start to point fingers. This is a slippery slope. It is less damaging to focus on the relationship and try to find amicable solutions. In strong joint ventures, there is nearly always a focus on the relationship rather than the contract, and it is acknowledged as a normal course for businesses to change and develop. The issue is that contracts are rarely designed to change with them. The learning deal makers should take from this is to build in the ability to regularly review the agreement once established.

The issue of control
A stumbling block for many newly formed joint ventures is the constant need for the partners to recognize that no one party has full control. To create a collaborative environment, close relationships amongst the partners (and others involved) are highly encouraged. To maximize the chances of success, early and constant vigilance is needed to ensure contributions and outputs are broadly in line with the agreement. Parties should also outline pre-defined plans to initiate immediate remedial action if there are any disparities from expectations. This agreement to fairness builds an open and trusting relationship, which generates value. If the joint venture is being managed through the legal terms and conditions, then it is fair to assume that the relationship is failing and ought to be readdressed.

Setting up a joint venture
Our observations on some of the other common pitfalls in a joint venture creation can be summarized as follows:

- Joint venture not coordinated between transactional and operational teams.
- Partners usually make joint venture creation complex, which consumes unnecessary resources.
- Partners disagree on respective investments into the joint venture.
- Complex interactions with government agencies and inappropriate time frames.
- Pre-deal operating model agreed during the transaction but insufficiently detailed for implementation.
- Solutions not mutually beneficial and understood by both partners who may be from very different cultures.
- Too much focus on the 'I win, you lose' rather than the 'win-win'.

Having the necessary insights and assistance from an independent party such as KPMG can be invaluable when setting up, optimizing, resetting or exiting a joint venture.

Contact us

Brad Johnson
Director, Deal Advisory, Joint Ventures
T: +65 6213 3800
E: bradjohnson@kpmg.com.sg

KPMG
16 Raffles Quay
#22-00 Hong Leong Building
Singapore 048581
T: +65 6213 3388
F: +65 6227 1297

Find out more about our services at **kpmg.com.sg**

kpmg.com/socialmedia

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