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Emerging markets, emerging opportunities

Strategies for automotive partnerships in today's global marketplace

Contents

Emerging markets, emerging opportunities

Increasing globalization of the automotive industry is changing the dynamics of traditional strategic partnerships, particularly cross-border joint ventures (JVs) between Western companies and their cohorts in emerging markets.[1] Ten years ago there was uncertainty about pursuing business in markets such as India and China because political and business conditions were not conducive to direct foreign investment. As a result, many automotive original equipment manufacturers (OEMs) such as General Motors, Toyota, Honda and Ford, and in particular automotive suppliers like BorgWarner and Magna, viewed strategic partnerships as a way to dip their toes into the water.

Because some governments in emerging markets require the establishment of formal relationships with domestic partners in return for market access, many companies interested in global expansion today view JVs as a required cost of entry and less of a strategic driver for justifying a strategic partnership. Outside of these basic market entry requirements, however, strategic partnerships today are becoming more focused on addressing a specific need, such as gaining access to a new technology, quickly securing a local presence to cost-effectively serve stakeholders and customers, collaborating on product development initiatives while sharing capital risk, and accessing highly skilled and/or low-wage workers.

What do changing objectives mean for companies that are considering a new strategic partnership? What should the ownership structure look like? How should partners that are focused on developing new technologies share people, processes and other resources while maintaining barriers that protect intellectual property? How does management know when it is time to dissolve the relationship?

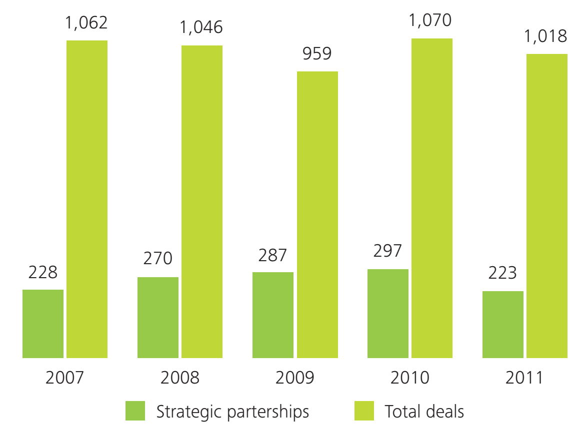
Given today's evolving business considerations amidst the rapidly changing dynamics of the global automotive industry, it is an opportune time for companies to examine the objectives and structures of their existing or contemplated strategic partnerships. The targeted end game is markedly different than it was 10-15 years ago; those companies that fail to clearly define objectives or comprehensively consider the opportunities and pitfalls associated with their strategic partnerships may find themselves in a situation similar to the now high-profile break-up between two automotive manufacturers, which was meant to bolster one company's presence in an emerging market while giving the other access to technology it could not afford to develop on its own, but in the end did not deliver significant progress toward either objective.

Despite the reluctance of some companies to enter into JVs in light of certain issues examined in this article, in some cases strategic partnerships are the only option available to organizations looking to grow in today's global marketplace. In the following pages we examine how the nature and structure of strategic partnerships have changed, and discuss what executives should consider when weighing the pros and cons and evaluating the details of establishing new relationships.

Automotive partnering activity remains strong

While buyouts have fluctuated and exhibited little growth over recent years, automotive strategic partnerships have witnessed consistent growth — outside of 2011, which can be attributed to slowing growth in emerging markets like China and the natural disasters in Japan in March, 2011. When comparing automotive transactions from January 2007 to December 2011, strategic partnerships represented between 20-30 percent or more of the total each year (Figure 1). Further, cross-border transactions comprised 35 to 40 percent of all strategic partnerships in recent years, and ticked up slightly in 2011 (Figure 2). This history demonstrates that, despite global economic uncertainty, automotive companies continue to recognize growth opportunities and are leveraging strategic partnerships in an effort to take advantage of them.

Figure 1: Automotive strategic partnerships vs. total deals



Source: Mergermarket

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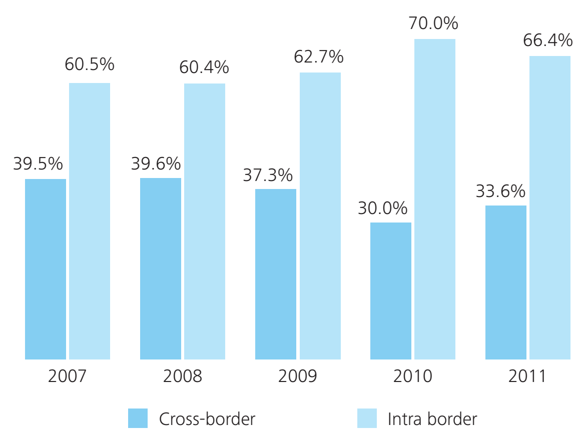
Figure 2: Cross-border vs. intra-border strategic partnerships



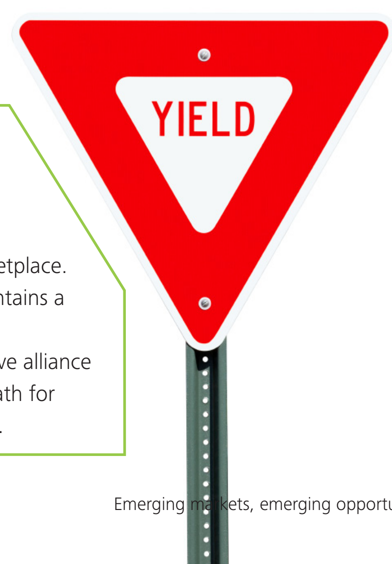
Source: Mergermarket

Today's strategic partnerships come in all shapes and sizes

Establishing strategic partnerships has long been common practice within a number of industries. These relationships vary in type and range from informal handshakes to complex agreements that frequently result in two enterprises forming a new company ("Newco JV"). Companies participating in JVs are often able to quickly pool resources and opportunities, or capture a less-than-whole ownership stake of an existing company in an emerging market to obtain a stronger or more strategic geographic presence. While the partnership types in the automotive industry are similar to those in other sectors, the dynamics of this industry present several unique nuances. Specifically, emerging technologies in areas such as alternative powertrains (hybrids, electric vehicles, etc.) and in-car connectivity are driving convergence across a number of sectors and creating opportunities for non-traditional strategic partnerships between automotive and technology companies, or even automotive competitors. For example, Toyota and Nissan are among automotive OEMs that have recently partnered with technology companies in Silicon Valley to make vehicles safer, more environmentally friendly, and more convenient to use.[2] Also, BMW and Toyota recently announced that they will work together on green car technologies, including joint development of lithium-ion batteries; BMW will also supply diesel engines to Toyota in Europe as part of the deal.[3]

Generally, the most active participants in developing automotive industry strategic partnerships have been automotive suppliers, particularly companies in the interiors, electronics, and powertrain sub-segments. Examples include Johnson Controls' JV with a Chinese manufacturer to supply interiors for an auto assembly plant being built there by a Chinese OEM and Italy's Fiat Group Automobiles SpA, as well as BorgWarner's JV relationship with 12 of China's largest automotive manufacturers to supply dual-clutch technology.

OEMs also frequently enter into JVs and alliances, which are often complex, large-scale arrangements involving a number of entities. The JVs GM and Ford have with local Chinese partners are examples of traditional OEM alliances; however, OEMs and suppliers have recently announced more nontraditional strategic alliances that may not have been considered a decade ago. For example, Ford and Toyota announced on August 22, 2011, that they will jointly develop as equal partners a new rear-wheel drive hybrid system and component technology for light trucks and SUVs.[4] GM has also recently announced that they will jointly develop a new line of battery-powered vehicles with a South Korea-based electronics company.[5] And on April 5, 2011, Toyota and Microsoft announced a strategic partnership to build telematics services — the fusing of telecommunications and information technologies in vehicles — on the Windows Azure platform.[6] These three non-traditional examples, as well as the BorgWarner-OEM JV previously noted, clearly reflect a shift in how companies are evaluating and leveraging opportunities associated with strategic partnerships.



Story from the road

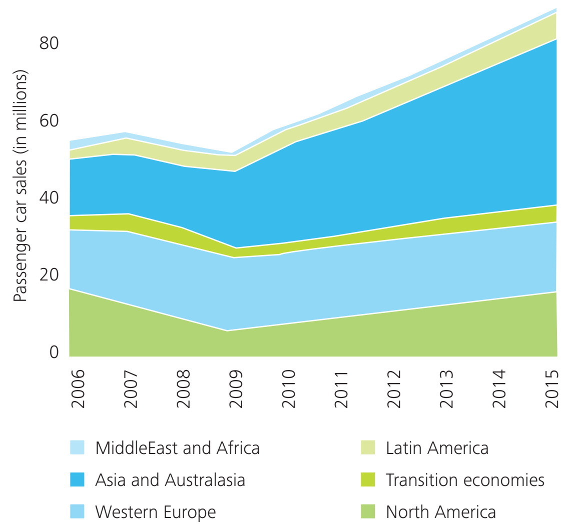
BorgWarner leverages a JV to introduce new technology into the Chinese market

BorgWarner, a global supplier of vehicle parts and systems, created an innovative JV in China to introduce its dual-clutch technology. By partnering with 12 of the largest Chinese auto OEMs, BorgWarner was able to accelerate adoption and acceptance of this technology in the Chinese marketplace. The OEMs each hold a small interest in the JV through an investment vehicle, while BorgWarner maintains a two-thirds stake. By providing key customers a stake in the technology's entry in the high-growth Chinese auto market, BorgWarner spread the execution risk and moved into an active alliance with customers. As new technologies are developed, this or other JV entities may provide a similar path for BorgWarner to push faster and broader marketplace acceptance in China or other emerging markets.

Gaining access to new customers or new markets

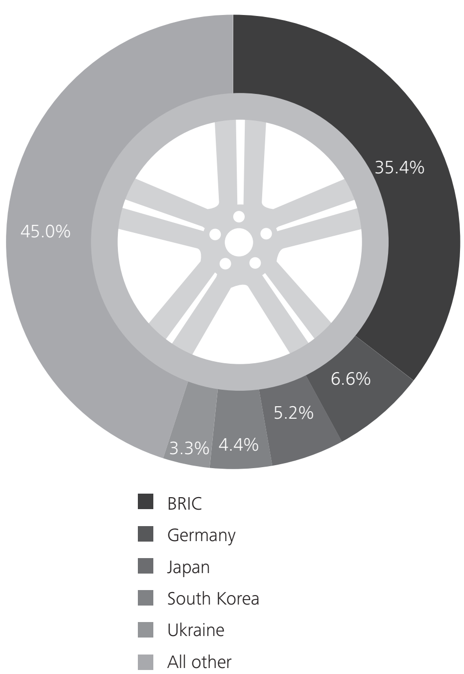
Emerging markets such as Brazil, Russia, India, and China (BRIC), as well as newer economies throughout Asia, the Middle East, and Africa, represent significant growth markets and, therefore, are important strategic partnership target geographies for automotive manufacturers and suppliers (Figure 3) (Note that the United States ranks approximately 12th). In fact, much of the growth forecasted for the industry — estimated to reach approximately 90 million units globally on an annual basis by 2015 — is expected to come from these markets (Figure 4). As a result, automotive companies — primarily based in the United States and BRIC countries (see Figure 5) — will continue to look at strategic partnerships to gain access to new customers and take advantage of increased consumer demand in these markets.

Figure 4: Global car sales, 2007-2015



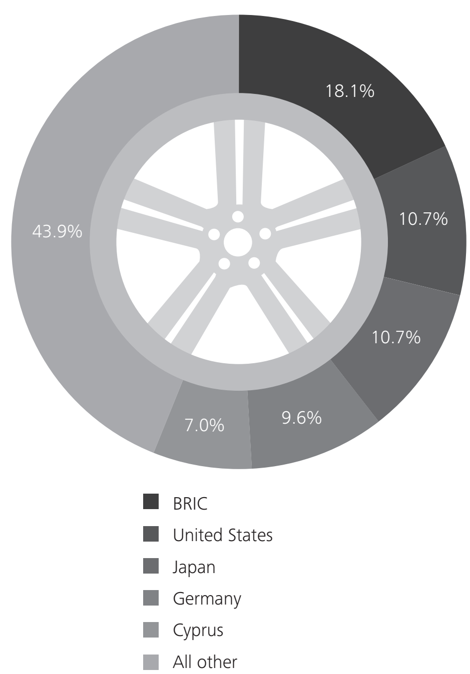
Source: Economist Intelligence Unit

Figure 3: Top five cross-border strategic partnerships — Target nations (2009-2011)



Source: Mergermarket

Figure 5: Top five cross-border strategic partnerships — Acquirer nations (2009-2011)



Source: Mergermarket

Until recently, the price of entry into some of these emerging markets had been to form a strategic relationship — typically a Newco JV — with a local partner. While a JV's governance structure may provide more limited benefits over time than a merger or acquisition, in certain situations some countries' governments, such as China, don't offer a choice and a JV is the only option for foreign entities. In addition, if a company's goal is to secure production capacity in a region to more efficiently reach new consumers or serve an existing customer, a JV may be the quickest and easiest approach. Small companies, in particular, tend to use JVs in this manner, seeking to expand without incurring significant capital expenditures while still providing enough funding to turn the local partner into an engine for growth. There are also some significant political and social benefits to pursuing a JV in a region where governmental influence over an industry is strong. For example, the local partner can use its expertise and presence to help the foreign company better understand market dynamics and gain acceptance, thereby helping to accelerate the introduction and adoption of new products and technologies.

Gaining access to new technology

In some instances, it may be more cost- and operationally efficient to form a JV that results in access to emerging technologies. Continued convergence of the automotive industry with both the energy and technology sectors elevates the urgency and priority of establishing technology-based JVs if automotive companies are to adequately meet the demands of today's connected and environmentally conscious consumer. Forming a JV to access complementary or important technologies provides technology companies with access to new consumers while also retaining intellectual property and ownership rights. Conversely, these partnerships allow automotive companies to focus on manufacturing vehicles and parts while the JV partner continues to participate in the technology's upside from an innovation and revenue perspective. The resulting relationship beneficial to both parties in that the automotive company has the opportunity to create a differentiated brand based on its ability to deliver technologically advanced products which consumers desire. This is becoming an even more significant opportunity when taking into account that many of today's automotive technology JVs center on advancements in safety, fuel economy, and powertrain management, as well as electronics that allow the driver and passengers to interface more easily with the car. Again, Toyota's relationship with Microsoft and GM's agreement with South Korea-based electronic company are examples of how companies are creating these kinds of technology-driven partnerships.

Convergence signals opportunities for non-traditional strategic partnerships

According to Deloitte's annual automotive Gen Y consumer study, available at www.deloitte.com/us/geny, consumers between the ages of 19-31 expect the cars they drive to interact seamlessly with their connected "personal technology cocoons." In-dash technology is the most important part of a vehicle's interior for a majority (59 percent) of Gen Y respondents, with almost three-quarters (73 percent) seeking touchscreen interfaces. Gen Y consumers also rank smartphone applications as highly desirable in a new automobile (72 percent). Moreover, they expect automakers to incorporate connected technologies such as GPS, mobile apps, etc., into their vehicles at the same pace as technology companies, who often introduce new smart phone technologies several times a year. For automakers, this consumer demand represents a significant challenge. In one example of a solution, Toyota and Intel recently announced a partnership to work on technologies for connecting cars with smart phones and other personal information devices.

Sources:
Deloitte's 2012 Gen Y Automotive Survey, www.deloitte.com/us/geny
"Auto Makers Racing to Form Tie-ups With Silicon Valley," *Nikkei Report*, November 11, 2011

Accelerating the development of new or emerging technology

A number of recently announced strategic partnerships focus on emerging or developing new automotive technologies. Unlike 10-15 years ago, however, these alliances are more frequently between peers — OEM-to-OEM or supplier-to-supplier. One recent example is the Ford and Toyota partnership to jointly develop a new rear-wheel drive hybrid system and component technology for light trucks and SUVs.[7] Strategic partnerships of this type often take advantage of the specific strengths of the individual partners, and may lead to other benefits, including:

- R&D cost reduction opportunities through collaboration between talent and existing infrastructure
- Accelerated innovation cycles as a result of leveraging advanced technologies that may be owned by one partner, but not yet perfected
- Improved manufacturing efficiencies through enhanced processes or use of advanced materials.

By partnering as peers, innovations and new technologies developed through these relationships often have industry-wide, game-changing ramifications that deliver value to the partnering organizations more quickly and at a lower cost than if they had gone it alone.

A number of recently announced strategic partnerships focus on emerging or developing new automotive technologies.

Creating the perception of scale

In emerging markets, it is often important to create a perception of scale to demonstrate the ability to meet customer demand. This is particularly true among suppliers, as OEMs continue to expand operations in emerging markets, develop global platforms, and look to existing suppliers to deliver the same support they do in developed markets. To demonstrate an ability to serve OEMs effectively in these new markets, it is important for suppliers to establish a strong presence and perception of being able to serve customer needs anywhere in the world. At the same time, suppliers may wish to delay large capital investments until an OEM's market entry strategy delivers results (e.g., increased market share). A strategic partnership with a local partner could be the solution that allows suppliers to quickly set up significant operations while also reducing risk and exposure resulting from large investments. Long-term, demonstrating such scale may also result in new customers, as many emerging markets, such as China, continue to invest in launching domestic vehicle brands.

Diversifying a risk profile

The devastating impacts of Japan's 2011 earthquake and tsunami have rippled across the global automotive industry and renewed focus on JVs as a way to diversify risk profiles. Parts shortages resulting from the earthquake may lead some automotive companies to consider moving from single-sourcing to dual-sourcing of suppliers through JVs in various geographical regions. In fact, according to a Deloitte survey following the natural disasters in Japan, available at **www.deloitte.com/us/automotive**, 31 percent of respondents indicated that due to concerns of parts shortages, they have either initiated or are planning supplier transitions.[8] Twenty-eight percent of respondents also indicated they were initiating or planning supplier transitions based on concerns associated with lead time.[9] While much of this concern is driven by OEMs, suppliers also have an opportunity to consider strategic relationships to demonstrate to manufacturers that they are fostering risk-avoidance by producing in multiple geographies.

Strategic partnership structures: Today's partnerships are less often perpetual ones

The way that today's automotive industry strategic partnerships are being created is increasingly different than a decade ago. This is a reflection of the impacts of globalization and global platforms, rapidly evolving technologies, industry economic conditions, legal and regulatory developments, and changing expectations about the value of long-term alliances. While traditional agreements were often "in perpetuity," companies that may have established such partnerships in the past are now realizing their potential limitations and are applying those learnings as newer partnerships are considered. The emerging trend appears to be shorter-term relationships designed to achieve a particular business or technology goal. The following are among important challenges and issues to consider before entering into a strategic partnership.

- **Governance and cultural tension**
- **Accounting uncertainty**
- **Tax inefficiencies**
- **Conflicting partner expectations**
- **Operational complexities**
- **Valuation considerations**
- **Confidentiality issues**

Governance and cultural tension

There may be differences between a JV's legal structure and how operations play out in real life. For example, a Newco JV's management may try to run the company as a standalone or independent business, while the JV partners have different views and objectives. Also, in many countries, the local JV partner may have minority rights that impact the role of the majority partner to govern as it likes. If, for example, a Western automotive company buys into a business in China as a majority shareholder, the Western executives may feel that they should have full say in how the JV is run. But they may find that employees and customers continue to report to and communicate more with domestic owners.

Important considerations

When entering a new joint venture or alliance, thought should be given to the overriding operating environment, perceived vs. actual structure, and roles and responsibilities. Lacking a well-thought-out and documented governance and reporting structure, difficulties are more likely to arise; this can add stress to the venture and its investors' relationships, leading to potentially diverging goals and results.

Accounting uncertainty

U.S. accounting rules have changed regarding the financial statement consolidation of a joint venture. Previously, rules centered on percentage of ownership and board seats. Now, other factors come into play, including level of control and sharing of business risk. For example, if the JV is highly leveraged, will the U.S. company be consolidating that debt onto its books? How do the partners value the technology one party may bring to the JV or the political/cultural knowledge or large customer base the other supplies? How will the profits of the Newco JV be distributed to the partners — or will the profits be reinvested?

Important considerations

The slightest of changes in the structure, influences, and economic interests of joint ventures can determine if consolidation or deconsolidation of such entities by a party is necessary. Ambiguity in structure, influences, interests, and responsibility can result in unforeseen and unwanted compliance and accounting results. A complete understanding of the circumstances surrounding the venture, as well as an understanding of the desired economic and accounting results, should be obtained prior to finalization of such agreements.

Tax inefficiencies

Choices made when structuring a strategic partnership may generate unforeseen tax consequences. To mitigate negative tax consequences associated with structuring a JV, consideration must be given to what each respective party will be contributing to the organization, where it is most tax-efficient to form the JV, and how tax administration and reporting will be handled in the ordinary course of the relationship. Additionally, in certain circumstances, the tax costs to unwind a JV have prevented the parties from completing the separation. All these outcomes require careful attention at the outset to mitigate costs and optimize results.

Important considerations

The guiding tax principle in creating a JV structure should be to enhance, not impede, the operational and financial effectiveness of the venture. This is not always easy, particularly when dealing with multiple countries' tax regimes and potentially different tax profiles of the JV partners. However, careful tax planning, including the use of tax-friendly treaty jurisdictions and negotiating and securing available credits, incentives and holidays, may help the parties achieve their objectives. Additional attention must be paid to tax compliance implications and reporting responsibilities. The careful drafting of terms regarding which party has primary authority over tax affairs and dispute resolution mechanisms can significantly mitigate future burdens. Further, thinking ahead to the potential tax implications to each party upon a JV exit or unwind, no matter how far down the road or unlikely, is a critical pre-formation step.

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Conflicting partner expectations

One party may view the JV as a way to gain access to a technology (or other asset) into which they can embed R&D to develop it further and spur innovation over the long term; the other party may see the JV as a way to gain access to a technology that they can run in the short-term and then spin off (or dissolve the JV) when it becomes outdated or is no longer needed. Clarifying the desired value to be obtained from a JV early in the negotiating process can determine if the deal is a good fit for both parties. In addition, partnering organizations should consider potential conflicts of interest that may arise during the life of the relationship. The Johnson Control-Saft partnership is one recent example where a change in the direction and scope of the relationship resulted in an end to the tie-up.[10]

Important considerations

Companies are well served by pursuing a formal and thoughtful process for determining (and documenting) the rationale behind the initial formation of a partnership. Furthermore, having the discipline to periodically re-evaluate and challenge the continuation of a partnership is important to re-establish a commitment or pursue dissolution in light of events which have occurred since initial formation. These evaluations should take place within the board-level governance of the partnership itself (as related to ongoing viability matters) and within the management structure of each partnering organization (as related to ongoing strategic and other confidential matters).

Operational complexities

Managing multiple JV partners in a specific region — especially if they offer similar goods or services — can be challenging. Additionally, complexities may arise depending on what the respective JV partners are bringing to the venture. In instances where one party is bringing the technology and know-how, they might enact restrictions on the ability of the other party to use and/or access the technology, limiting that partner's ability to grow with the venture. All parties want to grow and succeed; however, when managing multiple JV's it is important to strategically think about where new business is being placed to avoid unnecessary stress between the various parties.

Important considerations

In instances where companies are competing in a similar market segment, operating a JV together may add tension because the JV might give an advantage to one partner and consequently cause the other partner to relinquish market share. Additionally, the knowledge gap and the asymmetric technological capabilities between JV partner firms may grant the partner providing the technological know-how a greater influence over the key technical aspects of the JV management, such as technologies to be transferred, the timing and method of transfer, and the procurement of key capital goods; it may also influence which firm controls the future of the JV. In the JV's infancy stages, it is critical for both parties to address what each respective party wants to get out of the venture technologically and operationally and reach an understanding of what the JV structure might do in terms of direct competition.

Valuation considerations

Partners entering into a JV are typically focused on the strategic benefits of the new venture and often concentrate legal agreements on JV operations, governance, and dispute resolution. However, key elements of: 1) contribution value, 2) accounting measurement and financial performance, and 3) exit value are oftentimes not adequately addressed in JV agreements.

Contribution value

If all parties entering into a JV were contributing easily measured financial assets, the issue of valuation on entry would be quite simple. However, JV partners frequently contribute assets that are less easily measured than cash or have a different value to the JV than they may do on their own. For example, some parties may be contributing financing to the operation, while the others could be contributing a manufacturing facility, a whole operating company, technology, trade names, trademarks and brands, customers, people, and/or know-how. The further the move from hard assets to entire operations or to intangible assets (as esoteric as technology, brand recognition, know-how, reputation, and goodwill-like assets), the more nebulous the contribution's value can become. While management teams may have a perception of value, a clear and mutually agreed-upon understanding of how to value what is being contributed at the formation of the JV lays the foundation for a clear understanding of *what* is being contributed, can increase trust between the parties, and may decrease potential future disputes.

The use of options in a JV can create additional complexities. Often, one or more of the JV partners may receive an option to purchase the other party's interest in the JV; purchase certain operations or technologies; or divest (put) its own interest back to the other party at some future date. It is not uncommon for management teams to dismiss these options as mere structural elements, rather than value factors. However, there are accounting issues that should be considered. For example, if it has been established that party A's asset contribution value matches the financial contribution of party B so that each party owns 50 percent of the JV, and as part of the JV structure A issues an option to B so that B can purchase A's interest in the JV at a set price any time in the next five years, a potential value imbalance now exists. B is potentially getting more for its money than the agreed upon 50 percent. How much more? An amount equal to the value of the option issued by A. As part of financial reporting requirements, if an option is part of the JV deal, its value — and changes in value over time — should be recorded on the books.

The issue of valuation may also arise if there are capital calls during the life of the JV. For example, capital may be required if the JV is light on cash and requires additional investment for reasons such as mergers & acquisitions, property purchases, office upgrades, sales force expansions, etc. If future capital is contributed predominantly by one party, how much ownership will the partner receive for its capital contribution? A valuation of the JV at that point in time can establish a valid understanding of value of the respective JV partners.

Accounting measurements and financial performance

Profit is one of the many ways that JV partners may enjoy the success of their enterprise. Such profit can be taken as earnings that roll up to a parent company to augment its earnings per share (EPS) in the financial reporting of an SEC registrant, or as dividends of cash remaining after a reinvestment formula to provide the JV the ability to finance its operations and growth; or a more complex structure may be established so that while a party owns a set percentage, the dividend distribution is less or more than the actual ownership percentage. Differences in accounting standards, interpretation of what constitutes economic profit, and statutory/IFRS/U.S. GAAP considerations may inhibit a clear understanding for the JV partners to share equitably in the value creation of the JV. Clear accounting measurements can pave the way to measuring JV financial performance and reducing the risk of disputes arising from disagreements on key performance indicators (KPIs) and economic distribution to the JV partners.

Exit value

More and more, JVs are not expected to last indefinitely. When partners unwind a JV, either because it was structured to meet a sunset provision, its strategic goals have been met, or because of a dispute, value becomes a front-and-center element of the conversation. Oftentimes, JV agreements don't effectively address exit value. Some may discuss the unwinding process from a legal standpoint, but are silent about exit value measurements. Others may have a simplistic valuation formula (such as a multiple of EBITDA) or may map out detailed procedures to retain a reputable appraisal firm with escalation provisions if the parties fundamentally disagree with the valuation conclusions. Too often, these mechanisms are woefully inadequate to address exit value, leaving parties in the dark as to what to do. These simplistic approaches, possibly an afterthought when initially drafting the agreement, typically use a formulaic approach that relies on a poorly defined accounting or economic measure or a valuation metric that is out of step with economic reality when it comes time to employ it. This can lead to a potentially lengthy and expensive process that may involve arbitration and resolution through the courts.

Important considerations

When entering into a JV, parties should consider having an experienced finance/business advisor, not just a legal advisor, contribute to the creation of the agreements. Establishing a formal entry value that is designed to set the stage for clarity, define the asset value contribution of each party, and reduce any misunderstanding around value formation is time well spent. Formally addressing elements of structural value created by the optionality of certain contract clauses should be considered so that each party walks away with the appropriate ownership based on actual economic consideration. As the JV grows and matures, common agreed-upon accounting measurement and KPIs should be carefully evaluated to help increase the partners' appreciation of the JV's value creation and value sharing, and to help define how value will impact additional capital contributions through the JV's lifespan. Finally, agreed-upon processes and procedures to establish an exit value that is rooted in economic reality and the latest valuation techniques and metrics, rather than a formulaic and simplistic approach, can help provide parties unwinding a JV with a sense of fairness. One approach is to conduct scenario testing around value measurement — a down market may have *this* impact, an up market may have *that* impact — to address potential changes over time. Following these steps may further reduce the potential for lengthy and expensive litigation and conflict resolution.

Confidentiality issues

Given the increased frequency of today's technology-driven, peer-to-peer alliances, there is a greater need to plan ahead and take into consideration confidentially agreements that allow for a successful partnership, yet protect the intellectual property of the partnering organizations. Not taking these issues into account can spawn confidentiality and information-sharing issues, which could limit the potential to achieve the partnership's objectives, as well as reduce the value of the JV. In addition, one or both partners may inadvertently publically disclose information that the other considers confidential. Given the potential for these and other critical missteps, it is important for management of partnering organizations to clearly and proactively define the confidentiality terms of their relationship.

Important considerations

While non-disclosure agreements and confidentiality agreements are staples of upfront conversations between potential partners, in the case of JVs, what occurs after formation is equally important. Frequently, one of a partner's primary contributions will be intellectual property (IP) that enables the JV to obtain an ongoing revenue stream. It is the ownership of this IP and its disclosure outside of the JV (including, potentially, to the other partner or partners) that is typically complex to address.

Given that the typical JV governance structure will include a board composed of executives from each partner, a conservative approach is to assume that IP and other information provided to the JV (either explicitly through documents or through the knowledge of employees) will also become visible to the other partner (s). While IP ownership and usage may often be outlined in various legal documents, companies should be mindful of both the nature of the IP provided and the specific legal environment(s) where the JV is domiciled when determining the potential efficacy of these structures. Ultimately, as in all new business undertakings, each company must weigh the potential benefits of the partnership against potential risks.

Beyond the IP and confidentiality considerations at formation and during execution, companies entering partnerships should consider what occurs to IP upon dissolution of the partnership. While approaches may include a reversion of contributed IP back to its original owners, depending upon the duration of the JV it is the disposition of IP created during the partnership which is more complex. It is best if some mechanism for addressing this challenge is included in the original formation agreements, as in the absence of any mechanism this area often delays or causes the partnership dissolution process to be much more complicated and potentially costly.

Ultimately, as in all new business undertakings, each company must weigh the potential benefits of the partnership against potential risks.

When is it time to unwind?

Many companies enter into a strategic partnership with the view that it is a short-term necessity: "I want to be in this market NOW or secure this technology NOW and a JV is the only way I can do it." However, the value of a partnership can change or erode over time and a longstanding relationship may outlive its usefulness and technology. For example, some countries, like India, are changing policies to ease limitations on wholly owned foreign enterprises, making a merger or acquisition an increasingly attractive alternative to a JV. Reasons for exiting a JV may include:

- As a JV achieves success over time, the local partner's role may become more valuable than when the JV was formed. This could trigger dissatisfaction with the original terms of the JV or prompt that partner to be more vocal about where it sees the venture going and potentially generate escalating tension in the relationship.
- As a standalone company, the Newco JV may become a competitor to its originators. In this case, the original partners may each create new companies to compete with the venture they formed together; alternatively, one partner may desire to buy out the other. The previously mentioned strategic partnership between Johnson Controls and Saft is one such example.
- In today's volatile economy, changing market conditions or business objectives may result in the need to adjust capacity, adjust model mix, or even change manufacturing locations. As a result, over time, joint use of a manufacturing facility may no longer be warranted. Depending on the business objectives of each partnering organization, decisions made by one partner may adversely impact the other.

Today when companies formulate the structure of a strategic partnership, the parties should consider a view of what the exit strategy entails — a marked departure from the JVs of 10 or 15 years ago. Questions for both parties to consider up front include:

- How do we value the business at the unwind?
- Which partner will take which assets, including those existing at formation and those that may be acquired or developed over the life of the JV?
- Might the arrangement include access to intellectual property that both partners can apply to the rest of their business post-unwind?
- How do we manage employees' and customers' expectations when we want to change the relationship or have a third party buy out the JV?
- What are the tax and financial reporting objectives and implications?

Closing thoughts

Globalization is driving automotive companies to enter new markets and develop new technologies at a faster pace than five to 10 years ago. As these companies seek ways to expand in new geographies and customer segments, strategic partnerships — especially cross-border joint ventures — will continue to be a useful tool. However, when assessing the reasons for establishing a partnership, participants should consider:

1 The value they want to get out of the arrangement

2. The timeframe they need to obtain this value

3. Their exit strategy when the business objectives have been achieved.

Such an approach can help ensure the objectives of all parties are aligned and can also help preserve beneficial relationships for potential future opportunities even after the current arrangement has concluded.

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Notes:

1. Throughout this document, "joint venture" or "JV" refers to multiple types of strategic alliances and/or business partnerships. The term "Newco JV" refers to the formation of new company between two or more partnering organization.
2. "Auto Makers Racing to Form Tie-ups With Silicon Valley," *Nikkei Report*, November 11, 2011
3. "BMW, Toyota announce diesel, green technology tie-up," *Automotive News*, December 1, 2011
4. "Ford-Toyota Partnership: Hybrid Market Leaders Double Up," *The New York Times*, August 23, 2011
5. "GM Inks Another Big Battery Car Deal," *TheDetroitBureau.com*, August 25, 2011
6. "Microsoft and Toyota Announce Strategic Partnership on Next-Generation Telematics," *www.microsoft.com*, April 8, 2011
7. "Ford-Toyota Partnership: Hybrid Market Leaders Double Up," *The New York Times*, August 23, 2011
8. "Impact of disasters in Japan on U.S. manufacturing supply chain," Deloitte, August, 2011
9. Ibid
10. "Johnson Controls Buys Out Saft Joint Venture," *Edmunds Auto Observer*, September 7, 2011