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M&A Views

Deloitte M&A Views podcast:
The rise of joint ventures: Elements of success (part one)

Transcript

Greg: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions (M&A). I'm Greg Jarrett, and today we tackle part one of a two part series on joint ventures (JVs). JVs and alternative structures have become more popular within the marketplace because they enable companies to access resources and markets otherwise unavailable, while limiting risk and upfront financial investment. However when Deloitte surveyed companies for the success rates of JVs, only 50 percent of JVs were viewed as successful and over 50 percent of JVs end within three years, while less than 20 percent last six years or beyond.[1]

In today's session, we will talk with Deloitte's Mike Armstrong and Sejal Gala about how experienced M&A leaders are utilizing JVs to engage in business transactions and how to setup and plan the JVs to increase the probability of operating and exiting JVs successfully.

Greg: Mike, why don't we start with your overall thoughts on the increasing use of JVs in marketplace transactions? It's a very big topic but maybe we can start by discussing some of the reasons why we've seen such an uptick in JVs.

Mike: We've definitely seen an uptick in the marketplace with a lot of companies favoring JVs over traditional M&A. A lot of that has to do with the flexibility of the JV structure. And there are a lot of reasons why JVs are used, but I'd say the most common ones are on the one hand, access to resources and markets that you otherwise can't get access to. Think, for example, of launching a business in China and having to deal with the investment restrictions and ownership restrictions in that country. The second reason would be your desire to limit your operational, or financial risk by sharing that with another partner. The interesting thing though, is when we've surveyed companies that were involved with JVs, we found that only 50 percent of JVs were viewed as successful. In fact, over 50 percent of those JVs end within three years. And if you look at JVs lasting six years or more, only 20 percent of JVs fall into that category.

Greg: Those are some interesting numbers Mike: those statistics on JVs. Is there something an organization should consider in order to mitigate the risk of failure?

[1] Deloitte Consulting CFO Survey and "A study of Joint Ventures: The challenging world of alliances" Deloitte Financial Advisory, July 2010"

Mike: There is, and I think we run into a number of recurring themes as we look at JVs and those result in some key steps and decision points that we recommend our clients take as they embark on a JV. The first thing we recommend, something that often does not get enough attention at the initial stages, is that the companies, the joint venture partners, make sure that the joint venture aligns with the overall strategy of the parent organizations. We would say equally important is that the parents agree on what the strategy of what the joint venture is itself. Any joint venture is a new third entity you're creating and has to have its own strategy in the same way that any business or business unit does.

One example might be a joint venture we saw in the oil sector recently where two international oil companies were operating at different points in the supply chain. One was an upstream company, the other was downstream. They were forming a JV to build and operate an oil refinery together. As a result of that JV, the downstream company, let's call it Company A, obtained a guaranteed thirty year supply of crude oil and mitigated the risk of facing volatile oil prices. At the same time, the upstream company, Company B, received a guaranteed market and price for its crude oil. So in that case, you've got Company A and Company B able to meet or fulfill their own respective needs as parent organizations. They also had a clear strategy for the JV itself, which is that the JV would be built to source crude from the upstream company, refine it, and sell it on to the downstream company for a thirty year period. And the clear agreement on that strategy for the JV has allowed that JV to stay in operation today.

Greg: Let me ask Sejal this question. Strategic alignments of each partner to their own organizational objectives definitely seems to be very important. So then how do companies determine if they are the right fit for each other in the first place?

Sejal: Great question. A JV, at its most basic level, is a relationship. Selecting the right partner in a joint venture is absolutely core, and when you think about this, the question is: what is each party bringing to the joint venture, is it complimentary in nature, and are we minimizing redundancies between the two parties? If the one partner comes in with intellectual capital and the other one has the operational capabilities, you can start to see how those synergies start to play out. This is an effective joint venture relationship where each one has come in with key core assets. I'll give a simple example. We just worked with a large global retailer in India where they went into a joint venture where there was a global conglomerate which had the best practices in supply chain management and operations, but you know what? The Indian company had the best knowledge possible on how to get things done there. That's the nature of a lot of the joint venture relationships that we see in the market: a combination of global skill sets and local knowledge. And each party has a very specific asset or expertise to bring to that relationship.

The other thing is cultural fit between the two parties. That's something that's often far too much overlooked in the process. But it's something that needs specific attention as you're thinking of your joint venture partner. And it's a very soft subject, so it's hard to get your arms around. Knowing that you will have a cultural clash, knowing that you make decisions in a different way, knowing some of the ways in which you're different up front, means that you can put in the governance structures so that these unknowns or unsaids become ways of working together in the future. In that way, you can start to mitigate some of the issues of cultural fit, which are often one of the big reasons that joint ventures start to fall apart.

Greg: Sejal, how do they pick who runs the joint venture? Is it the entity with the most money? The entity who came up with the idea in the first place? A committee of the two? Or is there an independent management team involved?

Sejal: That's often the conundrum behind JVs. The best practice that we suggest and often is effective is what you mentioned, which is both parties agree to a single executive team that has fairly significant set of delegated rights to then run the JV on behalf of both partners. They are the ones that really determine whether it succeeds or fails, with the appropriate amount of advisory from both sides. We did a survey and 61 percent of CFOs that Deloitte surveyed said that management commitment is a critical success factor in the JV. What that says is the management team that you pick has a huge factor in determining whether the JV will be successful in achieving its final outcome.

Greg: I'm Greg Jarrett and thanks for listening to Deloitte M&A Views, sponsored by Deloitte's M&A Institute. We release new podcasts regularly, and if you subscribe, you won't miss a single one. To stay connected and receive more information on Deloitte M&A service offerings, visit www.deloitte.com/us/masubscribe and follow us on Twitter @DeloitteMnA. Be sure to listen to part two of our series on joint ventures. Until next time!

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