Stronger Together

Joint ventures (JV) can be an efficient mechanism for participating partners to realize synergies when it comes to sharing large-scale investments, gaining access to technologies, entering new markets, or strengthening market position in general. However, creating a joint venture can be a complex process that is not without pitfalls and risks. Given that JV establishment is likely to be an essential driver of growth in the Middle East, this article considers why this is a favored strategy and how adopting a number of best practice principles can maximize the chance of a successful outcome.

Why JV and why the Middle East?

The overriding macroeconomic factor that will see local businesses collaborate increasingly with international players is the need to diversify and create additional employment opportunities. Historically, up to 80 percent of government revenue and export earnings have been derived from the oil and gas industry. It is widely acknowledged that GCC policymakers need to develop a balanced, diversified industrial base to reduce dependence on hydrocarbons as reserves are depleted and alternative sources are developed. Additional and varied employment opportunities are required for a young and growing domestic workforce. Consequently, alternative industries outside of the public sector and the oil and gas industry will need to be developed. It is therefore highly likely that the private sector, and specifically family businesses, will play a major part in this trend given their pivotal role in the economy. Outside of government and the oil and gas industry, family-owned businesses are the predominant form of commercial entity within the Middle East. Some estimates suggest that 80 percent of non-oil GDP is accounted for by privately owned business. However, this segment of the economy is still relatively young and most businesses are still managed by first or second generation family members. Many started as trading businesses but now cover a broad spectrum of commercial activities. As these family groups in the region seek new opportunities to grow and diversify, it is likely that joint ventures with international partners will continue to represent an important strategic tool. In addition to the macroeconomic factors outlined above, there are compelling reasons why this will be the case:

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Growth is essential

Many family offices are now in, or moving toward their third generation. Given that the average family size is five children, there is an obvious requirement to grow the family business in order to preserve wealth and avoid significant dilution as more and more demands are made of the group's resources and investments. Some estimates calculate that annual compound growth (ACGR) needs to be close to 20 percent to avoid dilution.

Organic options are difficult

Establishing and growing domestic concepts is time consuming and difficult and will often be competing with established imported international brands and concepts. Additionally, local R&D (Research and Development) capabilities are seldom as advanced as those from long-established players in advanced economies.

Good acquisitions are hard to find

With commerce dominated by family groups having a tendency to buy and hold assets for the long-term or permanently, good fitting acquisition opportunities are relatively rare and therefore often fiercely contested.

For a family group, a JV with an international partner will typically be motivated by access to Intellectual Property (IP) and/or the transfer of technology or knowhow that is otherwise unavailable to them. A product or marketing alliance whereby distribution or franchise rights to products, brands or retail concepts are granted to a local player allows international brands to minimize the risk of entry to local markets that might otherwise remain closed to them. Joint domestic manufacturing may also be established developing local jobs and skills while cutting product manufacturing and distribution costs. Family office groups are uniquely positioned to develop international concepts and products within their home market given legislative requirements for a local partner and their strong local networks and relationships.

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JV Best Practice–what can be learned?

There are costs and benefits to JV structures. Having a clear understanding of these will facilitate making an informed choice.

JV pros

- Opportunity to leverage the distinct strengths of both partner organizations.
- Cuts investment or funding costs versus developing commercial opportunities in-house.
- Partner skill sets are complementary, making the value of the JV greater than the sum of its parts, as well as providing quick and low-cost access to expertise in areas of weakness.
- Reduces downside risk should the partnership not deliver the expected returns.
- Increased power over the activities and principles guiding the JV's operations and objectives compared to a minority interest investment.
- Allows a deal to be done when funding might otherwise preclude it, since partners can contribute things other than cash, such as assets, IP or know-how.

JV cons

- No overall control. In the event of deadlock between the partners there has to be a mechanism for decision-making, and by definition this will not always deliver each partner's preferred outcome.
- While different services will be provided to the JV by each of the partners, there will be synergies that are unobtainable under this structure.
- While the local partner gets immediate and low-cost access to established international brands, it will be investing in developing someone else's brand equity and remains exposed to shocks to that brand outside of the local market and their control.
- Rewards of success are shared with the JV partner.
- Need for an exit plan to avoid value destructive deadlock. In the event that the JV is terminated, each partner should be protected against the other to avoid using the knowledge or market entry gained through the JV to set up in competition themselves.
- Being more complex arrangements to enter into, JVs tend to require a more widely scoped and complex due diligence process and carefully drafted Sales and Purchase Agreements (SPA) and other contractual terms.

There are, however, a number of common challenges that JV partners face. Mitigation strategies considered and agreed upfront will set the foundations for a solid working relationship.

Challenge	Context	Mitigation
Vision	• The JV's vision and objectives are critical	• Early development and clear definition of the JV's operating model, objectives and priorities
Governance	• Each partner (and the JV's management team) will have different agendas, needs, ideas, and priorities	• Establishing the constitution of the Board and the governance structures upfront will create a framework for decision-making and issue resolution
Management	• The absence of a clear controlling stakeholder can create uncertainty around whose objectives performance is measured	• Appointing an effective and empowered Management team, responsible to the Board is critical for meeting objectives and driving value • Clear allocation of roles and responsibilities
Partner sponsorship and requirements	• The JV will be inefficient or fail without the full commitment of both partners • Understanding and managing stakeholder objectives and personalities is critical	• The commitment of responsible partner executives will simplify communication and decision-making • Early and comprehensive definition of the areas and mechanisms for communicating with, and reporting to, the partners is critical
Change	• A framework is required that enables change and avoids costly stalemate	• Investing up-front in the JV's guiding principles will be time well spent. Tightly defined legal arrangements may drive uncommercial decisions.
Synergy delivery	• Often JVs are established to deliver synergies neither partner could achieve independently • Delivery is therefore key to success	• Early identification of synergy areas and clear delivery plans needed • Robust progress reporting required to highlight issues and enable prompt corrective action
People management	• JVs are rarely transacted speedily as they depend upon diverse stakeholder agreement • A prolonged process may be distracting for employees	• Retaining and motivating key talent and providing certainty where possible requires an effective communications program
Conflicts	• Existing partner relationships may lead to conflicts within the JV	• Implementation of a clear framework for dispute resolution
Exit	• A shared understanding and agreement surrounding when and how the JV might end is an important component of establishment	• Early planning of exit scenarios recommended • Legal agreements are rarely effective at protecting the parties from changing circumstances

We believe successful Joint Ventures are characterized by consistent themes:

Clarity of purpose
- Ensure the JV's rationale and objectives are set out clearly from the start for all parties.
- Communicate clearly to ensure broad buy-in across the organization.
- Identify synergies and establish clear responsibility for their achievement.
- Agree how value will be derived and shared with the JV partners.
- Focus on a small number of critical initiatives.

Control
- Implement robust planning, program management and reporting processes to underpin the JV's objectives.
- Carefully consider the appointment and alignment of the JV's leadership team.
- Allocate your best people to managing the implementation of the JV.
- Make planning and reporting frameworks as practical as possible.
- Tackle risks and issues quickly and take tough decisions early.
- Track benefits rigorously and ensure only one set of numbers.

Managing people
- People management and open, honest and timely communication are the main differences between success and failure.
- Recognize that major change creates uncertainty.
- Plan for change at all levels across the organization and ensure effective support and training are available.
- Realign objectives and rewards.

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To conclude, the establishment of Joint Ventures will continue be an important driver of economic growth within the region. However, agreeing key issues up front and forward planning for all scenarios will minimize the risk of disharmony between partners.

by **Mark Taylor**, director, Corporate Finance Advisory, Deloitte Corporate Finance Limited (Regulated by the Dubai International Financial Center) and **Paul Osbourn**, director, Transaction Services, Deloitte Corporate Finance Limited (Regulated by the Dubai International Financial Center)