DealRoom

Building a Sustainable Joint Venture

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Introducing Joint Ventures

Every business aims at expanding and reaching new heights in order to achieve its organizational goals. One way to achieve the dream of expansion is to enter into a promising and effective joint venture with other businesses. This has been an essential means for businesses to improve on their stature and reach new goals within a short time. Joint ventures have their realities, challenges, processes, perceptions, as well as means of achieving successful results. Gathering the right information about it will reveal all of these and, in this short guide, we will take you through the basics and knowledge you need to have about joint ventures.

Defining Joint Ventures

A joint venture occurs when two or more businesses agree to come together, pulling their resources together in order to make a certain purpose work out. The purpose may have to do with a novel project or other forms of business activities. Joint venture places the profits, losses, as well as the cost of running it, on the shoulders of every participant while it remains a stand-alone entity without any form of ownership from any of the participants nor included as part of any participant's other business interests.

As opined by Ritch Schaafsma, the present President of Corporate Development, Global Mergers, and Acquisitions at General Motors, in a joint venture every participant is contributing to the creation of a new company. The process involves the setting up of an ownership structure that is subject to change based on those contributing to the relationship and the substance of their contributions.

He further claimed that the general starting point, however, is 50/50, which gives every participant equal rights over the venture. The organization is divided and the parties decide the specific decision-making roles that will be handled by each of them involved.

A successful joint venture is based on agreements that state out how the joint venture operates, with a board of directors that possess the oversight ability and have equal voting rights. The primary decision making is often given to the joint venture itself, while when we go above a certain level, the decision making responsibility is given to the board of directors. The right structure that makes it possible to make decisions as soon as possible is needed to make a joint venture grow strong for a long time.

The need to form a joint venture often arises as a result of any of the following reasons:

- **The need to leverage resources:** When businesses come together to form a joint venture, the newly formed venture has the opportunity to use the combined resources of the businesses that come together to achieve a common goal. These resources may be that one company has a strong manufacturing process while the other is well-established in distribution channels.
- **The need to save cost:** The companies involved in a joint venture can make use of economies of scale to leverage their production per unit cost, which would be higher if done separately. A good example of this is the technological equipment that is somewhat expensive to utilize. Also, in a joint venture, other costs, such as labor cost, advertising costs, and so on, are shared and this makes it easy.
- **The need to combine expertise:** Joint venture comes with the combination of unique and outstanding experts from different companies. With this, businesses involved in joint ventures end up enjoying each other's expertise and unique strength.

The central concerns of the executives in the process of entering into a joint venture include identifying the risks that are attached to the alliance, making a move to mitigate the identified risks, and having a clear knowledge of the nature of the deal in order to get the best result from it. Also, executives in a joint venture are concerned about strategic work, the financials that surround the deal, and the ways to handle conflicts and other forms of challenges that may impede the success of the joint venture.

Joint ventures come with their specified laid-out rules, processes, guidelines, and governance, among others. Business in joint ventures has its reasons and purpose for making the decision. More than the possibility of achieving a whole lot of together, there is more to being in a joint venture. So, let's check them out.

How Joint Ventures Work

The successful running of a joint venture is premeditated on the two parties involved in the venture coming together in good faith. They need to have well-aligned objectives toward the goal of the joint venture, and they should ensure that they are going into the venture for the right reasons. When all of these are intact, then the next steps come in. There is a need to define the KPIs of the merging. This action is followed by setting up the objectives of the joint venture and, finally, the selection of the leadership team.

Setting up the leadership team helps to create a unique culture for the joint venture. It is always fine to select the leadership first then move into working on the government because the leaders have a role to play in the setting up of effective governance. Also, a good joint venture works on setting up the roles and responsibilities of every party involved.

Creating an exit strategy is also of paramount value as well as having a clear vision and objectives of the exit strategy you are creating.

It is best for a joint venture to have an end date ahead and also have a setup date for renewal as these will help it to place a lot of effort and time into making the whole process successful and also to minimize any form of conflict. If the joint venture doesn't work, you are always free to walk away from it at the end date.

For every joint venture, there is a process of approvals for every transaction done. Usually, at the early stage of the negotiation, most joint ventures get approvals from their senior-level teams. This team must also have access to the progress of the transaction as the deal moves on, and when there is a need to raise an issue that the joint venture needs help with, they also raise it.

How to Make Joint Ventures Deal

Entering into a joint venture involves learning the art of the right deal-making. The best procedure to do it right when it comes to joint venture deals is to place your attention on establishing trust and creating an acceptable relationship with any business or partner you want to work with. A successful joint venture is only possible when there is a high level of trust and mutual agreement between the parties involved. The participants need to come to terms with each other on a single objective (s) and make a move to bridge gaps together.

As Ritch Schaafsma puts it, "It's important to try to be flexible where you can to help others achieve their objective, look for less important things to trade-off and try to really understand who you are dealing with. You are going to be much more concerned about how you feel about the partner, especially when you are dealing with longer-term relationships."

The parties involved in setting up a joint venture must have a clear understanding of why they are going into the venture in the first place. This makes their strategies well-aligned even before the joint venture is formed. It is possible for the participants to have different strategies, and this is a positive thing to expect since they are not competitors. Ivan Golubic, former VP Corporate Development at Goodyear, explained how this worked for him at a time, during his experience. Ivan has worked in a joint venture that involved a party who was interested in technology while the other focused on the need to access production facilities. The joint venture worked out because the two parties have different targets. But over time, their strategies had to evolve and change, and this needed to be incorporated if the joint venture was going to work.

Ivan believes the parties in a joint venture need to be aligned in objectives as well. He moved further to explain that it is also important for the parties to be aligned on the KPIs, communications in terms of governance, and governance in general. The experienced M&A executive explains that communication is a very vital point in the whole process of setting up a joint venture and even when the exit happens, communication makes sure the means of separation are fair.

Getting the Best Transaction Result

The deal-making process involved in a joint venture is like a transaction, and for anyone to get an awesome result, the party needs to have a preplanned strategy before the deal. Also, you need to learn about your partners and know their method of interacting with their previous partners. Have a handful of information about your partners before you get to the negotiating table. This will help you achieve the best result. Also, make sure you are ready to work towards helping your partners solve their challenges while you work on your own as well. When you work together with your partners, you get to make accurate decisions together faster and better. Understand the areas you need to introduce flexibilities without spending more, as this will help you weigh trade-offs and prepare your leadership team. If you lack this, you will end up reacting and this usually leads to the making of wrong decisions.

International Joint Ventures

Setting up a joint venture in a foreign country has its nitty gritty that every business executive needs to pay attention to. Primarily there is a need to have a clear knowledge of the culture of the country you are planning to set up an alliance in, know what comes with their culture, and how their local customers act in their market. When you are working on a joint venture in another country, be ready to have a longer period of negotiations because you may have to make the deal in another language, and this may make the whole process of deal-making difficult.

Setting up an international joint venture comes with a lot of communication and cultural challenges. However, when you want to make such deals, ensure you get experts from your country that can perform in different roles and bring these people together to have an internal meeting discussion with them. Set up a plan for the joint venture with them before they start working and ensure you educate them.

Working with Third Parties

In some instances, you may have to work with a third party in order to facilitate the transaction process and make everything go smoothly. This often occurs if you are entering a transaction in which you don't have a clear knowledge of how the country's regulatory bodies act. Try working with an M&A firm in a foreign country that has experience doing deals in the locale. They will help you protect your interest in the deal and show you possible challenges you are likely to face in the future. Just note that you will be paying an extra fee for this.

When choosing a third party firm, ensure you pick one that has a strong connection with the administration and agencies you need to connect with. This will make it very easy and possible for them to let you know the policies and paperwork you're working with. With their help, you will manage your resources, time, and effort and get the best result.

Joint Ventures and Partnership

Many people don't have clear knowledge about the difference between a partnership and a joint venture. A joint venture is all about a corporate structure that is set up for two organizations to come together with their assets and share the results of their investments. However, the partnership is a collaboration that involves different fruits of labor.

In a joint venture, the parties involved share equal risks and benefits, while a partnership often places more control in the hand of one party than the other as well as the risks and benefits. A joint venture gives you the right to make the same contribution as the other party. It offers an equal level of responsibility for every party involved.

It is important to note that a potential partnership may result in a joint venture and vice versa. This often happens when a party lacks the ability to function optimally in any of the initially planned processes. It is also possible for a joint venture to metamorphose into a partnership when a party decides to relinquish more rights and responsibility to the other party.

Joint venture and partnership have their specific driven aim. Basically, the business needs to serve as the central purpose that distinguishes the reason for both. For a joint venture, it is usually considered when a business wants to conduct its business activities in a specific location for a while when you are dependent on other partners for certain elements when your interests are aligned, and both parties are motivated to go in the same direction that gives the business the most chance to succeed.

There are more factors that show the differences between a partnership and a joint venture. Let's take a look at a few of them.

- A joint venture has to do with the coming together of two or more companies for a business, but in a partnership, it is the coming together of individuals to set up a business.
- In a joint venture, the companies involved enter into an agreement to carry out a certain task, but in a partnership, two individuals sign an agreement that involves them bearing the profits and losses of the business they are running.

- Parties involved in a partnership are co-owners of the business, and they are only in the business to make a profit. However, parties in a joint venture are not only concerned about profits. They are together to carry out a certain task that none of the parties can do alone.
- A joint venture has a short time-frame of when they are able to achieve their goals, but a partnership often lasts for several years. The parties stick together unless they have differences between them.
- The issue of identity is paramount to a joint venture because parties involved still retain their identities or properties. However, in a partnership, the parties cannot do as they want because the venture has a separate identity independent of any of the parties.

Choosing the Right Joint Venture Partner

Despite the differences between a joint venture and a partnership, a joint venture still has to do with working with a partner. Working on a joint venture means you are working with people around you. This means you've got to carefully select the right partner that will aid the purpose of the joint venture.

The best quality to look out for in a joint venture partner is a good history of successful partnerships, transparency, experience, and a good reputation. Make sure you do your background check on the partner you want to work with and find out how they have done in their previous partnership deals. What kind of reputation have they built over the years? Does the partner show a good level of transparency?

The right partner first extends a hand of friendship rather than that of a business. During your discussion with a prospective partner, if they start talking about the profit involved in the deal before they even care to know more about you or the project, beware. It is a red flag that you are not heading into the right joint venture. Another way to identify the wrong partner is by checking their history of litigation. If they have several litigation histories pertaining to their partnership, then you've got to look elsewhere.

Following the advice of Ivan Golubic, a former VP of Corporate Development at Goodyear, the best kind of people you should bring into a joint venture are, first, those from second-tier leadership without the CEO. They should be those who are experts in their fields because they will gain the respect of the parties involved in the venture. Also, they should be generalists and have the capacity to function in all aspects of the company. Those who work in a joint venture are expected to take on different functions.

Aside from the experts, it is also advisable that you bring in the human resources personnel into the joint venture at an early stage. These people will help to set up and communicate the culture of the joint venture. Golubic believes that it is after selecting this set of people that the joint venture can now decide who the CEO is. It is best for the team to choose who the CEO is rather than the CEO selecting the team because the team has a crucial role to play, which revolves around engaging with the two parties every day.

Creating a Strong Governance

Strong and viable governance is the soul of every joint venture. To create a strong governance, two things are crucial. The first is how you set up the organization, and the second is choosing those that have the decision-making powers in the joint venture. All of these are a structural piece of a joint venture, and the way you choose to structure it sets the tone for how its affairs will be run daily. When these are in place, there needs to be a board of directors to manage the essential decisions in the joint venture.

In a joint venture, the rights of every party and the process of voting must be documented. The governance structure also determines the decision making and the strength of every employee in the joint venture. All of these rules and policies must be well enforced in order to ensure the success of every joint venture.

Challenges of Joint Ventures

On a general level, there are four likely challenges attached to the setup of a joint venture. These challenges come with the launching, planning, and execution of most joint ventures, and when they are dealt with, the alliance works out perfectly fine. Below are the challenges:

- **Alignment in strategy:** It is a must for the goals and objectives of launching a joint venture to be clear to every party involved. If not, conflicts have a high tendency to occur. Strategic misalignment occurs when entities involved in a joint venture have different objectives and vision for the alliance.

- **Setting up governance:** Governance has been a challenge for most joint ventures. Setting up the right governance ensures the progress and success of every business merger. The alliance governance looks over the whole activities of the joint venture. If the corporate entities lack a shared decision responsibility, failure is imminent.

- **The challenge of economic dependencies:** At all costs, every joint venture must look out for the allocation of resources at the launching stage in order to prevent duplication of cost. Every party involved in a joint venture needs to reach an agreement on how they want to contribute resources.

- **Lack of organization:** A skilled leader is needed for the successful and effective running of any joint venture. Without an effective leader, the venture can be exposed to high risks, and this often affects the long-term goals of the joint venture.

These challenges affect the success of a joint venture, and when they are dealt with, the alliance enjoys smooth sailing all the way.

Why Joint Ventures Fail

Many business ideas fail every year, and the same thing happens to business mergers around the world. Following statistics, around 60 to 70 percent of joint ventures fail within their first five years. For this to occur, there are several reasons. Some are:

- **Cultural challenges:** Cultural challenges don't refer only to what is obtainable in a nation or region. It refers to corporate cultures and the differences that exist among them. When there is a wide gap of difference in the corporate culture of the companies involved in a joint venture, failure is looming. It is like two opposing forces working together.
- **Strategic fit:** Changes occur in strategies over time. At the launch, a joint venture is likely to have just a single strategy, but as time moves on and the strategy is implemented, there may be a need to change it. The ability of the companies involved to fit into the new strategy determines the success of the joint venture.
- **Participant's priority:** Most companies involved in joint ventures have a priority issue. They often place their priorities above that of the venture, and this affects the alliance in the long run. There must be a mutual agreement based on the need to achieve the central goal of the joint venture between the participants.

Cause of Conflicts

Conflict is a general reality in most business ventures. The means of handling it determines the level of the effect it will have on the joint venture. Several factors can lead to conflicts in a joint venture, and these have been notable over the years as potential reasons for the failure of most failed joint ventures.

The common causes of conflicts are:

- Interpretation of the contract
- The rights of intellectual property licensing.

When there is no clear interpretation of what the terms reached in a contract are, conflict is bound to occur. It is best to reach an agreement with a clear understanding between or among the parties. Each party should know its obligations toward the joint venture, its responsibility, and what the central solution of the joint venture is about; all of these work with having both contractual and commercial terms that each party has a clear interpretation before they commit themselves to the joint venture.

How to Handle Conficts

Conflict is a challenge that most joint ventures face, but it is not unsolvable. Issues relating to contracts can best be related to the appropriate authority by the functional experts in the joint venture. It is now the function of the CEO of the joint venture to work with the partners to bridge the gap that exists in the contract.

The process involves:

- Identifying the cause of the conflict
- Seeking the various means of solving it
- Looking out for those that are responsible for the conflict

This process requires impartiality and a perfect understanding of what is going on in order to identify the best solution to the challenge. At times, conflicts may be higher than what the functional experts or the head of the team can handle; this is when there is a need to involve the senior leaders who are likely the board of directors.

Making Joint Ventures Work

Every joint venture wants to be successful because no company will plan to pool resources together with others with a plan to lose all of its contributions. If you are planning to run a joint venture, you've got to have done the following:

- **Define success and have KPIs:** Having a clear definition of success is the first milestone you've got to reach to make your joint venture work. When you've got this, set up KPIs that you can easily measure from time to time. As you are hitting those KPIs, you will know what the next step you have to take is. As a joint venture, you'll have little to no interference from the parent companies, and as such, it needs to have its specific definition of success.
- **Setting up governance:** After working on monitorable KPIs, the next is to have a strict governance process in place. There must be a clear knowledge of where the communication is coming from and to whom it is directed. The process of conflict resolution also has to be in place, and finally, the process of addressing certain operational items need to be identified.
- **Hire a joint venture manager:** In order to get everything done for the success of the joint venture, it is advisable to hire a joint venture manager. The manager should be an individual that has the capacity to influence the parent organization, manage the relationship and governance in place within the joint venture.
- **Set up an exit strategy:** It is also very crucial to have a clear exit strategy as a means of dealing with uncertainty if things fail. Your exit strategy will help you resolve issues while the joint venture still holds strong.

Successful Tips

The truth is this, the failure of any joint venture is not because it is not good enough as an idea but usually as a result of how it is executed. As you plan to go into a joint venture, ensure you take your time to ponder on the possible issues that may arise. Look into the future and bring up possible conflicts that may come up. Using your foresight ability will help you deal with any challenge that may want to come up in the future.

At times, despite your preparation, the joint venture may still fail. When that happens, note that there is a reason you formed the relationship in the first place and ensure you preserve the reason. To reiterate, it is essential that you assign a manager to handle the activities of the joint venture. The manager you choose should be someone that is dedicated to the success of the joint venture and one who has a clear knowledge of the joint venture objectives. Preparation and right leadership are what determines the success of any joint venture.

Conclusion

A joint venture is an alliance that thrives on clear and well laid out objectives that every party agrees to achieve. Choosing the right partners, forming strong governance, and getting ready to face the challenges that come with a joint venture are some of the crucial ingredients needed for running a successful joint venture. In the world of business, knowledge is essential as it determines a whole lot, and this makes it crucial for you to have a basic knowledge of what a joint venture is in order to enjoy its benefits and run it successfully.

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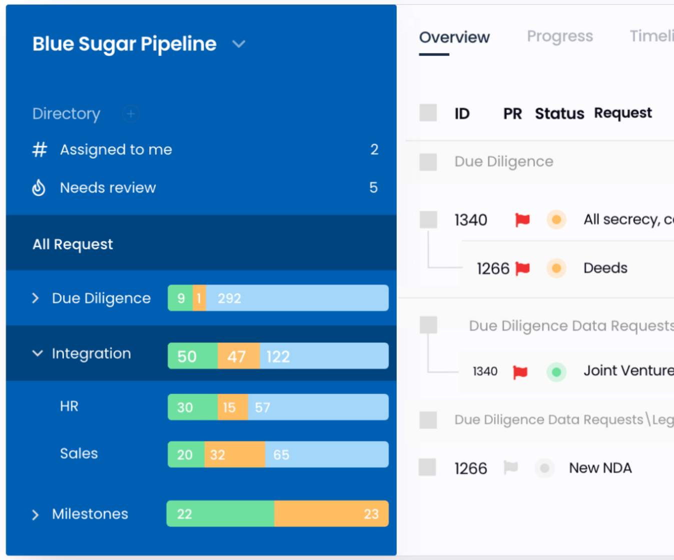

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