

Mirror, Mirror, On the Wall...

The Essential Role of a JV Review

In most JVs, no one is responsible for ensuring that the shareholders as a whole are optimizing their interactions with the JV ♦ We're not simply talking about the JV Board ♦ 10-30% performance upside available

WE RECENTLY ANALYZED the shareholder review processes in some three dozen large, 50-50 style joint ventures, and discovered a paradox. On the one hand, most joint ventures today are subjected to quite rigorous financial and operational scrutiny. Rarely held to an audit standard below wholly-owned assets or businesses, JVs are more likely to be exposed to duplicative reviews and excessive reporting demands from shareholders.¹ But (here's the paradox), shareholders aren't looking at what's likely to be the biggest risk, source of value, and driver of personal frustration: less than 25% of JVs conduct any kind of Joint Venture Review that systematically looks at how the shareholders and management team are doing as a group – i.e., whether all the economic, governance, organizational and operational interfaces between the venture and the shareholders are functioning well (Exhibit 1).

This is puzzling.

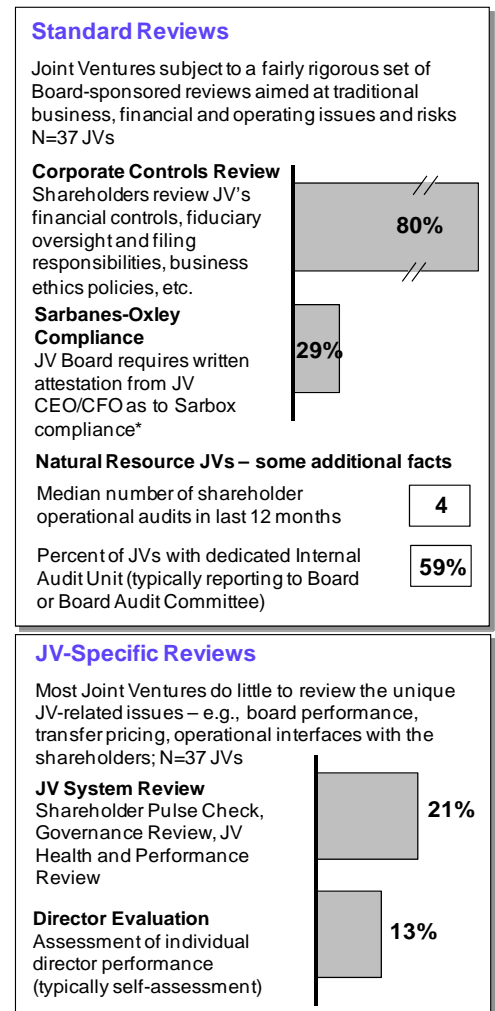
It's not as if people don't appreciate that JVs are different. History has made us all aware that, by their very structure, JVs are a highly dynamic business, prone to unique opportunities and risks – untapped synergies with the shareholders, economic misalignments, governance challenges associated with delegations of authority and capex approvals, pricing tensions related to parent-provided services, and complex operational interfaces between the venture and the shareholders, such as joint sales protocols or product development. Not all joint ventures face all these issues, of course – but few escape without some of them.

The review processes of most JVs ignore these issues altogether. As one JV CEO said, "Sure, we have regular reviews – but we've never taken a good look at how the Board and committees are working, or at the delegations of power – which have not changed since the JV agreement was written."

This is a mistake.

There is significant evidence that most JVs can benefit enormously from some form of Board-sponsored review that assesses the overall

Exhibit 1: The Paradox of Shareholder Reviews of JVs



*Not legally required for vast majority of JVs; Sarbox legally required of US publicly-traded companies

¹ This risk of excessive shareholder reviews and audits is most prevalent in energy and basic material JVs, where several JVs in our sample set were subjected to 20-30 shareholder reviews (in areas like operations, engineering, HSE, financial controls) over the previous 24 months, making them among the most audited assets in the world.

health and performance of the JV. Such Joint Venture Reviews are aimed at capturing additional synergies, reducing costs – and making life more productive and easier for those serving on the JV’s Board and on the JV’s management team. A complement to the financial, operational, and strategy reviews already in place (Exhibit 2), a Joint Venture Review focuses on the “details” of governance and shareholder and management interactions that make the difference between whether the JV thrives over the long-term – or simmers with tensions and inefficiencies and, ultimately, collapses under its own weight.

Isn’t it time to ask, who’s watching the watchers?

VALUE AT STAKE

There is more than \$2 trillion in assets where JV governance is not being managed or reviewed in a recurring, systematic way.² Within this asset class, there is often sizable direct – and indirect – value in optimizing how the shareholders relate to the venture. Our client experience and data on more than 100 JVs shows a 10-30% performance improvement for a typical JV in making adjustments to this relationship. This value can be broken down into a number of different categories (Exhibit 3), ranging from cost savings by consolidating certain functions or activities inside the venture or shareholder, optimizing product, channel or other operational interactions, reducing the governance tax, and the like.

To bring this to life, consider two examples:

Example 1: Metals and Mining JV

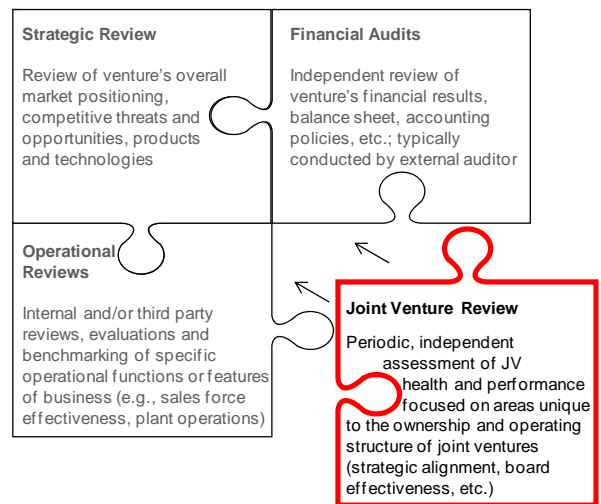
A few years ago, a global mining player and local emerging market partner entered into a 50-50 JV to construct and operate a multibillion-dollar production and processing facility in a key regional market. On the surface, the venture was performing well – the project was on schedule and on-cost, and was viewed as a great success story in terms of national economic development as it employed several thousand people and was making significant contributions to building a local supplier base and related downstream industries. The Board was extremely senior, and meetings were extraordinarily cordial.

But a review of the underlying JV performance and health revealed a different story. For instance, it showed that the shareholders were leaving significant value on the table because the venture was operating too independently – missing roughly \$500mn in purchasing, warehousing, and marketing synergies because the venture was not leveraging its global partner’s corporate scale. It also showed excessive manning levels – \$20-60mn in added annual costs because the venture had essentially adopted one shareholder’s HR model which proved to be a significant deviation from global best practice. And it showed some indirect – but hard to quantify – costs. For instance, the delegations of authority construct had placed significant de facto power in the hands of shareholder committees (e.g., Contracting Review & Approval Committees) rather than the CEO or management team. This structure made it very hard to attract a sufficiently experienced project and operating talent, and seriously undermined efforts to create a culture of accountability in the venture.

Exhibit 2: Where a JV Review Fits

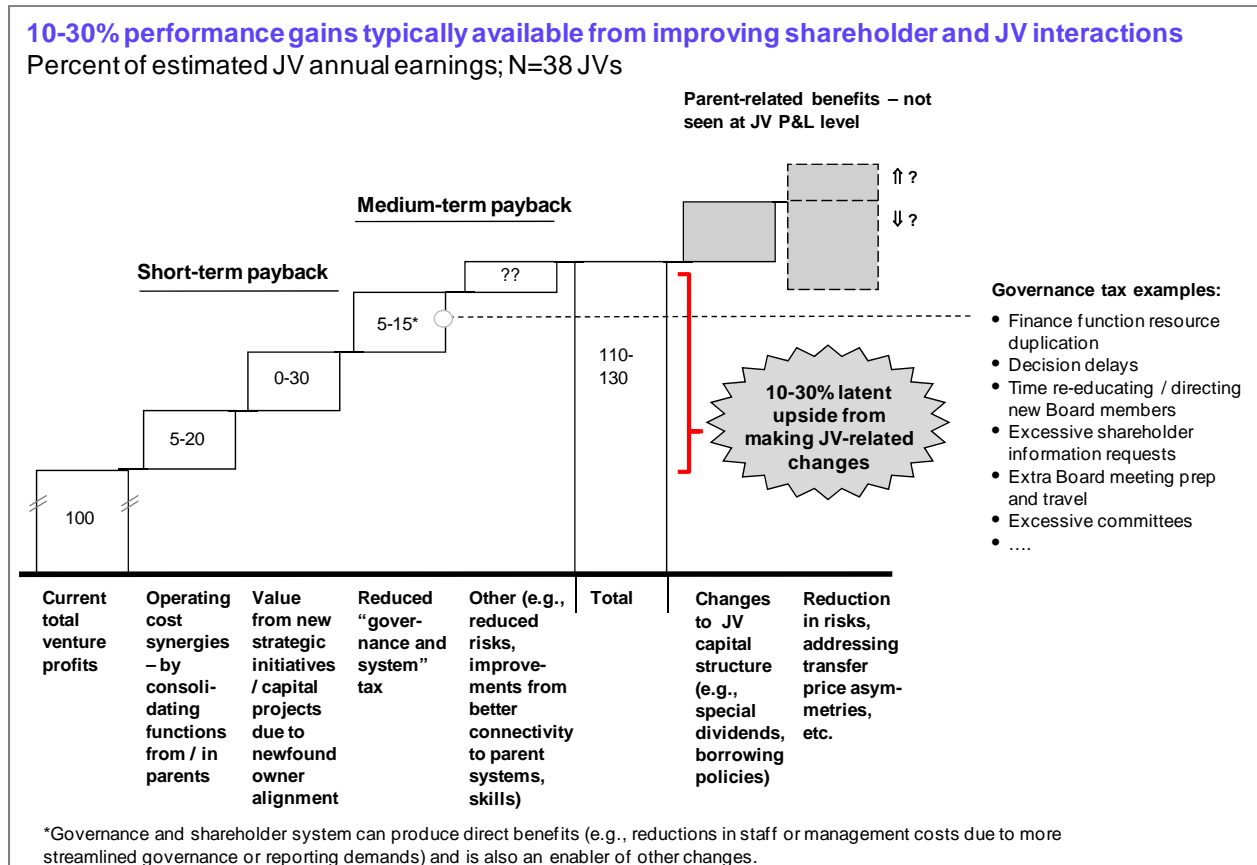
How it fits with other reviews

Focused on a set of JV-specific issues that tend to fall outside the scope of most shareholder reviews



² For an earlier analysis of the value invested in joint ventures, see “Sizing the Prize: Assets and Earnings in Large JVs,” The Joint Venture Exchange, August 2008.

Exhibit 3: Value-At-Stake – Summary Analysis



None of these issues were picked up in other shareholder reviews because they were driven by unique JV factors – which are typically out of the scope of traditional audits and reviews. The Board was simply not having conversations about them.

Example 2: European Telecom JV

Or consider a 50-50 telecom JV operating in Europe. The JV was extremely high-performing – one of the best businesses in either parent portfolio. Nonetheless, there were two significant improvement opportunities that sat unaddressed by the Board for two years. The first proved easy to quantify: \$25-30mn in untapped annual cost savings that could be accessed by consolidating into the JV certain functions and technology platforms of related parent company businesses.

The second was harder to dimension – but critical to the long-term efficiency and health of the venture. Quite interdependent with its shareholders from an operational standpoint, the JV continuously suffered from little bumps, obstacles, and headaches in trying to operate the business. Board members continued to ask the JV for “favors” – e.g., in exchange for driving subscribers and audience traffic to the JV, the Board members wanted the JV to promote other services of the parent company, and thus crowd-out paid advertising and other promotional campaigns. But there was no method to account for these flows. According to the JV CEO: “Our Board members treat us like a wholly-owned business unit – and expect us to behave like a good family citizen. The problem, of course, is that we have another shareholder.”

The shareholders also imposed financial and accounting policies that did not match the JV’s size or situation. Dependent on one owner as its tax and accounting partner, the JV had “big company” financial systems. While this created some advantages, it came with some larger costs and often demanded senior management time to create workarounds.

For example, all capital expenditures under \$700K were treated as operating expenses – not assets to be depreciated over time. Perhaps appropriate for a very large parent company, this distorted the financial profile of the JV, a much smaller enterprise. As a result, the CEO directed the CFO to make a whole series of one-off changes to how the system handled depreciation.

While each item like this was small, the list was very long. Collectively, it created significant potential costs and risk to the JV. And yet, the Board was not discussing or addressing these issues – which collectively placed a sizable “tax” on JV management’s time.

SOME EARLY SIGNS OF AWAKENING

A few high-performing JV Boards are starting to recognize the value at stake – and do something about it.

These Boards are conducting some flavor of Joint Venture Review – *a structured look at how the JV Board, management, and shareholders are functioning collectively in governing and operating the JV*. The benefits are improved performance, decreased costs and risks – and a whole host of others gains from just making these interactions work better (Exhibit 4) by proactively identifying and addressing the set of issues that uniquely plague joint ventures. Conducting such a review is arguably the one “real” piece of work that the JV Board will perform itself over the year. As a result, it can have significant spillover benefits in the often elusive art of “board building,” deepening personal working relationships among the director group.

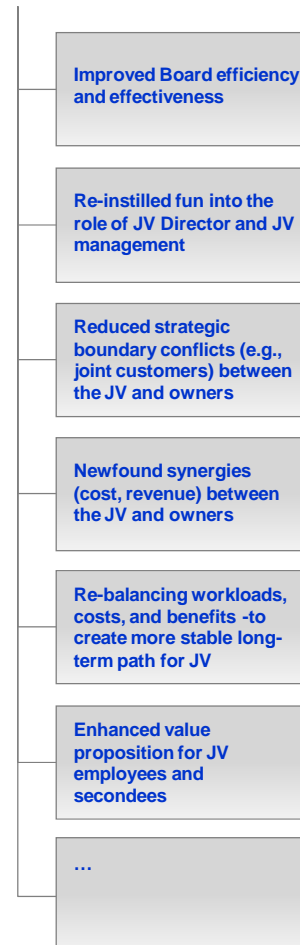
Most JVs can benefit from such a review – but the exercise is especially valuable for ventures undergoing some form of fundamental change in leadership, operating model or phase of development, those with performance issues – or for shareholders that want to be proactive in their approach to self-governance (Exhibit 5).

Such a review will also reinforce Director and Board responsibilities. It can help prevent small problems from becoming large ones. And it can enable the JV to evolve – and/or avoid becoming “stuck.”

Many of these reviews include a focus on governance and board dynamics. This is appropriate. Our data across more than 100 JVs shows a clear correlation between good governance and sustained financial and operating performance in joint ventures. Yet JV governance systems are prone to getting off track – with new Board members not quite playing the right roles, decisions taking far too long, the real issues not being put on the

Exhibit 4: Catalog of Benefits from a JV Review

Benefits of a JV Review



What JV Board Directors and JV CEOs have to say

“This was the first time the Board really **looked at itself**. It made us see that we were too focused on operations, and not enough on strategy and growth.”

“I had been telling my wife that I was **going to quit** before year end. No more. This is **fun**.”

“Before this, both the Chairman and the CEO seemed to be having perpetually **bad hair days**. Those days are behind them.”

“We fixed a lot of **low-level tensions** between the JV and the owner staff – who’d been rubbing elbows on product development and sales.”

“The exercise made us see **three new growth opportunities** where the JV should work with individual shareholders ...”

“Our partner was allocating some corporate overhead costs into the JV – not a big deal, but a **burr in the saddle**. We got that fixed and are focused on far more important things.”

“Potential employees could **smell the confusion** among the shareholders. I don’t think that will be the case now.”

table, and the like.³ Absent some form of governance review there is not an easy or polite way to reset expectations. And it is not the role (or professionally healthy) for the JV CEO or a single director to evaluate the Board or suggest governance changes.

In many instances, however, such reviews are selectively tackling topics beyond governance – for instance, looking at alignment and evolution, skills transfer and learning, financial policies, secondee issues, and product or channel conflicts between the venture and the parent companies.

HOW AND WHEN TO DO A JOINT VENTURE REVIEW

Certain common themes cut across the successful reviews. Done well, such reviews are sponsored by the Board, which will shape the appropriate scope and desired level of analytical depth, and be led by the Chair, Lead Directors, or Governance Committee (if one exists). The successful reviews almost always have active participation from individual Board members – to share insights, prioritize issues, express allergic reactions, and help find solutions that are politically palatable and workable. We’ve found that “getting to yes” on these issues requires building understanding, trust and alignment along the way, and almost never works by simply presenting a final answer. (See Box 1: *Running the Process: Role of the Chair, CEO and other matters*)

The best reviews tend to be built on data and facts – but also are made highly relevant by the use of off-the-record interviews that reveal areas of alignment and misalignment. By their very nature, joint ventures tend to generate strong opinions on what’s working and what’s not. Having a balanced and structured set of facts and a business case can be critical in indentifying the real issues and root causes, and in gaining agreement on the answer. The best reviews tend to keep returning to the questions of value-at-stake, risks, and future needs. There can be real benefits in showing how other JVs are set up and deal with similar issues. Finally, the Board will hold itself explicitly accountable for making progress against agreed actions and, ideally, make such a review part of its annual cadence, rather than a one-off event.

Beyond these common guidelines, however, the nature of the review needs to be tailored to the venture. For instance, some JV Boards have scoped the reviews quite narrowly (e.g., on board composition and workings) or more broadly (e.g., on shareholder alignment, governance, and transfer pricing). Likewise, some Boards have felt a need for hard data and comparative analysis of their venture to peers, while others have chosen to limit the analytics and focus on qualitative assessments (e.g., by using a survey tool). And some Boards have actively engaged the JV CEO and management team, while others have chosen to involve the CEO as a source of input rather than a partner in shaping the solution.

Exhibit 5: When To Consider a JV Review

Main catalysts behind these types of reviews		
Change	Yes	No
<ul style="list-style-type: none"> The JV is facing a new operating context – e.g., new competitive demands, shift from build / launch to operate phase, substantial maturing of the JV and its management team – but has not changed its governance model 	<input type="checkbox"/>	<input type="checkbox"/>
<ul style="list-style-type: none"> There's a new CEO of the JV 	<input type="checkbox"/>	<input type="checkbox"/>
<ul style="list-style-type: none"> There's been a recent influx of new Board members – people who don't understand the venture's history or have the personal relationships of the outgoing board members 	<input type="checkbox"/>	<input type="checkbox"/>
Problems		
<ul style="list-style-type: none"> Obvious problems – misalignments, frictions, “bad behavior” on the Board or ill-will, delays in key decisions 	<input type="checkbox"/>	<input type="checkbox"/>
<ul style="list-style-type: none"> A sense of recurring inefficiencies in the operating relationship – but without a sufficiently deep or shared view as to what is really going on, how big the problem is, or its likely root causes 	<input type="checkbox"/>	<input type="checkbox"/>
Pre-emption		
<ul style="list-style-type: none"> Shareholders appreciate value and complexity of the JV – and importance of staying in front of the issues 	<input type="checkbox"/>	<input type="checkbox"/>

³ For more details on this data, and on the importance and challenges of JV governance in general, please see: James Bamford and David Ernst, “Governing Joint Ventures,” McKinsey Quarterly, 2005, special edition; and CalPERS Joint Venture Governance Guidelines (co-authored with Water Street Partners); February 2009.

Box 1: Running the Process – The Role of the Chair, CEO and other matters

The JV Board will need to answer a number of important questions in designing an effective Joint Venture Review process. Here's a summary of the experience of practitioners we talked to:

Who sponsors a JV Review? In almost all cases, the full JV Board is – and should be – the sponsor of the review. Alternative approaches (e.g., one shareholder sponsoring with the other shareholder(s) participating; having the JV CEO sponsor; or having the parent companies “perform” a quasi-outside review on the Board) tend not to generate the level of individual director engagement or ownership that is so necessary to success.

Who oversees the work – and what is the role of the Chair? Typically, the Board will ask a subset of members, including the Chair and, potentially, the JV CEO, to oversee the specifics of the process. Unless the Board is unusually small and extremely engaged, it is much more efficient to have a smaller group direct the process. The role of this steering group is to:

- Ensure sufficient engagement from all Board members and others in the shareholders
- Help prioritize issues, interpret competing opinions and facts, and provide guidance as to how to build the case
- Preview the diagnostic findings – and helping to sharpen definition of options and ensure practicality of recommendations
- Own the follow-up – be accountable for ensuring implementation of Board agreed changes

While this group is usually led by the Chair – or co-led by the Lead Directors from each shareholder – it is also the natural domain of a Governance Committee, if one exists in the JV.

Who performs the analytics and leg-work? While obviously driven by the scope and depth of the review, a typical process might require a team of 1-3 people to

perform 2-4 weeks of dedicated work (although the elapsed time unfold over a longer period to match schedules and Board cycles).

JV Boards take different approaches to staffing these teams. The Board of an emerging market pulp and paper JV created a fulltime Board Secretary position – and included in his responsibilities the development of the annual Board Report Card, and six-month follow-up. In contrast, the Board of a large, multi-owner natural resources JV recently created a dedicated Governance and Internal Audit function inside the venture (which had direct reporting line to the Audit Committee of the Board). The Board asked this internal group, which was composed of secondees from each of the three parent companies, to lead a JV Review focused on committee performance and shared services practices.

The Board of an upstream oil JV chose to apply a “peer review” model to the situation: It assembled a team of individuals from around each of the parent companies – each of whom had significant experience across JVs – to come in, conduct interviews and develop ideas and recommendations.

In other cases, JV Boards have turned to outside consultants, believing that the neutrality, independence of perspective and freshness of thinking – and broader experience base – are highly valuable.

What risks do I need to watch for? Some JV Board members have been hesitant to initiate such reviews because they fear that the process will be a mechanism for the partner to re-open or re-negotiate the joint venture legal agreement – or will devolve into a “gripe session.” Others worry that the process will expose their company (or their partner) to criticism – e.g., for failure to fully support the JV, asymmetrical economic benefits, inadequate board member attention – and damage the broader relationship. In other cases, we've seen such reviews start to polarize the shareholder by over-stating

differences in views – and risk creating discord where little existing.

These are all fair concerns. But rather than avoiding such reviews altogether – and not reaping what can be very significant benefits – the better Boards manage the process tightly, very clearly defining the scope and ground rules. For instance, in three very successful reviews – in healthcare, petroleum, and financial services JVs – the Boards all were very explicit that the review was about improving the workings of the venture, and that changes to the JV Agreement were not on the table. Each asked that the diagnostic to be fact based and honest – but not personal. All emphasized improvement ideas – how to make the venture better – rather than rehashing the details of the diagnostic and of what was wrong. And all were led by a Chair who set a tone of openness and fair play.

Does one shareholder ever do this without their partners? Yes, but this is a different exercise with a different objective that the JV Reviews discussed in this article. For instance, in one petroleum JV where operating performance was weak, one shareholder wanted an “independent read” on the venture – i.e., a view as to whether the complex governance structure was a root-cause of the problems, what the answer might look like, and a strategy for engaging the other owners in broader review of the JV.

Likewise, in an industrial JV in India, certain executives within the European shareholder was growing concerned that the operating autonomy of the JV (in technology selection, distribution and sales) was undermining the parent company's global portfolio strategy and cannibalizing sales in other markets (via gray market sales emanating from the JV). As such, it has launched an internal review to develop an integrated assessment of the strategic and economic impact of the JV's policies. Once it understands the impact on its company, it will then decide whether to approach its partner about reining in or restructuring the JV.

More proactive JV Boards have built such reviews into their annual calendar – believing that these issues, especially those related to governance, are simply too important to wait for problems to emerge. Other JV Boards have chosen to sponsor such reviews periodically – driven by changes in the venture’s strategic context, phase of development, addition of new partners, or awareness of a pattern of inefficiencies.

All of these approaches are reasonable.

FOUR FLAVORS OF JV REVIEWS

To illustrate how these joint venture reviews look in practice, consider four different flavors – Shareholder Pulse Check, Board Report Card, Joint Venture Health and Performance Assessment, and Restructuring Options Analysis – that we have observed or helped companies design (Exhibit 6). Each review is has different features, and is applicable in different situations (Exhibit 7).

1. Shareholder Pulse Check. A number of JV Boards regularly sponsor a reasonably light qualitative review of joint venture health that we call a “pulse check.” Observed in industries as diverse as alternative energy, industrial high-tech, basic materials, and financial services, a pulse check is usually built around 8-12 confidential, one-on-one interviews with board members, venture management, and others in the shareholders. The objective is to identify strengths, concerns, and emerging issues in the relationship, with a focus usually on strategic direction, performance, and board dynamics and governance effectiveness, rather than venture economics, incentives, channel conflicts or financial policies (which would require a deeper analytical fact base).

The output of a pulse check is a structured synthesis of these discussions – as well as a 60-90 minute Board conversation about the findings and potential implications. According to the Chair of an alternative energy JV that now conducts a pulse check every 18-24 months: “This is an incredibly easy and effective way for the Board to take stock as to where we are – and to have a single integrated conversation about a whole series of ideas, thoughts, and concerns. In the past, a few board members raised their pet issues in a one-off and sometimes disruptive way, while others swept things under the table – neither of which was the best way to handle these things.”

2. The Board Report Card. The Board of a large, 50-50 emerging market pulp and paper JV creates an “annual report card on board governance” – a quasi-independent review of the workings of the Board, including assessment of critical health dimensions related to shareholder governance more broadly. Sponsored by the Chairman, the report card is conducted by a full-time and independent Secretary to the Board.

The report card is *anchored around a set of pre-agreed key performance indicators related to JV Board processes and decision making outcomes*. For instance, the scorecard tracks items such as: i) the number and percent of issues resolved at the Committee, Board, and Shareholder levels; and ii) the number of “cycles” (e.g., board or committee discussions) it takes to resolve key issues such as the operating budget, management compensation, vendor selection, capital investment proposals). It also includes an “Aggravation Index” – a qualitative assessment of the types of issues that have caused the greatest aggravation among the shareholders in the previous 12 months. On this and other dimensions, the report card tracks scores across time to give the Board a baseline comparison. The results are presented to the Board, followed by at least 60 minutes of facilitated discussion aimed at identifying potential adjustments to improve the governance health in the coming 12 months.

Exhibit 6: Different Flavors of JV Reviews

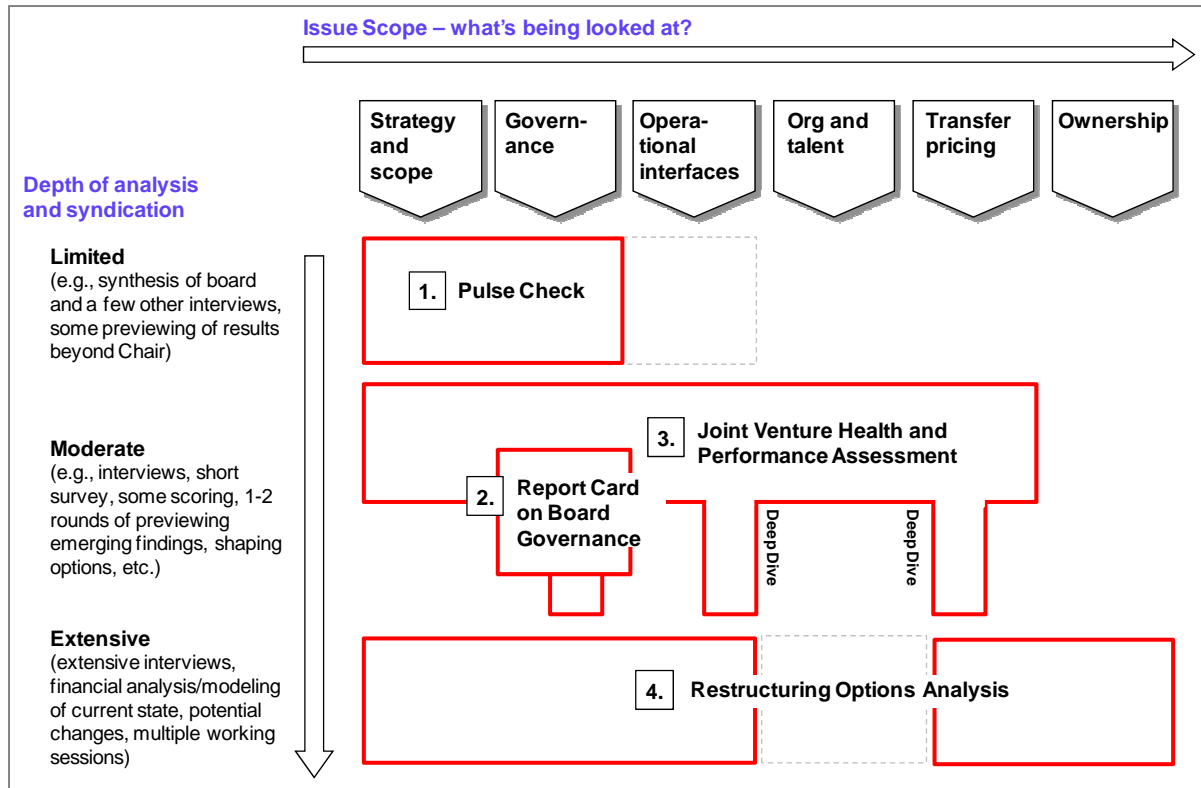


Exhibit 7: JV Reviews - Key Elements Of and When to Use Each Flavor

	How - Key inputs and analyses	When to use
1. Pulse Check	<ul style="list-style-type: none"> • Interviews – of Board and Management • Focused on top-level Board and CEO 	<ul style="list-style-type: none"> • No issues • When quick, qualitative assessment desired
2. Report Card on Board Governance	<ul style="list-style-type: none"> • Board Interviews • Dashboard of key board performance indicators • Review of Board materials, action log, minutes 	<ul style="list-style-type: none"> • JV quite independent / limited operational touch points and flows • Essentially all shareholder issues manifest at the Board
3. Joint Venture Health and Performance Assessment	<ul style="list-style-type: none"> • Interviews and survey of Board, management and owners • Comparison to best practices, peers • Summary of issues/gaps against original objectives, health indicators • List of improvement ideas, options • Board working session 	<ul style="list-style-type: none"> • Felt need for some moderate changes in governance and other owner interactions • Desire for a broader and more fact-based review – and value in having Board members engage with the issues, options • Especially valuable when JV has numerous “flows” between shareholder and venture – e.g., product development and sales, transfer pricing/shared services
4. Restructuring Options Analysis	<ul style="list-style-type: none"> • Interviews • Detailed economic and strategic analysis – e.g., total venture “P&L”, both sides over time, integrated impact of potential changes • Assessment of alternative scope, structure, financial, governance arrangements • Review of contract terms, side agreements, degrees of freedom • Partner negotiation 	<ul style="list-style-type: none"> • JV governance “broken” • Funding issues • JV outgrown scope • Major inefficiencies / competitive disadvantage in current structure • One partner under severe external pressure – e.g., to raise cash, divest, etc.

A Board Review – whether as formal as a report card or a less quantitative but holistic self-assessment – can serve as a process for the Board to focus on itself. Done well, this provides a time out for Board to agree on its desired role, how Directors will work together, and what it hopes to accomplish as a group in the coming year.

3. Joint Venture Health and Performance Assessment. A third approach is more rigorous – and aimed at a *more holistic set of value and health-related issues*. Done well, such a review will assess key dimensions like *alignment, accountability, transparency, and decision making speed*. It will cover not just board *governance*, but also look at structures, practices and terms related to *economic arrangements, shared services, employee value proposition, and operational touch points* between the venture and shareholder companies. It is not about radically restructuring the venture but, rather, making the venture work better. At Water Street Partners, we call this a “Joint Venture Health and Performance Assessment” – but different companies use different names.

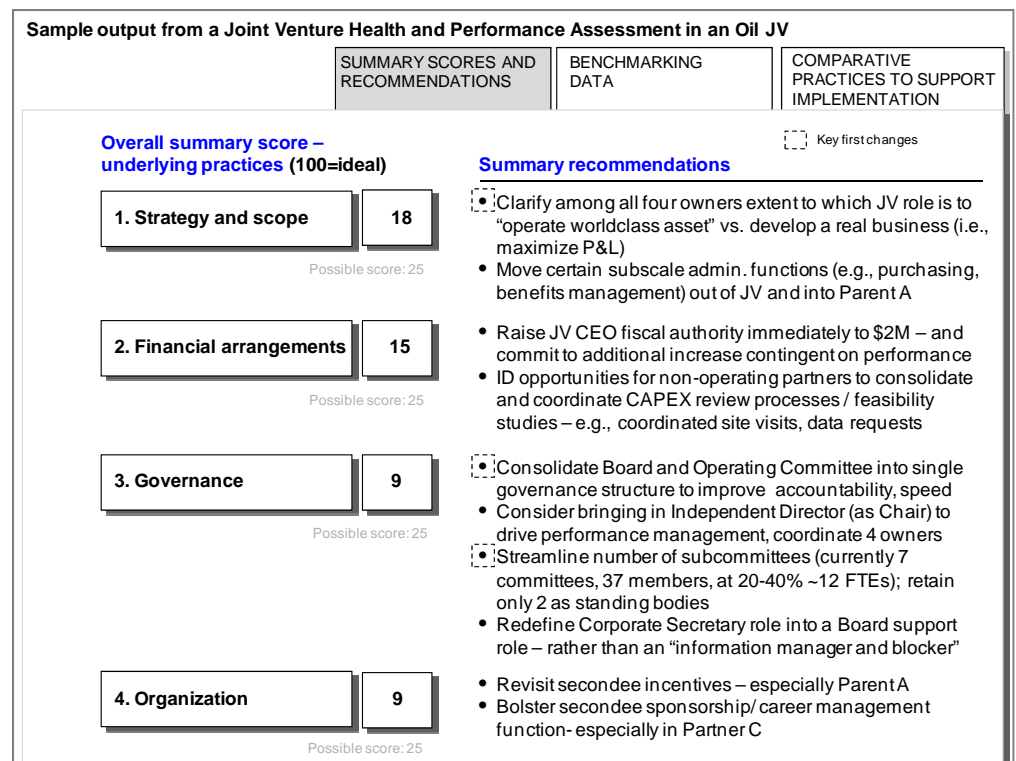
Each JV Board scopes such assessments a little differently – though there are common themes. Typically, the diagnostic element will include interviews not just with the Board – but also with the top 5-10 managers in the venture and 5-15 people in the shareholders who support or depend on the venture in some way. And it will include other inputs that the Board deems appropriate – for instance, an online “voice of the owners” survey, or a comparison of the venture to best practice peer JVs. The diagnostic will typically include some root-cause analysis, and, in some instances, a dimensioning of the value at stake. And it will also look at the future needs of the venture – and start present ideas and options as to how the JV model may need to be tweaked or more fundamentally altered to thrive under future conditions.

All these outputs should be made available to Board members – as this may be the first time that many have a real chance to thoughtfully reflect on the dynamics and untapped potential of the business as a joint venture. As one Board member of a cross-border JV explained: “For the first time in years, it reminded me why I was excited to be on this Board in the first place. In all the struggles, I had forgotten how cool this joint venture is, and how novel and exciting the issues are.”

The process for developing the assessment and generating recommendations tends to be highly-structured and highly-collaborative – a balance not always easy to strike, but critical to success.

For example, in an upstream petroleum JV, the Board asked that the venture be “scored” against best practices within strategy and scope, governance, organization and talent, and financial arrangements (Exhibit 8). The recommendations within each of those areas had

Exhibit 8: Summary Scores and Recommendations



been worked with individual board members from each owner prior to the board working session, and alternative options, underlying rationale, and illustrations from other JVs were presented within each recommendation.

In a number of cases, such reviews have included a few “deeper dive issue areas” that the Board believes merit particular attention. Usually limited to 2 or 3 topics, the choice of where (and whether) to go deep will vary from venture to venture, and from year to year. For example, the Board of an emerging market aluminum JV recently chose to supplement a broad-based health review with a look at alignment and delegations of authority issues (Exhibit 9); in contrast, the Board of an industrial JV was interested in potential channel conflicts and synergies between the shareholders and the venture, as well as the value proposition for JV employees.

Done well, such review processes will deliver the Board to greater understanding and a better working relationship (valuable in their own right) – and to productive changes in how the venture and the shareholders interrelate. In a healthcare JV, the Board agreed to rewrite the set of guiding principles – and to drive those into targeted changes in director roles, voting rights. It also catalyzed a process to more closely monitor joint product development, which had become a point of friction. In a petroleum JV, the review led to the creation of a COO position and agreement to move the commercial function out of the JV – decisions that flowed logically from the Board’s shared view that the venture should be a “worldclass operating asset,” rather than a business. In this case, these and other changes have resulted in a noticeable uptick in venture operating performance and, with it, a decrease in the amount of time that Board members need to invest in the venture.

4. Restructuring Options Analysis. In select cases, the shareholders are taking a much harder – and financially oriented – look at the venture, developing *restructuring options that included fundamental changes in scope, economic terms, equity ownership, or operatorship*. In most cases, these Board were prompted into action by significant performance problems (e.g., major cost overrun, significant disputes of transfer pricing cost allocations), major threats (e.g., a disruptive technology entering the market, one partner exploring exit), or recognition of sustained inefficiencies in the way the venture operated.⁴

The owners of Airbus Industrie, which included Aerospatiale of France, British Aerospace and Daimler of Germany, went through such a restructuring process a decade ago, after concluding that the venture’s highly-disaggregated value chain was suboptimal. Prior to the restructuring, Airbus depended on its four owners to

Exhibit 9: Deep Dive Focus Areas

Examples of where different JV Boards have chosen to add special emphasis in joint venture health and performance assessment

Aluminum JV – 2009 Review

- 1. Overall alignment**
 - Overall alignment on operating model, venture evolution, where JV vs. owners natural owner of various functions (e.g., purchasing, warehousing, maintenance), staffing philosophy
- 2. Committees and delegations of power**
 - Level of power and influence of non-board committees vs. venture management – on contractor selection, project financing, cash policies
- 3. Seconded policies**
 - Seconded selection process, incentives (pct tied to parent vs. JV), formal and informal reporting relationships, career development, performance and ratings trends (similar to non-seconded control groups?)

New Media JV – 2010 Review


- 1. Product development process**
 - How venture and owner product / marketing staff work together on shaping JV’s product roadmap, project prioritization, technology and vendor selection
- 2. Board composition and director roles**
 - Overall composition of the Board (Does the Board have the right skills to lead the JV in the next 3-5 years?), expectations of individual directors (time commitment, role coordinating internal organization, etc.)
- 3. Joint sales protocols and channel issues**
 - Joint territory and accounting planning, sales process and protocols when venture and owners selling related products into same market, reconciling conflicts in sales force incentives

⁴ See, David Ernst and James Bamford, “Your Alliances Are Too Stable,” *Harvard Business Review*, June 2005.

separately manufacture different aircraft component systems (e.g., fuselages), while the venture itself was simply responsible for final assembly, marketing and sales. This structure created widely-reported tensions in the relationship, as it pitted the owners against one another and against venture management in negotiating transfer pricing terms. The annual pricing meeting was dubbed the "poker game," and JV auditors called themselves "the liars' club" because they worked to smoke out pricing bluffs.⁵ Lacking an integrated view of the economics, neither the shareholders nor Airbus management knew whether finished airplanes were profitable. In 2001, the Airbus shareholders restructured the business by consolidating their manufacturing activities into the venture – a move that drove cost savings and improved accountability and transparency.

Most joint ventures will confront the need for radical restructuring once or twice in their lifetime. Given the stakes and nature of the issues, the process almost always requires a dedicated team. This team will be sponsored by the JV Board but includes other staff from the shareholder (e.g., from finance, corporate development, legal) to support the analytics and restructuring options generation. If the venture is material to the shareholders, the process will need to engage other parent company executives including the CEOs. That said, it is the role of the JV Board to understand when the JV has – or has not – reached this point.



JVs don't need more shareholders reviews – but they do need the *right* reviews. Isn't it time that the Board took a look at itself, and how the shareholders behave toward the venture? With trillions of dollars invested in JVs, we think so. 

Box 2: Conducting JV Reviews – The Water Street Partners Approach

RECENTLY, WE'VE BEEN ASKED by a number of JV Boards to support their efforts to look at how an asset or business is doing as a joint venture. To support this work, we've developed a set of proprietary tools, methodologies, and benchmarking data that allows these Boards to better identify opportunities – and to manage a process that has a higher chance of collective action:

Benchmarking database. Our database currently includes detailed performance and practice data on more than 120 JVs from across industries and around the world. The dataset is organized along some 450 different dimensions related to how joint ventures are structured, operate and perform. The database allows JV Boards to calibrate how their JV is doing relative to similar joint ventures.

Methodologies. Our methodology combines facts and analytics, qualitative assessment, and census-building.

For JV Boards that value independent data and facts, we have developed a way to score directors, boards, and governance systems relative to good practice, to benchmark a venture against peers, to perform root-cause evaluation, and to conduct value-at-stake analysis on joint-venture specific issues. For JV Boards less interested in hard data, we have created end-products like the Voice of the Owners Report™ – a qualitative synthesis of what's on the minds of the Board, others in the shareholders, and, potentially, management that is an independent way understand where the owners are.

We've also found that there is an art to how to orchestrate an effective JV Board conversation on these issues – an approach that mixes data and analogs with structured framing of options to consider, in a way that drives engagement, alignment, and collective action.

Other tools and practices. Underlying these methodologies lay a set of proprietary tools that support the issue diagnostic and recommendation development.

Through these methods, our assessment gets at specific JV issues such as shareholder alignment, secondee value proposition, and director effectiveness.

⁵ For more details, see "Revamp of Airbus Reduces Friction And Redundancy – European Partners Bring Sense to the Consortium; No More 'Harlequin' Planes," Wall Street Journal, April 3, 2001

THE JOINT VENTURE EXCHANGE

The Joint Venture Exchange is a forum that connects senior joint venture practitioners, including Joint Venture Board members and CEOs, through the sharing of ideas, practices and experiences unique to joint ventures. It was conceptualized and is managed by Water Street Partners, a boutique consulting, research and information services company focused exclusively on joint ventures and partnerships, founded by the former co-leaders of the Joint Venture and Alliance Practice at McKinsey & Company.

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