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Partners in profit: Creating successful business alliances

As partnerships grow more complex, putting the right foundations in place from the start becomes even more crucial to lucrative and lasting collaboration

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In this episode of the *Inside the Strategy Room* podcast Ruth De Backer and Eileen Kelly Rinaudo share insights on ways to manage business partnerships successfully. In their conversation with Strategy & Corporate Finance communications director Sean Brown, they discuss the four key principles that help partners in joint ventures and alliances thrive, which they wrote about in a recent article. (For more conversations on the strategy issues that matter, subscribe to the series on iTunes or on Google Play.)

Sean Brown: From McKinsey's Strategy & Corporate Finance practice, I'm Sean Brown. Welcome to *Inside the Strategy Room*. In this episode we talk to two of our experts about ways to make joint ventures and alliances more successful. The better companies do at managing such increasingly complex partnerships, the more likely they are to emerge as partners of choice for tackling new markets or channels. Ruth De Backer is a partner in our New York office and leads our global joint ventures and alliances work within the M&A practice. Eileen Kelly Rinaudo, also based in New York, is a senior expert on transactions.

Ruth, let me ask you first: how do such partnerships typically evolve? Do companies start with small joint ventures and then expand them?

Ruth De Backer: A lot of it tends to be industry-specific. In some industries, such as the pharmaceutical sector, partnerships tend to focus on specific products, so if you get a successful product, you may work on development for five years and have a patent life of another ten years. Now we see lots of partnerships with finite objectives in the digital sector as well.

In industrial sectors, companies often turn to partnerships to access new geographies, and these tend to be larger joint ventures. Some companies are starting to partner with more digital firms as well to gain new capabilities. It also tends to shift over time. We've heard people say at the start of a partnership, "It's going to be five years, just to help us put a beachhead in China," but then the companies want to scale up and carry on for decades.

Eileen Kelly Rinaudo: It's important to recognize that having a partnership end doesn't mean failure. It can end very successfully because it has achieved its objective. The key is to make sure you have the capabilities and tracking mechanisms in place so you can adjust as a partnership evolves.

Sean Brown: What are some of the unique challenges in managing joint ventures and alliances?

Ruth De Backer: The main reason partnerships need somewhat different management attention is that you don't operate a joint venture in the same the way you would operate your own business unit. First, you have multiple owners, each with their own characteristics, so you need alignment of objectives among the partners. Otherwise, the partnership becomes inherently unstable.

Second, you create a new entity with its own independent character. It has its own culture that is usually a blend of the two partners' cultures, and it has its own objectives and strategy. The governance of such partnerships is quite complex, and certain questions require a lot of thought. For example, if they have a formal structure with a board, who sits on the board? How often do you rotate the board members? How is the board involved with leadership? Complex governance structures can lead to slower decision making, which can cause friction among the partners.

Finally, there is the issue of partner interdependence, especially in operations, with one or both partners providing services to the separate entity.

Sean Brown: What do you see as the key factors that determine whether a joint venture or alliance succeeds?

Ruth De Backer: We surveyed several hundred people involved in business development and management of partnerships and asked them what is most critical for partnership success. We saw clearly that two factors contribute the most to the success of partnerships, and, when they are absent, to their failure. One is being clear on the venture's objectives and strategy, and the second is communication and trust, because you are dealing with other human beings and it comes down to whether you trust the people you work with day to day (exhibit).

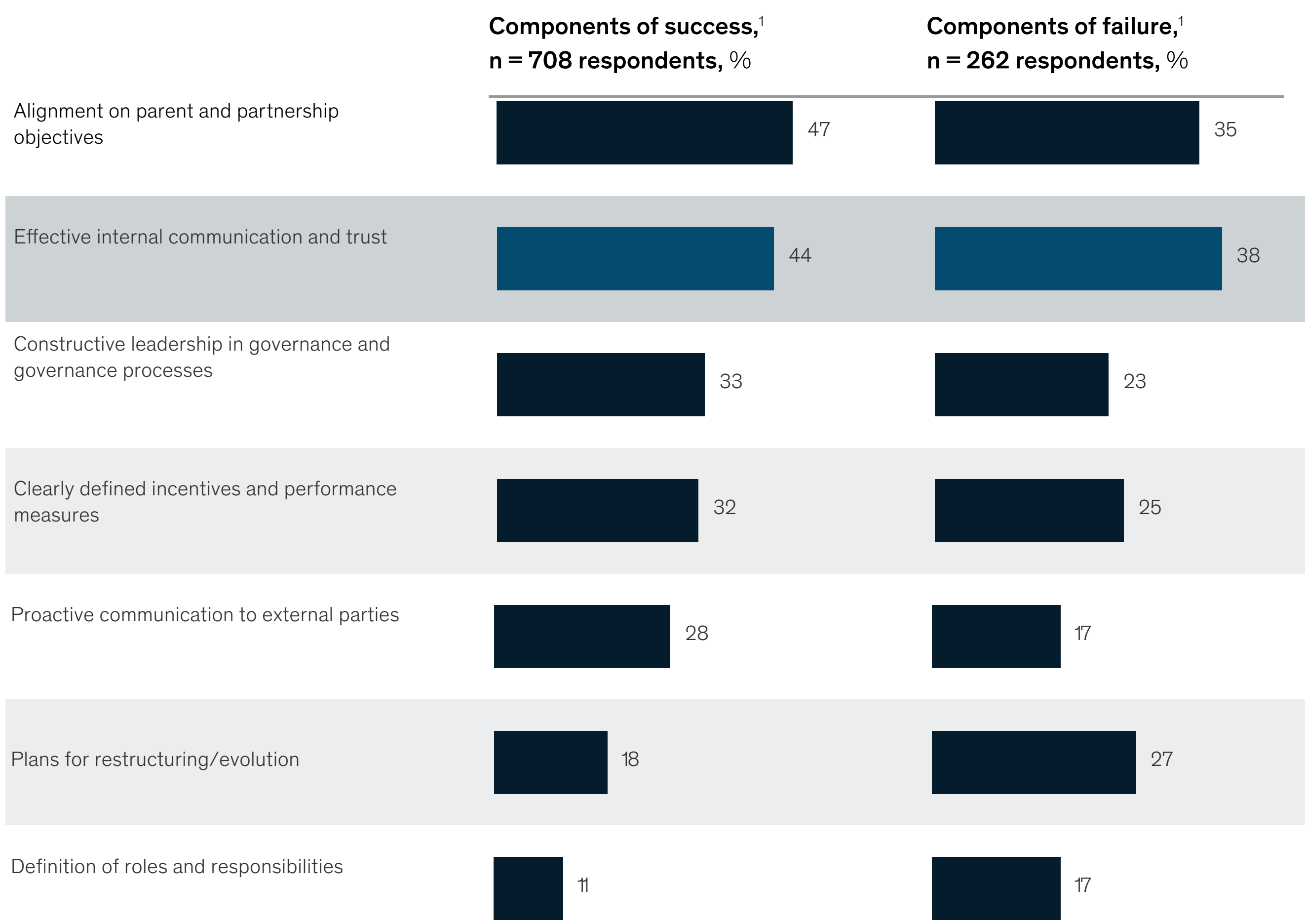
The third and fourth are governance and key performance indicators (KPIs), which really speak to the systems and processes for accountability and clarity on what you're tracking, and what you want the management of the partnership to achieve. The last is a factor that's less important to success than it is to avoiding failure: a plan for restructuring. The world changes. The partners will change. How easily you adapt to a changing environment, or changing strategic objectives, or changing markets will determine the partnership's fate.

Sean Brown: Eileen, what did this research suggest to you in terms of how leaders should approach the management of partnerships?

Eileen Kelly Rinaudo: As we looked at these factors, we tried to figure out what the major levers were from a management perspective. We saw that the first focus has to be on establishing a clear foundation. In the preparation phase, that

Exhibit

Success and failure in joint ventures often hinge on trust and communication.



[1] Most selected by respondents from a list of 10 components.

means making sure there is alignment within every department on the objectives and priorities. Sometimes this early phase is short-circuited. It's also useful to involve team members who are experienced in negotiations in those alignment discussions. Ideally, you also have your operating team and your management team already involved during the negotiation phase so there is a clear understanding of the overall market and objectives. Without those expectations being defined, setting up the next phase of KPIs and processes will be much more difficult, along with making sure everybody has clarity on their roles.

Sean Brown: In establishing that clear foundation, are there particular failure points that you tend to see with clients?

Eileen Kelly Rinaudo: We often see people walk into negotiations thinking they are all on the same page, but because they haven't taken a disciplined approach to getting things articulated and written down, they end up disagreeing with their own teammates about what they are trying to achieve. It's important to make sure you get that done before you walk into the negotiation room—that's the number-one failure point.

Ruth De Backer: One thing I would add is, be mindful of who the ultimate decision makers are. It's especially important when negotiating with private-equity-owned companies. The private-equity owners' timeframes and objectives may be different from the management's, and it is really important to know who is at the other side of the table. Otherwise, they could swoop in at the last minute, and if your objectives don't meet their exit plans, that would jeopardize any agreement.

Eileen Kelly Rinaudo: That kind of preparation becomes even more important when you think about who should do what task and how you will manage operations. Sometimes you get focused on the day-to-day and lose track of the decision makers who need to be incorporated into the ongoing discussions. You should consider how to handle the alignment when you have a mixed partnership portfolio or a large joint venture or a group of smaller alliances. Smaller partnerships tend to have more clearly defined objectives, and joint ventures tend to be more all-encompassing. As a rule of thumb, the broader the partnership, the more critical it is to have clarity on your priorities and strategy. It's sometimes easy to wave your hands a bit and assume everybody is on the same page, especially when it's about big issues on which you think people would have a similar perspective. But making sure those perspectives are clearly defined becomes exponentially more important as you deal with broader topics, bigger partnerships, and longer timeframes.

Sean Brown: Can you discuss some specific ways managers can make sure everyone agrees on those core perspectives?

Eileen Kelly Rinaudo: When we think about the partnership strategy across the design, launch planning, and post-launch phases, there are a couple different techniques we can use. First, bringing in your operational and management teams early is a best practice because it ensures everybody understands how strategic decisions are made and what the major value-creation opportunities for the partnership are. During launch, we again come back to communications. It's critical to communicate frequently and clearly, and to be sure everybody has a similar set of expectations.

When tracking performance, you want to make sure that you clearly define the KPIs early in the process. How are you going to evaluate the partnership's performance over time? Dashboards are very helpful. And finally, the financial aspects. You have to make sure that financial incentives are clearly defined and that you understand the financial flows.

Sean Brown: Once you have established that foundation, what is the next big lever that partnership managers need to pull?

Eileen Kelly Rinaudo: One of the most critical aspects of successful partnership is maintaining a positive and productive relationship. While people work hand-in-hand with their own teammates, they also work with individuals from another company, and that dynamic can create some tension. The two

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groups don't necessarily have the same approach, they don't necessarily communicate in the same fashion, whether electronically or in person, and they come from different cultures.

As a result, you have to put a lot of effort into finding opportunities to build trust and keep communication flowing. Make sure the teams can connect socially, and that it's not all about business, so they can get to know each other and understand how each approaches problems. This should start even prenegotiations, and continue right through the management phase.

Sean Brown: I would think cross-border and cross-cultural partnerships create some challenges on that front. Can you share any advice on how to overcome those barriers?

Eileen Kelly Rinaudo: Cross-border partnerships are tricky. However, because people expect those differences, they put in some extra time and care making sure they address the different communication styles, and that they understand and appreciate the different cultural situations. Unfortunately, that sometimes stops at the negotiation phase, whereas it should be encouraged and role-modeled on a continual basis.

Understanding the cultural predilections and how people want to operate can be tremendously helpful in cross-border situations. Sometimes, it requires a little bit of cultural training. Sometimes, it's about a shift in your communication style. For example, some people like to have meetings that are all action—you send out a preread, everybody does their homework, they walk in ready to problem-solve on any sticky situations—they want a strong, working team meeting. Others walk in and want to review the progress to date, then they want to think about a tricky situation, and then have committee meetings and smaller group discussions to come to the answer. Knowing what type of meeting you are walking into is critical because you could have the best of intentions and yet a horrible meeting.

Domestic partnerships deserve the same level of thoughtfulness too. They require the same understanding of your partner's communication style and culture. That sometimes gets missed, in particular as we see more partnerships between traditional industries and innovation-driven industries.

Ruth De Backer: Having an explicit conversation about this is very important. People should be aware that a Japanese partner, for instance, will have a final sign-off meeting that is quite different from the American style, where many issues could still be open for discussion. Digital companies are accustomed to releasing beta versions and tinkering with solutions. Compare that with pharma, where they have ten-year development cycles, or oil and gas, where the exploration phases take a long time and if you make a mistake, you can't say, "Oh, we drilled a well in the wrong place. Now let's move it six months later." So being aware of how the partner makes decisions is key. You may think, "Well, we're both from the Midwest, we have a similar culture. They're innovation-driven. We're innovation-driven." But it's what is under the surface that needs to get exposed.

Sean Brown: That's helpful. Are there other elements to nurturing the relationship with your partner?

Eileen Kelly Rinaudo: There needs to be clarity from a corporate perspective on the capabilities and motivations, and who is best suited to what task. Sometimes individuals or organizations get attached to doing one task or another. We worked with two consumer companies that wanted to set up a joint venture and the first company walked in expecting it would be in charge of all the financial aspects. About halfway through the negotiations, they realized their counterpart was actually very rigorous and thoughtful about their financial assessments and KPIs, and had strong procedures in place. The first company ended up having one of its senior executives lead the finance team but leveraged its partner's finance team, processes, and dashboards.

That brings up the final point in nurturing relationships, which is involving the right personnel. Having senior sponsors for the partnership is critical. They should be there in the internal partnership-design phase and through the negotiations and launch and management of the partnership. Those sponsors should stay involved, both in terms of ensuring there is clarity in the decision making and to course-correct if the situation warrants. You also need a partnership management team within the parent organization, which monitors the cross-company relationship. And then, of course, experienced negotiation support is key because you want to make sure people are going after a "1 plus 1 equals 2.5 or 3 or 4" result, and not a "we win and you lose" kind of mentality.

Sean Brown: Can you elaborate a bit on the tools and processes that you would recommend?

Eileen Kelly Rinaudo: We mentioned the issue of agendas—these are critical. How are you handling meetings? How do you make sure that agenda items are addressed ahead of time? Similarly, you have to make sure you define the KPIs for the performance updates, and even more importantly, define why and how your KPIs reflect the goal. It can be hard for an operating team or a management team to track thousands of KPIs, so you have to define which ones really matter. The last process is the portfolio review, making sure you have time set aside to review the performance of each partnership and how it is furthering the strategy of your parent organization.

Finally, as we think about the tools, obviously the financial models and guidelines are important. Those get a lot of discussion because everybody thinks in terms of hitting financial targets, but it's also important to think about the tools you will use for that tracking—especially when you have a portfolio of partnerships or multiple similar partnerships.

Sean Brown: Do you find that most partnerships have these tools and processes in place?

Eileen Kelly Rinaudo: In our survey, we asked companies whether they had tools to support their joint ventures and alliances, and we had some surprising results. About half the respondents did not have the financial models and guidelines for financial evaluations. That's lower than we expected. But it was nothing compared to the surprise of learning that very few companies have the playbooks to support the launch and ongoing management of their partnerships.

Sean Brown: What about accountability? I assume many of those processes and tools are intended to track that. Ruth?

Ruth De Backer: There are two parts that underpin accountability. One is governance and the other is performance metrics. On governance, most people think about who the CEO will be and how the CEO/chairman role will be split, but we emphasize that governance starts with structure. The most successful partnerships have one central point of accountability—the CEO of the joint venture, or the central management team, and an active board. You do want to link back to each partner organization and the board should provide that link, but not in all the decisions.

We also like to see independent board members in joint ventures. The board should not consist solely of executives from the partner organizations. Instead, think about capabilities you may need on the venture's board and find independent directors who have them. As for roles and responsibilities, the management's and the board's roles need to be clear. You don't want the joint venture to function like a kids' soccer team where everyone wants to be involved in all the decisions. Certain veto rights are the role of the board, especially on capital allocation and key executive appointment, but otherwise the board should track performance and intervene when metrics are missed. For that, you need regular meetings that track partnership performance. Where are we falling behind? Do we need to evolve this partnership, or expand it because it's so wildly successful?

And be mindful that these have to be joint metrics. Often, companies say they track metrics, but it turns out they only track their own—they don't care whether their partner is successful! But it's a bit like a marriage: you want to know whether your partner is happy as well, because otherwise the relationship won't last very long.

Sean Brown: Can you share any examples of a partnership governance structure that worked well?

Eileen Kelly Rinaudo: In one situation, two energy companies created a joint venture to reduce cost and risk, inked the deal rather quickly, and ended up with a board of 28 people. That's very large. All of the board members were from the two parent companies, and they ended up getting mired in these long meetings. The board also felt the need to control virtually all decisions, which made the management team very frustrated, understandably, and made everything very slow. There was confusion about what the operating team was supposed to be doing and how they were being judged. The lack of efficiency during board meetings and in the joint venture's operations became a critical point.

So, the companies restructured the governance processes. They clarified the roles and responsibilities for the board and operating team—first, in who was in charge of which pieces and, second, giving the board members more of a committee-like approach. They also reduced the board to 11 members. The committee structure made the meetings much more efficient because the full board would deal with committee recommendations that it either ratified or sent back. And, importantly, the operating team became much happier and more effective.

Sean Brown: That brings us to the final of your four levers, which is about making the partnership dynamic. How much change typically happens over the course of a joint venture or alliance?

Ruth De Backer: Most partnerships experience change either in external environments or internal roles. A partnership is a living, breathing thing. In our survey, among alliances that were deemed successful, four out of five had at least one restructuring, and of those that remained unchanged only a third survived. As for what elements of a partnership change, it could be pretty much anything. Some partnerships go into entirely different markets over time. The governance and the board's

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composition may change. The decision-making terms may change. You may evolve your KPIs, especially as you change your strategy. Organization of talent—oftentimes partnerships start with legacy employees from partner companies, but as the organization works to adapt to the competitive situation, it brings in outside talent. So, don’t be afraid to evolve the partnership, and make your negotiations reflect this, putting in place mitigation plans and formulas on how things may change.

Sean Brown: So, of these four levers, which do you find is most important, or the one on which people most frequently stumble?

Eileen Kelly Rinaudo: I’d say those are two separate questions. The clear foundation is probably the most critical, because without that you are potentially wasting your time. The one that most people miss is the ability to have this dynamic partnership and setting up the reevaluation and restructuring mechanisms ahead of time. People have a very negative view of restructuring, and it isn’t actually a negative thing.

Sean Brown: Would you advise then that partners discuss the conditions that might require a potential restructuring even at the early partnership stage?

Eileen Kelly Rinaudo: Best practice is absolutely to have clear triggers for reevaluation. Ideally it would be every year for the first five years, and then every two or three years after that, the partners should evaluate whether they are still achieving their goals and what needs to shift. So instead of saying *whether* we need to shift, it’s *what* needs to evolve, because it could be something very small and simple or it could be something wide-reaching and complex.

Ruth De Backer: Things often morph over time. The people who negotiated the partnership may have been very clear on the foundation for it, but then the operators, and especially the second-generation operators, may not be fully aware of that foundation. If you put together the dynamic partnership and the metrics, it's a way to keep everyone aligned over time.

Sean Brown: How do you decide when a joint venture or alliance is the right solution, and when you should look at a merger or an acquisition instead?

Eileen Kelly Rinaudo: That's complicated. I'd say the order is usually M&A versus a joint venture, and then joint venture versus alliance, and alliance versus contractual agreement. That's the spectrum you usually see. In terms of M&A versus joint venture, you should ask yourself, are you the right company to buy and operate the asset? Because if the answer is yes, then M&A may be preferable. The control can be quite appealing. However, if you are not the right owner and don't have the skill sets to operate the asset, you can destroy value, whereas a joint venture may be safer, if a bit more complicated. Also, there are situations where regulatory constraints, geographic concerns, or just the fact that you can't get access to the right assets might make a joint venture the right path.

Sean Brown is McKinsey's global director of communications for strategy and corporate finance and is based in the Boston office, and **Ruth De Backer** is a partner in the New York office, where **Eileen Kelly Rinaudo** is a senior knowledge expert.

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