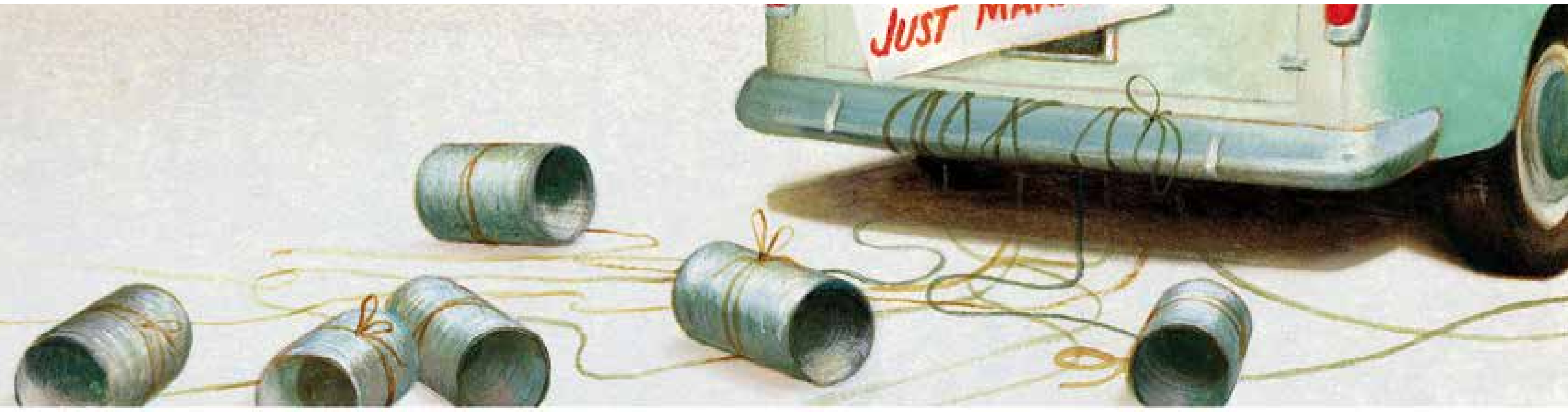


Avoiding blind spots in your next joint venture

Even joint ventures developed using familiar best practices can fail without cross-process discipline in planning and implementation.

John Chao, Eileen Kelly Rinaudo, and Robert Uhlaner

Joint ventures (JVs) often seem destined for success at the outset. Two companies come together in what seems to be an ideal match. Demand for the planned product or service is strong. The parent companies have complementary skills and assets. And together they can address a strategic need that neither could fill on its own. But in spite of such advantages, revenues decline, bitter disputes erupt, and irreconcilable differences emerge—and managers call it quits.

Not all joint ventures fall apart so spectacularly, but failure is far from a rare occurrence. When we interviewed senior JV practitioners in 20 S&P 100 companies—with combined experience evaluating or managing more than 250 JVs—they estimated that as many as 40 to 60 percent of their completed JVs have underperformed or failed outright. Further analysis[1] confirmed that even companies with many joint ventures struggle, even though best practices are well-known and haven't changed for decades. In fact, most of our interviewees endorsed several that have long been the gold standard for JV planning and implementation: a clear business rationale with strong internal alignment, careful selection of partners, balanced and equitable structure, forethought regarding exit contingencies, and strong governance and decision processes.

So why do so many joint ventures fall short? Our interviewees suggest that in the rush to completion, even experienced JV managers often marginalize best practices or skip steps. In many cases, the process lacks discipline, both in end-to-end continuity and in the transitions between the five stages of development—designing the business case and internal alignment, developing the business model and structure, negotiating deal terms, designing the operating model and launch, and overseeing ongoing operations. Moreover, parent-executive involvement often declines in the later stages. Finally, many JVs struggle with insufficient planning to respond to eventual changes in risk. Such lapses, even in the early stages of planning, create blind spots that affect subsequent stages and eventually hinder implementation and ongoing operations. We'll examine each of these issues, along with the approaches some companies are taking to deal with them.

Rush to completion

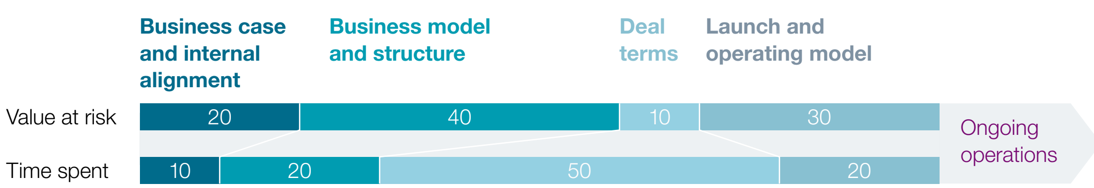
Many of the practitioners we interviewed noted the pressure—from investors, senior executives, and the board—to get deals done quickly, as companies strive to stay ahead of evolving trends or aim to meet fiscal deadlines. When that pressure for speed meets the complexity of the JV process, it can overwhelm even experienced practitioners—especially during the transitions between stages of development. As the head of a global pharmaceutical company lamented, "We continually fall prey to the pressure to get a deal signed and then forget to plan for operational realities."

Many companies lack the forethought and discipline to address those operational realities at each phase in a JV's development and spend more time on steps where less value is at risk and less time where more value is at risk (Exhibit 1). Some rush through the business-case design by skipping steps—usually thinking that it will be easy enough to return to any issues later—and end up trying to reverse engineer the business case. Others focus more on a deal's financials, which are familiar and comfortable for those with M&A experience, than on the less quantifiable strategic and operational issues, such as what might trigger a decision to walk away from a deal, the cost of ancillary agreements, the impact of exit provisions, and the effect of decisions to delegate authority. Still others substitute boilerplate agreement language in critical terms

Exhibit 1

Companies spend more time on steps where less value is at risk and less time on steps where more value is at risk.

% of total time spent on each stage of joint-venture development



Source: Interviews; McKinsey analysis

of the agreement or in arbitration clauses rather than tailoring them to the deal at hand.

Not surprisingly, our interviews suggest that taking such shortcuts leads to many proposed JVs failing prior to implementation. In general, as the head of business development for a high-tech company commented, “The assumption that a business case will just happen leads to a great deal of pain. People underestimate the difficulties they’ll encounter.” In one pharmaceutical partnership, for example, managers defined only a cursory business case, hoping to move quickly to reap the potential financial benefits of the arrangement. When they later were forced to reconsider certain decisions given the lack of focus and detail in the business plan, they realized that the two companies had different visions for the partnership and terminated it without realizing its expected returns.

The solution is intuitive: companies must find ways to balance the pressure for speed with the demands of planning a healthy joint venture—especially allocating their time and resources in line with the potential for value and impact. No single approach will work for every company or in all circumstances, but the approach taken by one global industrials company is illustrative. Any business unit presenting a JV proposal to the executive committee of this company must include in its presentation a detailed business case, an investment thesis, an assessment of competitors, and detailed profiles of priority partners. It must follow an explicit checklist of expectations for each stage in the planning process—including deal structure and terms, financial analysis, launch, and operating-model design. Senior managers must also use this checklist during progress reviews, both to ensure alignment and consistency and to serve as a forcing mechanism for raising issues. Although this approach demands significant time and resources even before detailed negotiations with a JV partner, it also increases everyone’s comfort and confidence in the vision for the deal.

Lack of leadership continuity

Companies often struggle to maintain continuity of vision as they develop and execute joint ventures. Even if they start with a clear business case and explicit internal alignment, the strategic intent can get lost in the details as execution issues emerge and people move in and out of the process at different stages.

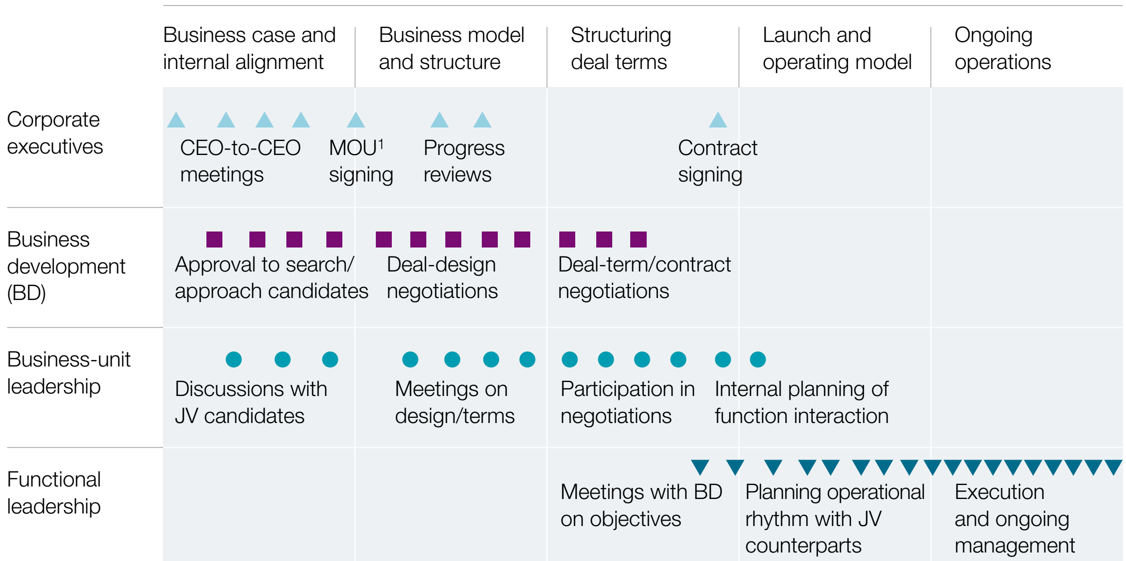
Part of the problem is that a different team member is usually responsible for each of the five phases of a JV’s life cycle. In fact, among the different groups represented by our interviewees, including business development, top management, and business-unit leadership, none has responsibility for more than two phases. They also each have different ways of defining success and are compensated accordingly. Business-development teams, for instance, are typically evaluated and compensated based on the speed of a JV’s design and execution process, which can create a bias toward haste, even among the most thoughtful team members. Moreover, in all groups, senior decision makers often step back as others get involved, feeling they’re no longer essential. And JV managers themselves aren’t appointed, or don’t assume their roles, until late in the process, usually about halfway through the launch, at which time the integration team abruptly pulls out.

When leadership is this disjointed, decisions made early in the process can have a disproportionate effect later on. In the transition between developing the business case and negotiations, for example, a lack of continuity can lead to poorly defined objectives and vaguely aligned priorities—which in turn creates confusion over who should drive

Exhibit 2

Senior managers are less involved in the later phases of development.

People involved in each phase of the development of a joint venture (JV)



[1]Memorandum of understanding.

Source: Interviews; McKinsey analysis

business-model development, lead the corporate business-development office, settle on deal terms, or manage the business unit itself. Worse, there is often no consistent referee to resolve trade-offs without reaching into very senior ranks—in many cases, the CEO.

To compensate for discontinuity, we've seen companies assign end-to-end accountability for a joint venture to a single senior business-unit executive with clear authority to make executive decisions, supported by team members who serve overlapping terms across the core phases of its design and execution. This creates a balance of executive sponsorship and specialized authority throughout the process. As one executive observed, "Successful JV development depends on a single empowered executive who lives and breathes the JV from business-case development to launch and handover to the management team." The ideal candidate is a business-line leader or a future leader of the JV with experience in the JV's strategy and operations.

Declining parent involvement

If allowed to proceed organically, JV planning would naturally require executive input throughout the entire process. While it may seem self-evident, many parent companies underestimate the detrimental impact of an absence of senior decision makers toward the end of the process. Even when they appoint a single JV manager as recommended, other senior executives are usually most present at the beginning of the deal design and initial partner meeting and then disappear until the final signing of the

JV agreement—whether because they naturally refocus on other projects, because their interest wanes, or because they feel less useful on an ever-expanding team. In fact, many top executives are involved only in decisions regarding deal terms at a handful of points before the ink is almost dry (Exhibit 2). This creates tension and risk for the JV as more junior executives assume responsibility for negotiating an agreement.

To ensure that the structure and operating model are aligned with the vision and strategic rationale, critical issues must be resolved when senior decision makers are in the room. The best approach requires parent-company executives to resist putting decisions off, on the one hand, and to commit to being around for late process decisions on the other. Managers of one high-tech JV, for example, set firm and clear standards for both parents' executive teams to keep decision making on track. Those executive teams committed to a high level of participation and accountability to ensure they were aware of and able to manage any issues; their involvement helped launch a large-scale JV quickly and smoothly and set the stage for a healthy long-term relationship that remains profitable today.

Since it isn't always possible for executives and senior leaders to maintain a high level of involvement, companies may need to forgo the usual linear flow of decision making. That means front-loading the most important decisions—about which partner will have operational control, for example, or which critical positions each will hold—rather than waiting for them to emerge organically. Determining the right questions and the sequence of decisions will jump-start partner discussions and draw attention to tough decisions, such as how much control each partner has, that should be made by the leadership teams early rather than left to the integration team later on.

Insufficient planning to respond to changes in risk

At the beginning of any JV relationship, parent companies naturally have different risk profiles and appetites for risk, reflecting their unique backgrounds, experiences, and portfolios of initiatives, as well as their different exposures to market risk. Parent companies often neglect this aspect of planning, preferring to avoid conflict with their prospective partners and getting to mutually agreeable terms—even if those terms aren't best for either the JV or its parents. But left unaddressed, such asymmetries often come to light during launch, expand once operations are under way, and ultimately can undermine the long-term success of the joint venture.

Certainly, some JVs must be rigidly defined to be effective and enforce the right behavior. But when that isn't the case, JV planners too often leave contingency planning to the lawyers, focusing on legal protection and risk mitigation without the business sense, which shows up in the legalese of the arbitration process and exit provisions. Both tend to be adversarial processes that kick in after problems arise, when in fact contingency planning should just as often focus on the collaborative processes that anticipate changes and create mechanisms or agreements that enable parent companies to adapt with less dysfunction. As the head of strategy for one insurance company noted, "If a JV is set up correctly, particularly regarding governance and restructuring, it should be able to weather most storms between the parents." Such mechanisms might include, for example, release valves in service-level agreements, partner-performance management, go/no-go triggers, or dynamic value-sharing arrangements and can allow a joint venture to maintain balance in spite of partners' different or evolving priorities and risks.

One industrial JV launched in the mid-1990s used just such an adaptable approach to get through the financial crisis. While the JV had benefited both parents, its future was threatened when the crisis buffeted the majority owner. Rather than dissolve the partnership, the minority partner temporarily bought a larger stake in the JV, giving the majority owner some much-needed cash. Once it was back on its feet, the majority owner was able to buy back its full share and restore the ownership balance.

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Even companies that rigorously follow the common best practices for JV planning will falter if the process lacks a comprehensive view of execution both within and in between stages of development. Maintaining vigilance and balancing these four pressures is critical to the success of a JV.

[1] We examined joint ventures valued at more than $250 million that were launched between 1998 and 2012 and in which one of the parent companies was in the Fortune 250.

John Chao is a McKinsey alumnus, **Eileen Kelly Rinaudo** (Eileen_Kelly_Rinaudo@McKinsey.com) is a senior expert in the New York office, and **Robert Uhlaner** (Robert_Uhlaner@McKinsey.com) is a director in the San Francisco office.