

Perspective from Practice

Joint Ventures:

The Next Frontiers of Analysis

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In a 1993 interview, Peter Drucker commented that: “Businesses used to grow in one of two ways: from grassroots up or by acquisition. ... Today businesses grow through alliances, all kinds of dangerous liaisons and joint ventures, which, by the way, very few people understand.”¹ In some ways, a lot has changed since then. Over the ensuing decades, business practitioners and their advisors, including lawyers and consultants, have come to understand the importance and challenges of joint ventures and other partnerships, and have grown much more sophisticated in conceiving and evaluating collaboration-based strategies, structuring joint venture transactions, screening and performing due diligence on joint venture counterparties, and governing and managing joint ventures.

But much has also remained the same. There is still much to understand about joint ventures and other partnerships. Over the last decade we have advised on more than 400 joint venture-related client matters, held thousands of conversations with executives and other advisors, and conducted several dozen benchmarking studies and research initiatives on different aspects of joint venture performance and practice. And yet much remains underexplored. What follows is a practitioner-based view of six joint venture topics – topics that relate to firm strategy, structure, and performance in the context of the widespread but novel corporate form of joint ventures – that are prime candidates for rigorous academic examination.

1. What Makes JVs Succeed?

Over the last 30 years, various consulting firms and academics have tried to evaluate JV success rates and, in some instances, identify correlations between success and ownership structure, partner types, geography, and other venture characteristics. Most consulting firm studies have operated at a very general level – i.e., using a self-assessment survey-based approach, with limited access to independent facts and without direct challenge to claims of performance – to gauge whether a company’s joint ventures have been successful.² These

¹ “The Post-Capitalist Executive: An Interview with Peter F. Drucker,” T. George Harris, *Harvard Business Review*, May-June 1993.

² See for instance: “Avoiding the Blind Spots in Your Next Joint Venture,” John Chao, Eileen Kelly Rinaudo, and Robert Uhlaner, *McKinsey Quarterly*, January 2014; “Getting More Value from Joint Ventures,” Alexander Roos, Dinesh Khanna, et al., BCG,

studies diverge widely in their assessment of JV success rates, though most assert significant room for improvement. They have generally been used to provide evidence of joint venture challenges and, implicitly, the need for consulting firm support.

In other cases, however, consulting firms and academics have done more rigorous analysis, for instance looking at stock market announcement effects of new joint ventures³, evaluating the lifespans of joint ventures and using longevity as a proxy for success⁴, or analyzing investment performance patterns of pools of non-controlled entities based on company public filings or large government datasets⁵. In some cases, firms have looked closely at governance, restructuring, and other aspects on joint ventures and correlated the presence of specific practices against venture or company performance⁶. While providing useful windows into venture dynamics and certain aspects of performance, such analyses have limitations to understanding what drives success more broadly.

A variety of academics have endeavored to establish frameworks for measuring JV performance and identify causal factors driving success rates. One of the earlier contributions comes from Bruce Kogut, who, in a 1988 paper, surveyed the existing literature on JV formation and stability, advancing three primary theories for why companies form JVs but finding conflicting results as to what determines their stability⁷. Another early literature survey came from Geringer and Herbert (1989) who sought to synthesize prior studies of international JV control structures and their relationship to performance⁸.

Since then, others have probed the question of JV performance from different angles. A.B. Sim and Yunus Ali, writing in the *Journal of World Business* (1998), examined 59 international JVs from developed and developing countries to measure differences in performance⁹. Though the performance drivers varied between the two geographic groups, Sim and Ali did not find significant overall differences, and the

December 2014; or "Tapping the Unexpected Potential of Joint Ventures," Arnaud Leroi and Philip Leung, *Bain Insights*, February 2017.

³ "Do Firms Learn to Create Value? The Case of Alliances," Bharat N. Anand Tarun Khanna, *Strategic Management Journal*, 2000, Vol 21; and "When to Think Alliance," David Ernst and Tammy Halevy, *McKinsey Quarterly*, 2000 No. 4

⁴ *Collaborating to Compete: Using Strategic Alliances and Acquisitions in the Global Marketplace*, David Ernst and Joel Bleeke, Wiley, 1994

⁵ See: "Value Destruction in Joint Ventures? Why U.S. JVs Abroad are Less Profitable than Wholly-Owned Ventures," Benjamin Gomes-Casseres, unpublished working paper, July 27, 2003; and "How Joint Venture Staged a Quiet Comeback," Gerard Baynham, *Chief Executive*, October 6, 2017

⁶ See, for instance: "Joint Venture Governance Index: Calibrating the Strength of Governance in Joint Ventures," James Bamford, Shishir Bhargava, Martin Mogstad, and Geoff Walker, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, March 2020; "Your Alliances are Too Stable," David Ernst and James Bamford, *Harvard Business Review*, June 2005; "Putting Your Partnership Portfolio on the Move: How Market Leaders Maximize Returns by Actively Shaping and Reshaping Their Joint Venture and Partnership Portfolios," Shishir Bhargava and James Bamford, *Ankura Insight*, forthcoming; "Performance Implications of IJV Boards: A Contingency Perspective," Elko Klijn, Jeffrey J. Reuer, Frans A.J. Van Den Bosch, and H.W. Volberda, *Journal of Management Studies*, November 2013

⁷ "Joint Ventures: Theoretical and Empirical Perspectives," Bruce Kogut, *Strategic Management Journal*, August 1988

⁸ "Control and Performance of International Joint Ventures," J. Michael Geringer and Louis Herbert, *Journal of International Business Studies*, Summer 1989

⁹ "Performance of international joint ventures from developing and developed countries: An empirical study in a developing country context," A.B. Sim and Yunus Ali, *Journal of World Business*, Winter 1998

study did not seek to quantify success. Bettina Buchel, in a 2003 paper for the *Sloan Management Review*, found a significant correlation between the quality of parent company relationships and the performance of their JVs, though this was a survey-based study and also did not rigorously define success¹⁰.

Arguably, the last broad-based serious study of joint venture success rates was done in 1994 by Joel Bleeke and David Ernst of McKinsey¹¹. Bleeke and Ernst evaluated 49 cross-border joint ventures, conducting more than 150 interviews, reviewing original joint venture business plans, and evaluating financial and other information on these ventures to determine success rates, as defined by whether the venture was meeting the owners' original financial and strategic objectives. Bleeke and Ernst used these success determinants to identify correlations with partner type (competitors or not), venture scope (cross-border vs. regional) and other factors.

Researchers could add value by updating and expanding such a success rate study. Beyond following the methodology of Bleeke and Ernst, such analysis could be usefully expanded to include:

- Perspectives from joint venture owners, board members, and management on venture performance and health (Bleeke and Ernst did not evaluate joint venture health, such as levels of alignment, trust, or decision making efficiency, nor discuss differences of views based on an executive's role)
- A broader set of industries and venture types (Bleeke and Ernst focused on cross-border joint ventures, with a heavy focus on industrial joint ventures, and did not look at some key venture characteristics, such as the relative level of independence in the operating model)
- Performance comparison to market competitors (Bleeke and Ernst did not evaluate a joint venture's performance relative to its competitors, including wholly-owned businesses, and therefore did not provide insights into how joint venture performance compares to other ownership structures)

2. Why Do JV Negotiations Break Down?

Thousands of new JVs – including hundreds of JVs with contributions valued at \$250 million or greater – are consummated each year around the world.¹² But, anecdotally, the “close rate” on potential JV transactions is quite low. In our experience, less than a quarter of JVs

¹⁰ “Managing Partner Relations in Joint Ventures,” Bettina Buchel, *MIT Sloan Management Review*, July 2003

¹¹ See: *Collaborating to Compete: Using Strategic Alliances and Acquisitions in the Global Marketplace*, David Ernst and Joel Bleeke, Wiley, 1994, and “The Way to Win in Cross Border Alliances,” David Ernst and Joel Bleeke, *Harvard Business Review*, Nov-Dec 1991

¹² For a current discussion on the use of joint ventures and partnerships, please see: “Joint Ventures and Partnerships in a Downturn,” James Bamford, Gerard Baynham, and David Ernst, *Harvard Business Review*, September-October 2020; “Joint ventures on the rise,” Eileen Kelly Rinaudo and Robert Uhlaner, *McKinsey Quarterly*, November 2014; and “Why your next deal may be a partnership,” Bob Saada and Benjamin Gomes-Casseres, *Strategy+Business*, Spring 2019

where the counterparties have entered into serious negotiations – i.e., have received internal permissions to negotiate, signed confidentiality agreements, formed dedicated internal deal teams, hired external advisors, started to develop business plans and financial models, commenced due diligence, and begun draft term sheets or definitive legal agreements – actually close.

This close rate may be similar to buy-side acquisitions – but for totally different reasons. In JVs, the failure to close a transaction is rarely because another bidder has won, as is the case with a typical sale process. In our experience, the failure to close joint venture transactions arises principally from fatigue: company leadership growing tired of the complexity and volume of material business issues (e.g., authorized scope and exclusivity, design of the JV’s business system and what activities are “in” the venture versus performed “by” the owners, contribution and valuation of intangible assets, governance and control, exit). This is exasperated by the lack of a competitive and tightly-managed transaction process – something that investment banks bring to an M&A transaction. Because investment banks are rarely involved in JV transactions – for a variety of reasons, including difficulties applying a percent-of-transaction-value fee structure to joint ventures where investments are phased over time and conditional on business performance – the deal process does not have real discipline around milestones, and companies often struggle to prioritize issues.

Having a broad, independent, and fact-based understanding and supporting data as to where and why JV transactions breakdown is critical to improve the close rate – that is, getting to a “quick no” or a “good yes.” This analysis could deploy a combination of interviews and survey of corporate executive sponsors, corporate dealmakers, and external advisors that captured for the outcome for specific JV transactions, and for those deal that were not consummated where in the venture transaction lifecycle negotiations broke off and an explanation of the issues that drove such terminations. Such an analysis could seek to generate additional insights:

- Key correlations of outcomes, deal duration, breakdown points, explanations – by industry, geography, partner group profile, venture type, and relative ownership and control
- Relative resource spend, including both internal and external costs
- Relative executive time spent during the transaction, and whether this corresponds with perceptions of actual value¹³

Practitioners and advisors could leverage this analysis to negotiate more, and more effective deals – and to recognize transactions that, retroactively, appear “doomed from the start.”

3. How Do JVs Manage Unique Governance Demands?

¹³ The issue of relative time dedication to value was explored, at a directional level, in “Avoiding the Blind Spots in Your Next Joint Venture,” John Chao, Eileen Kelly Rinaudo, and Robert Uhlaner, *McKinsey Quarterly*, January 2014.

The shareholding structure and regulatory requirements of joint ventures differ in substantial ways from that of public companies – which drives fundamentally different governance challenges and practices of these entities. For example, JV Boards are almost always composed of current employees of individual shareholders – executives who are implicitly or explicitly charged with protecting and promoting the interests of their employer, in addition to fulfilling their fiduciary duties to the JV entity and the collective interests of all shareholders. Meanwhile, JV board committees are typically composed of at least some non-board member functional experts from individual shareholders – a practice which expands the size of the governance group, diffuses board accountability and cohesion, and can create disconnects between the board, committees, and management. Meanwhile, because JV board members are executives of individual shareholder companies with big “day jobs,” they generally have less time to spend on governance than a director of a public company director (15 vs. 35 days, based on our analysis) and are prone shorter tenures compared to public company directors (2.5 vs. 9 years), due to the fact that JV board positions tend to be linked to an executive’s specific role in a company, which is subject to change every few years as careers advance and organizations are restructured.¹⁴

At the same time, the demands on a JV board are often more diverse and intense than that of a corporate board. JV boards often serve as a perpetual negotiating table, a forum for shareholder representatives to expose and resolve misalignments in strategy, financial and risk appetites, product and technology preferences, and financial incentives and returns. Airbus became famous for the challenges of joint venture governance. For the first 30 years of its existence, Airbus was owned by four European aerospace and defense companies from France, Germany, Britain, and Spain. The venture was structured such that each owner contracted with the JV to design and manufacture separate parts of the aircraft, which were then shipped to Airbus’s headquarters in Toulouse, France for final assembly. The owners reportedly called their annual pricing meeting the “poker game,” while the companies’ auditor referred to themselves as the “liars club” with the job of detecting less-than-candid pricing assertions. Reportedly, no one held a complete picture of the integrated economics, and thus could not determine whether an airplane was profitable or not.

Airbus has since restructured its shareholding and resolved its governance peculiarities. But many JVs suffer from similar, albeit usually less intense, governance issues. Despite joint venture governance being more physically-demanding and pound-for-pound more consequential than public company governance, very few academics have looked closely at the unique issues that governing joint ventures introduce – or into the details of the governance structures

¹⁴ For additional details on joint venture governance, please see: “Joint Venture Governance Index: Calibrating the Strength of Governance in Joint Ventures,” James Bamford, Shishir Bhargava, Martin Mogstad, and Geoff Walker, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, March 13, 2020; “Public Company vs. Joint Venture Governance” James Bamford, Tracy Branding, and Lois D’Costa, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, Dec. 28, 2019; and *CalPERS Joint Venture Governance Guidelines*, James Bamford and David Ernst, CalPERS, 2015.

and practices to address those issues. Some questions which merit academic investigation include:

- How are joint venture boards and governance systems structured – in terms of board mandate, composition, workings, delegations to management, relationship with committees, and self-governance?
- How do JV governance practices vary across industries, geographies, and venture types, and what explains such differences?
- What JV governance practices most strongly correlate with performance?
- How do regulators look at the governance of joint ventures – and how where do laws and regulations have gaps or unintended consequences on the governance of joint ventures?

4. What Makes an Ideal JV CEO?

Many JV CEOs would argue that they have the toughest job in business, and it's not hard to sympathize with them. JV CEOs face all the leadership challenges of typical corporate CEOs, along with a litany of additional issues that are specific to the shared ownership and control structures of a JV. Anecdotally, we can divide those challenges into four categories:¹⁵

1. Strategy – JV CEOs must answer to multiple corporate parents, each with its own set of strategic objectives, investment preferences, and risk tolerance.
2. Operational and commercial interdependence – as most JVs are partially dependent on parent companies for services and support, CEOs must navigate contentious issues around whether one parent is deriving more value than others through its service agreements and pricing arrangements with the JV.
3. Governance – JV CEOs answer to a Board composed of representatives from separate parents who are not always be final decision-makers within their companies, adding an extra layer to the complex decision-making process.
4. Human resources – JV CEOs may have a workforce composed heavily of secondees from parent companies whose loyalties are divided, or face the opposite problem of having to build a workforce from scratch for a young organization with a potentially uncertain future – a risky proposition which can make it tough to recruit top performers.

Despite these challenges, the literature on what makes for successful CEOs in the JV-specific context is sparse, especially when compared with the mountains of research and advice on “traditional” CEOs.

Much of the existing work on JV CEOs comes from Water Street Partners, which has undertaken several studies specific to the role over

¹⁵ These categories are described more thoroughly in “Memo to a New JV CEO,” James Bamford and David Ernst, *The Joint Venture Exchange*, December 2008.

the past decade. In one study, we examined over 100 JV CEO transitions – including sourcing, selection process, tenure, and future career path – through interviews with several dozen JV CEOs as well as a number of JV Board members and human resources executives¹⁶. A separate study benchmarked executive compensation in 38 JVs and developed a framework for JV Boards and HR or remuneration committees to use in determining what peer companies should serve as models for setting compensation of JV CEOs and other senior executives¹⁷. More recently, we analyzed 110 JV legal agreements to determine what percent of agreements establish contractual rights for the owners to appoint executives into the JV CEO and other executive positions.

Academic studies on JV CEOs are rare, but one of note is Oded Shenkar and Yoram Zeira's paper in the *Journal of International Business Studies* (2001) investigating conflicts and ambiguities in the relationship between a JV CEO and the parent companies of international JVs¹⁸. Shenkar and Zeira examined the performance of 265 CEOs of China-based international JVs using a transaction cost economics analysis, and quantified the degree of conflict and ambiguity in each CEO's role. While they identified a set of factors that influence conflict and ambiguity (e.g., conflict is lower when a foreign parent is the dominant venture partner and higher when a local parent is the dominant partner) they ultimately found that neither conflict nor ambiguity had a detrimental effect on JV performance.

Perhaps the only study that has drawn concrete conclusions regarding qualities of a JV CEO that lead to high performance is a Water Street Partners study by Gerard Baynham and Paul Flatin (2016).¹⁹ Baynham and Flatin surveyed 81 JV CEOs globally and across industries, ranking their abilities across 43 variables identified as potential best-practices. They used parent company surveys to correlate these scores with the strategic and financial performance of each JV relative to expectations, and ultimately identified a set of 10 key practices that collectively accounted for 41% of performance variation.

For those that handle the JV CEO role well, it can be a launching pad for business stardom. For instance, consider Bob Dudley, who headed BP's massive Russian JV with TNK for six years before being put in charge of BP's response to the Macondo disaster (also a JV-related incident). He then became the Group CEO of BP.

On the opposite end of the spectrum, Andrew Lack, CEO of the Sony BMG JV, had to contend with fundamentally misaligned shareholders from the start. Sony sought to integrate the JV into its media business; BMG preferred to keep it as a standalone entity. Sony thought Lack

¹⁶ "JV CEO Transitions: Getting it Right," Water Street Partners, *The Joint Venture Exchange*, July 2011

¹⁷ "Show Me the Money: Are JV Executives Compensated Fairly," James Bamford, Joshua Bright, and David Ernst, *The Joint Venture Exchange*, January 2011.

¹⁸ "Role Conflict and Role Ambiguity of Chief Executive Officers in International Joint Ventures," Oded Shenkar and Yoram Zeira, *Journal of International Business Studies*, 2001.

¹⁹ "The JV CEO Success Equation," Gerard Baynham and Paul Flatin, *The Joint Venture Exchange*, November 2016

was highly successful and well-suited to the role; BMG thought he was disliked by colleagues and was undermining the JV's value. He was eventually replaced in an effort to repair the relationship between the two shareholders.²⁰

A broad-based study of JV CEOs could seek to correlate JV performance with factors in the following areas:

- *Professional background.* This would include mapping basic demographics, including education, functional expertise, seniority, gender, and prior experience with joint ventures
- *Sourcing and employment status.* This would capture where JV CEOs come from (i.e., seconded from a parent firm, severed from a parent firm, or hired from outside) and features of their employment status (e.g., term limits, appointment and dismissal rights of the shareholders)
- *Competencies and attributes.* This would capture softer skills and attributes, including leadership and management style, communication, and cultural sensitivity. Naturally it would be a more subjective investigation, though by using a survey- and interview-based approach and focusing on a broad range of stakeholder groups – including parent company executives, Board members, JV management team members, and lower-level staff – researchers could achieve reasonably objective results.

Consultants, corporate executives and Board members tasked with selecting and advising JV CEOs would benefit greatly from further research on what makes them successful – not to mention JV CEOs themselves, who would find significant value in a rigorous examination of the experiences of their peers.

5. How Do Diverse JV Talent Populations Work Together?

Joint ventures are often composed of and managed by diverse talent populations. These populations *individually* introduce unique questions with regard to talent engagement, career development and advancement, performance management, and rewards – and *collectively* introduce significant organizational complexity that JV owners, boards, and management teams are often ill-equipped to deal with at scale.

A joint venture may be staffed with some combination of direct employees (potentially including external hires and re-badged former owner employees), owner company secondees (potentially including secondees on a short- or longer-term basis, at senior leadership, senior technical, or developmental levels, and from one or more owner companies), hybrids of the two (potentially including former owner employees who have severed their legal employment relationship with the owner, but remain on the owner company's

²⁰ See “Sony, Bertelsmann Take Step To Mend Rift at Music Venture,” Ethan Smith, *The Wall Street Journal*, March 20, 2006.

long-term incentive or pension plan, and retain some agreement to be rehired by the owner in the future), and third-party contractors. Joint ventures may also have some employees on short-term rotations or reverse secondments into the owner companies.

Adding to the talent mix, owner companies often structure the scope and governance of the joint venture to rely on – or at least open the door to – heavy operational involvement of owner company employees. For instance, owner staff may be providing corporate support services such as finance, IT, or regulatory affairs to the venture, or they may be performing essential business functions such as research, development, technical support, marketing, or sales to the venture. On any given day, it can feel like these staff are part of the venture. At the same time, owner company executives and other employees engage in governance and assurance of the venture. This includes, but often extends well beyond owner executives serving on the joint venture board. Less senior functional experts are often placed on board committees and sub-committees, or serve as part of an internal shareholder governance team supporting the company's directors and internal assurance, risk management, and approval processes. These owner groups can be quite large and not well-coordinated. For example, in a global airline joint venture we helped restructure, the nine owners had 620 staff participating in committees and working groups. In a six-partner oil and gas joint venture, the five non-operating partners had a total of 90 FTEs providing “oversight” on the operating partner. To paraphrase from a Wall Street Journal article describing Airbus when it was a joint venture, joint ventures can make the United Nations seem like a model of industrial efficiency.

This complex talent profile creates a number of interesting research questions:

- What is the relative size of these talent populations in individual JVs? How do talent population profiles vary by venture type, industry, or geography, and how do they change over time? Is there any correlation between talent profile and performance or longevity?
- How are these different JV talent populations selected, trained and onboarded, motivated, evaluated, and rewarded? What unique challenges and opportunities do joint ventures introduce into these roles? For instance, given the JVs are smaller organizations than their owner companies and that owners often have the right to fill certain senior positions in a JV through secondments¹, how do JVs manage career advancement for high-performing talent who have limited lateral moves?
- What competencies and personal attributes – in addition to required education and functional skills – correlate with high performers in different roles? For instance, among JV Managers on owner governance teams...
- How do JV CEOs and Boards manage and optimize these diverse employee populations, and create a cohesive organizational culture?

6. What Types of Litigation Risk are JVs Actually Exposed to?

Joint ventures raise the specter of partner litigation, as one owner or other stakeholders may pursue legal action against another for violating the venture agreements. Such legal action may be triggered by alleged infringements to intellectual property rights, failures to make promised contributions, violations of non-competition provisions, or one partner's actions in its own interests at the expense of the other partners. Over the years, such partner litigation has made it into the mainstream press: Swiss watchmaker Swatch filed suit against its partner Tiffany's for failing to make promised commitments to promote their joint venture's product. Dow Chemical sued its partner Nova Chemical, which operated the companies' 50:50 ethane cracker joint venture in Canada, for failing to operate the asset at its full productive capacity, thereby damaging Dow's economic interests.

No serious study has been done on partner-related litigation in joint ventures and, as such, practitioners may have an over- or under-inflated view of the risks and mitigants. An analysis would look at court and other public records to identify and categorize where a JV partner has pursued litigation against another partner, potentially seeking to answer such questions as:

- What types of litigation do joint venture partners and other stakeholders actually pursue against each other?²¹
- How prevalent is such litigation, how has it changed over time, and how does it vary based on jurisdiction, industry, or venture type?
- Do courts ever hold JV Board Directors who are employed and nominated by one owner to be in violation of their fiduciary duties to the entity for supporting actions that asymmetrically benefit their employer?²²
- To what extent does the evidence change if the JV is publicly-listed or has one or more small minority owners not represented on the Board?
- To what extent have JVs used Delaware law that allows a company to sue for "wasting of assets" to trigger an exit from a JV where exit provisions didn't allow?
- How often are JV owners sued for non-arms-length pricing on services, inputs or outputs?
- How often are JV operators sued by other owners, and for what?

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²¹ For a starter framework, see "Three Areas of Litigation Risk in Joint Ventures," Reginald Goeke, *Corporate Counsel*, October 31, 2014.

²² For additional details, please see "JV Directors' Duty of Loyalty," Meghan McGovern, Tracy Branding, and James Bamford, *Harvard Law School Forum on Corporate Governance and Financial Regulation*, November 16, 2019; and Sarath Sanga, "A Theory of Corporate Joint Ventures", *California Law Review*, October 2018.

As usual, Peter Drucker had it right: almost thirty years after he said it, companies continue to enter into joint ventures and other dangerous liaisons, which we still don't adequately understand. By applying academic rigor and the insights of corporate strategy, governance, and organizational design into the unique structure and dynamics of joint ventures, we hope that the academic community will help to finally make Drucker's comments outdated.

~3900 words (excluding footnotes)