Managing Joint Ventures: Rules of the Road

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There has been much debate about the rationale behind joint ventures and how they can open up new markets, distribution networks, supply chains and manufacturing capacity for organisations. However, not much attention is paid to what it takes to sustain an enduring JV relationship. As Harbir Singh of Wharton Business School notes, companies tend to be cavalier about alliances, regarding them as being 'no big deal'. As the old Turkish proverb goes, however, 'No road is long with good company'. So, the key issue here is, what exactly makes for 'good company' in a joint venture context?

Before addressing that question, it is useful to look at the four main reasons for setting up a JV in the first place:

Leveraging the firms' combined resources, including shared investments: Good examples of this include the Suntory-PepsiCo JV in Vietnam (SPVB), and EADS, a global leader in aerospace, defence and related services, which brings together Airbus, Astrium, Cassidian and Eurocopter. Here, the value unlocked lies in leveraging the 'Power of One' in terms of resources.

Mitigating risk: This was the driving factor behind such JVs as Renault-Nissan – the result of a major consolidation move in the auto industry in the 1990s – and that between Saint-Gobain and Pilkington. In the case of Renault-Nissan, the two companies are bound together by what was, at the time, a path-breaking cross-shareholding arrangement, but which has since been adopted by several others, including GM and PSA Peugeot Citroen.

Learning from and leveraging each other's strengths for mutual benefit: In the Ford-Toyota alliance, the main value lies in leveraging each other's best practices to create competitive advantage.

Being a competitive game-changer: Star Alliance, for example, radically changed the airline industry.

Ingredients of an enduring JV relationship: Over the past year or so, my role as CFO of SPVB has given me an opportunity to think about what makes for a strong and sustainable JV, and the CFO's unique role in the process. While the list below is not meant to be exhaustive, it aims to highlight the key elements of a successful JV.

Being a win-win economic proposition for both – or all – JV partners: This first, essential ingredient formed the base for SPVB, which was set up in 2013 as a 49:51 split between PepsiCo, a global F&B player, and Suntory, another global company with interests in alcoholic beverages and F&B. For both parents, SPVB provided a clear answer to the 'What's in it for me?' question. For PepsiCo, it was about monetising part of the investment in its beverage business in Vietnam and sharing its on-going growth investment, thereby reducing the NAB and improving the ROIC. It also allowed PepsiCo to focus on its core competence of building brands while retaining – through active management participation – a significant strategy-setting role. On the other hand, for Suntory, the 51 per cent stake provided immediate ownership of a profitable business in a new market with tremendous growth potential. With that came ready access to an existing make, sell and deliver infrastructure, and also a platform to launch products from the Suntory stable. Clearly, the JV proposition provided strong value to both partners.

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A clear and comprehensive JV agreement: To ensure that the JV's structure and operating model are aligned with its overall vision and strategic rationale, such agreements must be vetted by the right individuals from the two parent companies. One of the challenges inherent to a JV structure is ensuring an alignment of objectives between the parents. Such issues must be thrashed out upfront, and then clearly documented in the Joint Venture Agreement (JVA). For instance, when it comes to launching new products, it is imperative for the two sides to agree on which categories of products each parent can launch via the JV. A lack of alignment on this can breed conflicts of interest, and ultimately, distract the JV's focus away from its initial aim of capturing a particular market opportunity. Another example of this is transfer pricing: the JVA must spell our clearly the TP assumptions, which must be fair and equitable to both parents. Time-bound changes in TP should also be documented. Other examples of where alignment is needed – and which should be covered in a good JVA – include management structures, the performance and risk management framework, and the types of services that are to be provided by each parent. The key to smooth JV operations lies in sticking to both the letter and the spirit of the JVA. Exceptions to this should be few and far between, given that, more often than not, exceptions tend to dilute trust.

A robust performance and risk-management framework: This is key to a JV's success, especially when the parents – as is true of SPVB – have very different cultures. Typically, this starts at the Board level, with representation from both parents, and also, sometimes – particularly in the case of publicly-listed entities – independent members. Supplementing this should be a strong management team for the JV – people with the right skill-sets that are needed to execute its operations in line with the strategic intent. This would include the CEO, the functional leadership team (HR, Finance & IT, Legal, Sales, Marketing, and Supply Chain), and other members of the JV's Executive Committee (Excom).

As with any type of organisational structure, a JV needs strong performance management processes. These include monthly operating review, quarterly business forecasts, annual operating plan, and a longer-term (3-5 year) strategic plan. In terms of risk management, it is important to have an independent Audit Committee, comprising the CEO, CFO and Internal Control head from the JV, and one representative each from the parents. The JV should also have a Compliance and Ethics Committee represented from within the JV's CFO, HR, Legal and Internal Control functions.

Taking the 'Best from both Worlds': Effective JVs bring together organisations with complementary strengths in terms of their portfolio of products, operational best practices, and core business processes. Provided there are no 'ideological' barriers in terms of which practises the JV has to adopt, a successful JV like SPVB will learn from and imbibe the best aspects of both parents. Rather than having each parent set a 'Must Do' mandate – something that sows conflict and slows down execution – it is important to look at this issue through a 'what is right for the JV' lens.

Ensuring speedy and effective execution: Enabling strong execution in a JV setting is about minimising 'parental interference'. What is need, in fact, is a 'light touch' approach, where both parents agree on their role in managing the enterprise. Ideally, this should be restricted to providing – via the Board – strategic direction and governance; and supporting the JV with resources and best practices. Here, again, the lens that should be applied is one of 'value add', and not one based around an intrusive monitoring and control of the JV's activities. While the Excom must be sufficiently empowered to take decisions related to operational matters, matters that require Board approval should be carefully documented in the JVA – and this needs to then be followed in both letter and spirit.

Trust, respect, positive intent, flexibility and transparency: As with any relationship that endures, a successful JV requires its parents to demonstrate all of these qualities. What is essential is to always take a long-term view based around value creation, rather than having a myopic value extraction objective. A willingness to ride out the rough times together is the truest litmus test for a JV. Each parent will have internal pressures in terms of targets, which are typically driven by shareholder expectations. The key, however, is not to let these this weigh on the JV, and to allow the organisation to do what is right for itself independently, balancing short-term interests against the longer-term value of the partnership. This requires high levels of commitment and maturity from both sides, which hinges on compatibility. After all, as the saying goes, it takes two to tango.

What it takes to be an effective JV CFO

CFOs have a unique and critical role to play in ensuring the success of a JV – and several factors play into this. The very first thing that a good JV CFO must do is earn the trust of both the parents. In my case, I continue to be an employee of PepsiCo, having been seconded into the JV. A key challenge for me, therefore, was to earn the trust of the other parent, i.e. Suntory. This is a critical success factor for my role, and for that matter, any CFO in such a position. In order to earn trust, one must make a conscious effort to understand the objectives of both parents, to be sensitive to issues that impact each, and to communicate transparently and without bias not be biased to any one side.

Second, a JV CFO must always wear the JV hat – that is, he or she must always view decisions from the perspective/lens of what is right for the JV. For employees who have been seconded to the JV, this can be a tough balancing act, but the cardinal rule is to never let your judgment be coloured by the specific interests of one parent. The CFO is the guardian of the JV governance framework, and therefore acts as a collaborator, enabler and advisor to the CEO and the Board on governance matters. For CFOs in this role, the 'Bible' is the Joint Venture Agreement, and it is the CFO's job to ensure that it is followed in letter and spirit. In addition, an effective CFO has to act as the 'Conscience of the JV', championing values, the code of conduct, and compliance, while also mitigating risk through strong controls and policies.

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Finally, as in any business, the CFO is expected to be a strong business partner who enables growth, drives profitability, manages cash flows, ensures prudent investment, simplifies and automates processes, supports strong performance management, and promotes a data-driven decision-making culture.

In my experience so far, being CFO of a JV provides rich exposure to any finance professional. In addition to the normal challenges a CFO faces, this particular role provides unique experience in terms of managing Board-level and partner relationships, and working with diverse cultures. Professionally, it broadens one's leadership experience and helps build stature and maturity as an executive. I would certainly recommend a stint at a JV to my colleagues, were such an opportunity to come their way. ■

(The views expressed are personal)