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OPTIONS FOR JOINT VENTURES

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Abstract

There has been a wide range of joint ventures within resource industries. The author has had direct experience in a number and a keen observer of others. This paper builds on a previous paper that examined the rationale for, history and observations as to the success of longer term joint ventures within the aluminium industry.

In this paper options for the structure of joint ventures are discussed.

Introduction

1.0 Forms and Rationale for Joint Ventures Ref 4

1.1 A Joint Venture (JV) in a generic sense is usually established when each party does not have the resources or ability to develop, finance and manage the business and associated business risks by itself. Ref 4

They can be incorporated and governed by country company law or unincorporated and governed by specific agreements. The choice the agreement is usually based on taxation considerations.

The JV is usually structured to carry out a business in a way that leverages the inputs and minimises the risks to the parties. It is generally accepted that JV's, on average, create value for parent firms and that value location is mainly due to synergies and common beliefs to individual participants, but decreased by the inherent tension between co-operative and non co-operative behaviour in JV's Ref 5.

This paper covers issues associated with longer term JVs. Initially the JV is held together by those leaders who defined the objectives, and led the establishment and early work.

However, during the life of the JV it tends to change from an entrepreneur led business to being led by a large corporation .

Some forms of JV are outlined in Table I. Business arrangements are identified as Type A to E and technology arrangements as Type F and G.

Identifier	Type of JV
A	**Toll companies** formed to produce a single product at the lowest cost, through economy of scale. Output is allocated as per shareholding. Raw material is often supplied by one party in the JV. Examples include Queensland Alumina Ltd, Eurallumina Spa., Boyne Smelters Ltd, New Zealand Aluminium Smelter Ltd [Ref 1].
B	Companies where a **major industry player** provides technology, management and marketing services and sometimes raw material supply and take a **minor shareholding** while the major shareholder(s) are new to the industry and want to facilitate major development and marketing. Examples include Sohar Aluminium Ltd and Ma'aden.
C	Companies where a **major industry player** provides technology, management and takes a **major shareholding**, while the other shareholder(s) are new to the industry, but can provide resources and capital. Examples include Alcoa World Alumina, and Qatalum.
D	Companies where **several industry players** take a shareholding and output in a new promising development in a new country, while minimising their individual exposures. There may also be some government and or international finance company exposure, Examples include Halco, Alumar, Guinea Alumina Ltd and Fria.
E	Companies where **major industry player** and a **trading company** or companies combine. The trading company provides equity and takes an agreed output. The trading company may also arrange construction services or construction finance. An example is Albras.
F	Companies combine to **develop technology**. One example is the successful Dubal Aluminium / Comalco Ltd development of the CD200 reduction cell technology, which was the genesis of the Dubal DX technology used at Dubal and EMAL. In this case Comalco provided the technology and detailed design, while Dubal provided and managed the test cells. Each company had the right to use the Intellectual property involved [Ref 2].
G	A company formed by the industry to **broker precompetitive research** and development. One example is AMIRA International Ltd, which has recently celebrated its 50th anniversary of formation. It was started by Australian mining companies, and has had to reinvent itself over the years. It has extended globally in both client and research providers.(Ref 3) Particular achievements within in the alumina industry have included new concepts for grinding, thickener development and improved understanding of precipitation. In 1993 it pioneered the concept of developing an Industry Road Map of Technology Development for the alumina industry.

Table I – Form of Longer Term JV's within Alumina and Aluminium Industries

Analysis of JVs in aluminium industry suggests that on average and in time the number of JV parties has often decreased, the companies slipped up the cost curve and growth tapered off significantly after the first 20 years of the JV. Ref 4

2.0 Observations as to the Success of Longer Term JV's[Ref 4]

There are many similarities between a business JV and a political coalition

When David Cameron, the incoming Prime Minister of UK, formed a coalition in May 2010, he asked Angela Merkel, the Chancellor of Germany for advice. Her advice was based on considerable experiences within Europe, and was *"the secret of success was an agreed agenda, known to all key players".*

This is an excellent over riding principle but alone is not sufficient to base a JV over the life of capital intensive assets which must survive many changes of political coalitions and business circumstances.

2.2 Some observations include:

2.2.1 Strategy

The difficulty of gaining consensus on the strategic direction increases in proportion to a power of the number of parties, as well as the different languages and cultures involved.

- When the objective of the JV becomes solely cost minimization, it may be appropriate to minimize the number of cultures and complexities through a reduction in the number of parties.

- The interests of the parties change over time and unless a win-win outlook of each of the parties (and the JV) is maintained, tensions and conflicts can dominate strategic decision making. This is particularly important when one or more of the parties also operates within the same business sector.

- As with all successful Boards, the Board Members must be able to contribute in their own way at a level greater than the Chief Executive Officer (CEO), so as to be able to add value. They need to be able to gain and maintain the respect of the CEO, without compromising the right to guide, hire and fire the CEO.

  As a JV develops beyond the first generation of principals who established and guided the formation, the new representatives of the parties come from subordinates of the originators, or new staff within their respective organisations. Often there is a diminishment of the strategic intent and guiding vision and more focus is on governance and setting end point measure for the CEO.

  It is often useful for the JV parties to meet periodically by themselves, usually with an independent facilitator, to align and agree overall strategic objectives. This is particularly useful when CEO's change. Input from independent consultants can often be of value in breaking down tension and existing group think, as well as broadening the JV.

- In the formation of a business JV involving raw material supply by one party, it is necessary to establish pricing and quality mechanisms. If in time these become distorted from the market, the difference can result in considerable friction within the JV often resulting in suboptimal performance and a deterioration of the asset condition and potential. It is important to lay out the intent of the JV at the onset, or if needed endeavour to agree an updated intent at a later point in time. With this intent major review mechanisms, with independent input and or arbitration can be undertaken to recalibrate pricing of inputs.

2.2.2 Governance

- There is little difference in having a 10%, 49% or 51% or 90% interest in a JV as in general most JV's operate on a consensus management.

- The attitude borne of the consensus approach and or competitive tensions often leads to inappropriately restrictive authority levels for the CEO, especially with respect to capital expenditure. This inhibits the entrepreneurial drive and professional challenge and satisfaction of operating personnel.

- Often the JV is only as strong as the weakest party, particularly if capital expenditure is involved. This can lead to slower growth and less optimal performance with a starving of capital input to keep the business modern.

- Staff development within the JV can often be a limiting constraint. A healthy JV often has strong two way interactions and staff development arrangements with one or more of the JV parties, based on a clear Technical and Management Services Agreement.

- All significant agreements within the JV need to be made with all stakeholders, at the one time, otherwise misunderstandings arise.

- There is a continual conflict between board members having to choose between what is best for the JV and what is best for their own company interests. This is particularly important when allocating scarce capital. It requires a particular culture and mindset to contribute in a win-win approach to a JV that is quite different to leading a single company.

- Management of Intellectual Property (IP) is a particular issue within a JV, particularly in the issue of sharing of IP between companies (both ways), and the rights to use. A broad framework should be established initially.

- Over time protective stances regarding IP restrict the flexibility of the operation to adapt appropriately and compromises often arise in an attempt to comply with (or not infringe) different IP approaches of JV partners. Technical, rather than partner, compromise is king.

- As governance becomes the main focus, the goal-setting and remuneration performance indicators can become myopic with significant downside on the medium to longer term corporate success.

3.0 Structure of JVs

3.1 Management

Options for management are shown in Table 2.

Type	Board	Management by	Systems and Culture
1	Led by one Partner	One partner	Partner
2	Rotating Chair	Best person for the job	JV
3	Independent Chair	Independent CEO with some secondees	JV
4	Led by one Partner	Allocated tasks for each Partner	Each Partner
5	Rotating Chair	Rotating senior Management	JV, plus Partners

Table 2 - Options for Management

The likely fit of options for management for the different forms of JVs outlined in Table 1 is shown in Table 3.

Form/Type	1 Led by one Partner	2 Rotate Chair Best for Job	3 Indep-endent Chair Indep-endent CEO	4 Led by one Partner Tasks for each	5 Rotate Chair Rotate Manage ment
A Toll Co	x	x	x		x
B Major Player Minor share				x	
C Major Player Major share				x	
D Several Industry players	x	x	x		x
E Major Player Trading Co				x	
F Develop Technolog y		x			
G Broker Pre Compet-itive R&D		x	x		

Table 3 - Likely fit for management within different forms of JVs

Clearly each situation needs to be assessed carefully against the long term vision of the JV and the relative strengths of the partners.

However general observations include

- the Independent Chair and the Rotating Chair options are generally not stable, particularly when the level of trust between partners is low.
- the Toll Company and Several Industry player options can be difficult to manage, due to the competing nature of the companies in technology.

3.2 Balance within the JV

The relative contributions of each Partner over time influences the stability of the JV.

Some examples of relative contributions within JVs are shown in Fig 1.

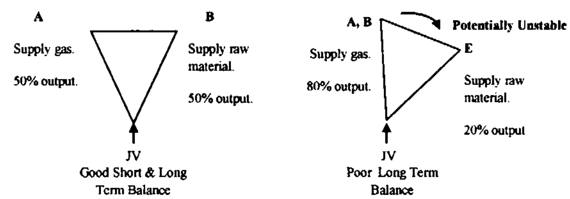


Fig 1 - Relative Contributions and resulting Balance for particular JVs.

It is suggested in the findings[Ref 5] that joint ventures are likely to add more value when both firms possess a considerable experience and valuable resources.

Mechanisms need to be established at the formation of the JV to rebalance the JV in time should circumstances change. These changes can include poor performance or changing circumstances of the Managing Partner, changing pricing of inputs, changes in the risk profile, changes in Government interaction and requirements, etc.

4.0 Exit Strategies and Mechanisms [Ref 4.]

There are a variety of reasons why a party exits a JV. These include a change in strategy, a change of economic circumstance, eg. liquidation, or a change of control and or consolidation, or a consolidation into a larger broader entity. It also reflects the change from a growth phase to one of consolidation.

- A number of JV's have survived for 40 or 50 years. This in itself is remarkable but may not be optimum.

  In many longer term JV's there is not a sufficiently robust valuation and or exit mechanism, so parties tend to hang on longer than is sensible. In some cases value for all parties is destroyed.

  Generally in single product companies it is difficult for the JV to grow independently of the parties, particularly if one or more of the parties is also in a similar business.

  However, in other industries there are examples of companies forming a JV to develop concepts outside but complementary to their mainstream interests. In cases where the JV is successful, an option to maintain growth (and value) is to reform the JV as a completely separate entity, governed by an independent board and not constrained by individual shareholder interests. Examples include the formation of Dow Corning, separate from the founding shareholders Dow and Corning.

- Generally the business JV's within the alumina and aluminium industry have been successful initially. However, over time success is more difficult to measure as the JV sometimes drifts compared to competitors within the industry and most have slipped up the cost curve. One reason for this draft is directly linked to a loss of an effective strategy.

A likely trend between strategy and governance and age of the business is shown in Fig 2.

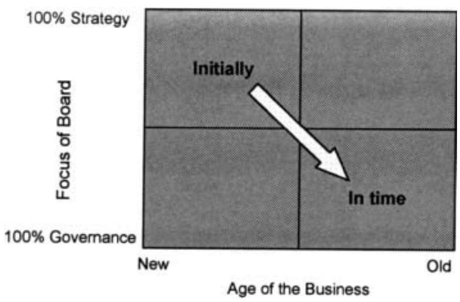
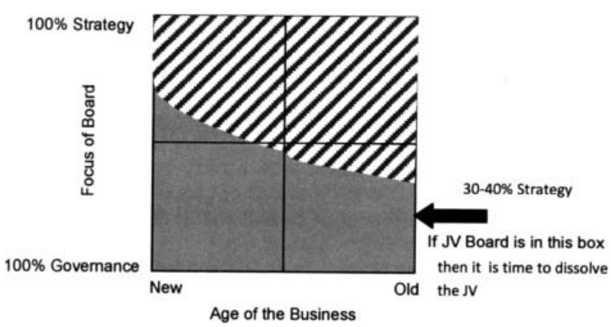


Fig 3 – Likely Trend between Strategy and Governance

This balance suggests that when the strategic input of the board becomes modest, it is time to dissolve the JV as little value is being created, as shown in Fig 3. Typically this is when the Board time is spent much more on governance than on strategy.



As a benchmark, Rio Tinto report [Ref 6] that their Board spent 43% of Board time on strategy in 2010.

This model may provide a basis for each JV partner to evaluate their future participation.

5.0 Conclusion

A JV can be very successful for an initial period when led by those who established them and while the rationale for their formation exists.

There are a number of lessons to be learnt by the board to lead the strategic and governance of a successful JV.

However, after a period the driving forces and or the rationale changes. At this time the JV Board can drift into a governance dominated mode.

At that time it is appropriate to question the rationale for the JV and take appropriate actions to renew the vigour or reduce complexity through a new relevant strategy or otherwise an effective exit mechanism so as to maintain value for all stakeholders.

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