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Organisational Risks of Joint Ventures, Consortia and Alliance Partnerships

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ABSTRACT

Joint ventures, consortia and alliance partnerships are used in many industries and countries for temporary or selective cooperation. They are attractive means of undertaking projects and contracts. This paper reviews their special risks and how these risks may be minimised when forming any such cooperative arrangement.

FORMS OF JOINT VENTURE

Studies on joint ventures, consortia and alliance partnerships ("JVs") suggest that most are temporary arrangements for the purpose of carrying out one project.[1-6] Some are continuing arrangements for development work, a series of related projects, manufacturing a product or selling a service.[7-11]

Most JV's are formed by commercial companies. In addition, some are formed or joined by governments, other public organizations, consultants, charities or individuals. As a result, JV's vary greatly in their form and their legal status, but all of them are systems for cooperation as distinct from amalgamation to form one enterprise. They are selective in that the partners continue with other business activities independently, sometimes in competition.

DEFINITIONS

The terms joint venture, consortium, alliancing and partnering are not used consistently in all industries. Table 1 lists their most common meanings, which are used in this paper. Also listed are some terms which are helpful in defining the organisation of JVs.

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Joint Venture	Any cooperation between two or more enterprises for a project or a series of projects. (Working in a JV is also known in some industries as 'teaming'.)
Consortium	A contract-based cooperation or a jointly-owned subsidiary company formed by two or more enterprises.
Alliance Partnership	Joint management of a project between a customer and one or more contractors, and sometimes including subcontractors.
Partner	A company, partnership or publicly owned trading organization which is a member of a JV.
Incorporation	Formation of a JV as a legally separate company, usually wholly owned by the partners.
Horizontally Related Activities	Partners' work proceeds in parallel and simultaneously.
Vertically Related Activities	Partners depend upon each other's work in a sequence.

Table 1: JV definitions

POTENTIAL ADVANTAGES OF JOINT VENTURES

The primary objectives of JVs vary, but as shown in the reported cases, textbooks and previous papers, there are several potential advantages in entering any form of JV.[12-26] These potential advantages can be summarised as follows:

- To share the costs and spread the risks of a project, contract, new market or development work.
- To combine technical, financial, managerial and other resources.
- To respond to a customer's wish to deal with a single organization, or to demonstrate to a customer that the enterprises concerned are seriously committed to cooperating with each other in carrying out a project and in accepting a proper share of the risks involved.
- To gain entry into a market or a potential customer's list of approved bidders.
- To share partners' licenses, agencies, commercial or technical know-how etc.
- To utilise international partners' credit advantages or lessen escalation risks.
- To form a more powerful basis for negotiations with customers, government, bankers, suppliers or others.
- To by-pass own organization's lack of flexibility or interest.
- To develop interdisciplinary teams with new skills.

- To cooperate as a step towards amalgamation.

THE ORGANIZATIONAL RISKS

JV's are of course subject to the normal risks of any organization, for instance the risks of buying and selling. The reported cases, textbooks, previous papers and our experience show that JV's also have their special risks. Table 2 is a summary of these special risks, and with them the actions we recommend should be considered.

Table 2: The organizational risks of JVs and their remedies

DIFFERENCES IN OBJECTIVES

Risks

The partners may differ in their understanding or interpretation of the objectives of a JV, and this may not be apparent before the JV has entered into commitments to others.

Remedies

The objectives of a JV should be agreed by all the partners at the time it is formed.
If more than one objective applies, the agreement between the partners should state the priorities between the objectives and agree a procedure for resolving problems of priorities.

DIVERGENCE OF INTERESTS

Risks

It is easier to start a cooperative venture than to sustain it.
Divergence of interests between partners is greater if a JV is formed to share risks.
Some divergence of interests between the parties is inevitable as time passes.
At the start of a project the need for central control may not be apparent.

Remedies

A steering committee of the partners' responsible managers may be sufficient to plan a JV. A separate and authorised management team, appointed by and reporting to a steering group, is needed to create a single point of direction to hold all partners to their commitments and liabilities.
Legal incorporation of the JV provides a formal basis for commitment and control, but can take time to agree and can be inflexible. Whatever the structural choice, the partners have to accept that they must be subordinate to their own creation.
Two-tier boards have been used successfully by heterogeneous or large JV's, the upper board consisting of the partners' representatives who are authorised to take risks and settle disputes, and the lower board consisting of the operating managers who control the partners' resources required for the JV's projects. In some cases the upper board's decisions are required to be unanimous, to discourage unnecessary referral of problems. In others, voting is based upon the

share of funding or risk-taking in the JV.

CONTRACTING AUTHORITY

Risks

JV-dedicated staff have an interest in negotiating contracts which will bring the JV work.

Remedies

The JV steering group should retain the authority to enter into major contracts to sell goods or services.

PROJECT ATTITUDES

Risks

Partners can vary in their experience of JV projects and JV risks, particularly manufacturers compared to contractors, resulting in differences in the real authority and in the attitudes of their representatives.

Remedies

Every partner in a heterogeneous JV should be represented on the steering group by a parent company Director, and preferably one with JV experience.

PROVISIONS FOR RISKS

Risks

Partners may fail to make budget provision for the greater risks in a JV. Their liabilities may be greater than in normal business, but inexperienced partners may greatly under-estimate, or greatly over-estimate them.

Remedies

Risks should be assessed by the partners jointly, to avoid double-budgeting for risks.

Risks in an incorporated JV should be split between joint risks to be budgeted for by the JV management and partners' risks to be carried by each partner.

CHANGES

Risks

Simple collaboration between the partners' responsible managers may be sufficient to decide to start a JV project. More complex relationships between them may be needed to complete it.

Remedies

A JV should not initiate a project or get committed to a contract with another party before the partners have agreed their responsibilities and a structure for managing

the JV's commitments through to completion.
When forming a JV the partners should agree how its structure is expected to evolve as relationships become more complex during a project or contract.

BALANCE OF INTERESTS IN A JV
Risks
JV work is only a part of the interests of each partner.
They may have unequal interests in a JV, relative to total business.
Some or all of the partners' interests may change, for instance when they see new opportunities in other markets.

Remedies
The need to anticipate conflicts of interest in planning and controlling JV operations is least if the partners are in the same sector of industry and their JV operations are related horizontally. They may also be easier if the partners share other joint interests.
The partners in a heterogeneous JV are more dependent upon each other, but may also have less understanding of each others' work, compared to those in a horizontally related and homogeneous JV.
Reciprocal dependence can be the most complex, and is transitory in a project cycle with sequential changes in interests and risks. In such a JV there is the greatest need for a formal system of planning and control.

CONTROL
Risks
The need for control of a JV project or contract may become accepted only when policies are not proceeding as intended.
This is a special risk in an internal JV formed between subsidiaries of one enterprise.

Remedies
Care must be taken not only to institute the monitoring and managerial decisions needed to carry out JV commitments, but also to correct any more earlier failure to plan ahead and anticipate problems.
The authority and resources needed for planning and control should be located where the greatest risks may arise.

COLLECTIVE MANAGEMENT OF PROBLEMS
Risks
Joint activities and risks may need management styles and systems different from those used by partners in their normal business.
The partners' representatives on a steering group may run the risks of discontinuity in their knowledge and attitudes on the JV business.

Remedies
The potential risks may be reduced considerably by appointing people who have organizing and negotiating skills to manage the JV.
The JV sponsor in each partner enterprise should maintain an interest in how the cooperation is operating.

MANAGEMENT QUALITY AND MOTIVATION
Risks
A JV needs to attract managers comparable in ability to their opposite numbers in the partner enterprises.
There can be conflicts between JV and partner managers, not least because of their different roles, objectives and accountability. JV managers may have to represent a customer's interests in a conflict with a partner enterprise.

Remedies
Managers seconded from the partner enterprises to run a JV should have a future in their parent enterprises that will be based on success in their performance for the JV.

THE ORGANISATIONAL LESSONS

Table 2 above shows that the special risks to the partners in a JV largely consist in foreseeing and agreeing what relationships and commitments between them are needed to control and carry out their external commitments to others.

As a result, four principles are proposed for organising a successful JV:

- The first commitment of the partners must be to a precise agreement on the objectives, organisation and rules governing the JV. Priorities between different objectives must be agreed.
- The structure should be designed to minimise operational inter-dependence between the partners.
- The organisation, structures and rules of the JV should be suitable for completing its projects, not just commencing them.
- Organising a JV should be based on analysing the relationships and responsibilities needed as its projects proceed cyclically from a few initial activities to many more detailed and inter-dependent activities.

COMPLEXITY AND CONTROL

JV's are a means of sharing risks. They therefore demand sharing of control.[27] This can be achieved in a number of ways.

- Promoters and financing bodies normally require the performance of a JV to be guaranteed by its partners. Given these guarantees, a horizontal collaboration should be simple to operate if the partners have similar expertise and interests and can divide the work into independent packages. Parallel operation of their normal systems of organization can then be effective in achieving sufficient linking of decisions during the project. To achieve consistency a single channel of communications with a customer is always better for all parties, but control of the partners' operations need not be centralized unless some resource such as a common sub-contractor has to be shared.

- Vertical or more complicated collaboration may require formal linking and overlapping of the partners' systems of organization, not necessarily on a large scale, but starting before commitment to a project so that joint decisions are possible in a way unusual in their normal work. An unincorporated JV can be adequate for this if all partners are used to it. If not, either incorporation may be needed or the JV should be replaced by one partner taking control and the others working for it as sub-contractors.

- If there is a conflict between a partner's commitment to the JV and to its normal customers, the JV may get no more attention than any other customer. Indeed the JV may get less attention as it is only a temporary interest. A joint venture is no more unified than a part-time partnership, particularly dependent upon collaboration. Forming an incorporated JV is a means of committing its partners' resources to a joint project and establishing separate management of them.

- Formal delegation of authority to a separate dedicated management team may be particularly needed for a JV based upon a combination of commercial companies and public bodies, to avoid their differences in corporate autonomy and accountability causing operational differences in managing risks.

- A joint subsidiary can be strengthened by giving it the authority to commit its sponsoring firms and to accept risks in orders from customers. Logically, it then becomes responsible for profit and the control of financing to cover mistakes and other contingencies. It follows that it must also be free to act as a main contractor and employ its sponsor enterprises in competition with others.

Vague arrangements falling between these systems are possible in joint activities for complex projects. We believe that these will be successful only if a project is free of mistakes or changes in demand or if mutual longer-term interests lead to agreement to share extra costs.

The division of risks and other terms agreed between the partners are likely to depend upon their relative business strengths at the time. The lessons of difficulties in practice are the same as those which apply to all commitments between enterprises — that it is prudent at the start to foresee potential problems and to agree clear arrangements for resolving them. Every partner involved can then organize accordingly. An initial belief in a joint interest is better tested by anticipation of problems before entering into commitments to a customer or to others not sharing the risks.

RECOMMENDATIONS

The authors believe that joint ventures will become an increasingly normal way of doing business, but not the only or most common way. This paper suggests that successful JV's require formal attention at the outset to the organization and management of the JV itself. Most of the risks and problems are predictable and can be avoided or controlled by forethought. Companies looking to engage in a JV should therefore adopt a systematic and logical approach to take into account the nature and organization of the JV.

It is therefore recommended that all parties should consider the check list of questions shown in Table 3 when proposing to form a JV.

Table 3: Check list - Questions for forming a JV

Who are to be the partners?

Who are to be the partners of the JV, at the start and to complete future commitments?
Do they have the requisite ability, interest and resources?
Should the partners should be as few in number as possible, and preferably limited to those participating at an approximately equal amounts of resources and risks?

Which objectives are to have priority?

Is the objective of the JV simple and agreed by all partners?
Are there several potential aims?
If so, what is the priority between them?
How will changes to the objectives and to priorities be agreed?

What do our words mean?

What is the contract "dictionary"? What are the particular definitions used for technical activities, costing, pricing and accounting?
What are the partners' commitments?
What are the partners' commitments:
• For financing the JV?
• For interface responsibilities, flexibility and limits?

- For specifications and design standards?

What amounts of capital and other assets are to be contributed by each partner, short-term and long-term?
How will the partners share profit, risks and losses?
What are the procedures for dealing with possible changes to any of the above?
Who takes what on dissolution, especially assets created by the JV, such as patents and know-how?
Are special protocols needed because the JV is to be based upon a combination of commercial companies and publicly owned industry? Is formal delegation of authority to the JV management team needed to avoid operational differences in managing risks which may be caused by differences in corporate autonomy and accountability?

Is the JV to be incorporated?
Is a partnership agreement sufficient for the partners, for instance if their work and risks for projects are not inter-dependent vertically?
If legal incorporation is prudent or required, where and under which law will be acceptable to customers, bankers, suppliers and seconded staff?
What could be the tax effects?

How will tenders be managed?
Who will plan, assemble and submit tenders?
Who will be responsible for risk assessment, costing, pricing and contingencies?
Who will expend resources on assessing agents' contacts and answering customers' enquiries?

Who will negotiate contracts?
What will be the structure and authority of the team for negotiating with a prospective customer?
Should one partner act as lead negotiator, with the support of the others, and reporting to a higher steering group?

How will projects be managed?
What is to be the project management structure? If the JV is to be a joint subsidiary company, what will be its structure and sources of personnel (secondment or recruitment)?
What will be the appeals procedure? Will this comprise a joint committee of the senior managers who agreed to form the JV? With all partners represented and meeting regularly?
If the JV is large, will two levels of committee be helpful, the lower one acting as a steering committee for the JV, and the higher as a court of appeal?

Who can incur costs?
Who is to be authorised to commit expenditure in carrying out a project?

What insurances must be arranged?
What insurance cover is needed for stated amounts in respect of various specified risks? Should it be joint insurance? Can a partner take additional insurance at the JV's expense?

How will breach or default be controlled?
What are the liabilities of the partners if one of them causes the JV to default on its obligations to a customer or supplier? Does the same principle apply if a partner wishes to leave the JV part-way through a project?

What sub-letting is permitted or required?
Is a JV formed by contractors to be obliged to order all work through its partners? If the JV is to be a profit centre, is it free to choose its sub-contractors, and therefore expect its partners to compete against other enterprises to be a sub-contractor to the JV? Can partners follow their own policies and procedures for deciding what activities to sublet to which suppliers?

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