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Blue skies or grey clouds - Why joint ventures fail

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Joint ventures, whether incorporated or unincorporated, can work very well to facilitate two or more businesses joining forces, combining resources, and creating value. But they are notorious for failing. This article briefly explores some of the reasons why some joint ventures (JVs) fail, and others succeed.

1. Square peg, round hole - Is a JV the right model to begin with?

Some initiatives lend themselves to JV structures and operate successfully for years, such as the oil majors jointly owning, operating and maintaining a critical pipeline, or waste management companies joining forces to deliver an urban transfer station. However, a JV structure is not always the best business model for a proposed business venture. If the venture is fundamentally about marrying ideas and capital, or money and expertise, then sometimes what is needed is an investor, rather than a partner. Or if the main driver is to use another person's systems or know-how, a services agreement with a management or licence fee may be a better option.

JVs occasionally fail because the "cart came before the horse" in terms of parties setting up a JV prematurely, before establishing a robust business case that supports the JV structure. The first question should always be, 'is there a solid business case for a JV, or is there a better model for what we want to achieve?'

If the JV doesn't deliver the outcome hoped for, one or both parties may end up asking 'why didn't we just do it ourselves?' Where margins become slim, or where one JV partner's inputs become less important or valuable to the venture over time, the risk increases that the remaining partner(s) will question the rationale for the JV continuing.

2. Unrealistic expectations – blue skies can turn grey

Putting together a JV can feel exciting and innovative, but many joint venturers get swept up in the efficiencies and value to be created, and start off with overly optimistic financial modelling. JVs can burn through cash much faster than expected, synergies can be difficult to realise, and the desired outcomes and returns may not eventuate as planned. If the commercial modelling was overly optimistic from day one, when the financial reality hits and the blue skies turn grey, a JV partner can become much less enthusiastic about the JV and its prospects.

3. If you fail to plan, you plan to fail

Proper stage gate planning at the outset can be critical to the long term success of a JV – and a failure to do this can lead to significant costs down the track. Stage gate planning is all about working through key commercial terms and tackling the difficult potential legal issues (such as disputes, breaches, exits and asset division) before spending time and money drafting up detailed documentation. In particular, getting both parties to turn their minds to early termination and exit arrangements at the outset is important – it sounds very negative but it's an easier conversation to have while all parties are aligned. For more discussion about the stage gate process read the following article: Long-term joint ventures – surviving the honeymoon.

No-one likes turning their minds to doomsday scenarios when everyone is full of hope and expectation, but doing so can build trust and confidence and bring the parties closer together. The act of discussing and documenting termination triggers and exit scenarios will tell you a lot about your proposed JV partner. It is far better to know if you're on the same page sooner rather than later. If you have properly worked through potentially difficult issues, there is a greater chance of the JV surviving if and when they arise.

4. When cultures collide

Incompatible cultures can lead to difficulties. Choose carefully who you partner with – a proper cultural fit can go a long way. References here are to culture in the broadest sense – this is less about beanbags and good coffee, and more about things like considering each party's appetite for business risk, respective approaches to compliance with law, marketing, dealing with disputes, and protection of reputation, and views regarding most appropriate customers and future expansion of joint venture services.

Working with the wrong JV partner can lead to disharmony, mistrust or limited engagement. Testing how aligned the parties are in terms of putting energy and resources and knowledge into the success of the joint enterprise can be a valuable exercise. If one party is less committed than the other, the JV is less likely to work in the medium term.

5. Management and control – let's work as a team and do it my way

JV partners are typically accustomed to running their own business, and too much management interference by the JV partners can be deadly. There can be a fine line between good governance, reporting and oversight on the one hand, and interference by JV partners on the other. There is a lot to be said for empowering the appointed JV management to get on with the job.

If JV partners agree that the venture is to be actively managed by one of the parties, robust and clearly recorded management terms and KPIs are almost certainly needed. Unless everything runs according to the business plan, trust and confidence issues can emerge quite quickly.

6. When some contributions are more "equal" than others

Where one party brings expertise or services, and another brings capital, diverging views on relative value may emerge over time as the success (or otherwise) of the JV becomes apparent. Difficulties can arise around valuing qualitative contributions. Quantifying the qualitative can be difficult and can lead to disputes both initially and also down the track. Accurately scoping and concisely defining qualitative inputs is important to ensure everyone knows exactly what the relevant party is expected to contribute.

As time goes by, JV partners tend to form views on who is getting the 'better deal' and extracting more value out of the JV, which can also disrupt the harmony. For example, one partner may resent that the other partner is better positioned to more effectively leverage off the JV activities, eg through supply/services contracts, or offering consumers product/service bundles involving JV products.

7. When the stars no longer align

Things change, that's just a part of life in the real world. Whether or not a JV is empowered to evolve or change over time can have a direct impact on the useful life of a JV. A JV with a static purpose and with a very rigid business plan may not survive in a dynamic environment.

The dynamic nature of business can also affect how JV partners perceive the JV in relation to their own needs. A JV partner may shift its own strategic focus such that the JV is no longer core business or intrinsic to its needs. Some JVs fail simply because one partner said 'we changed our mind.'

Summing up

Increasing a JVs chance of success requires an honest upfront appraisal of the merits of the JV, clarity of purpose and a business case that actually stacks up. JVs work best if the partners are compatible, have a realistic approach to investment and success, and have agreed in advance a sensible approach on how to deal with issues as they arise.

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