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PERSPECTIVES

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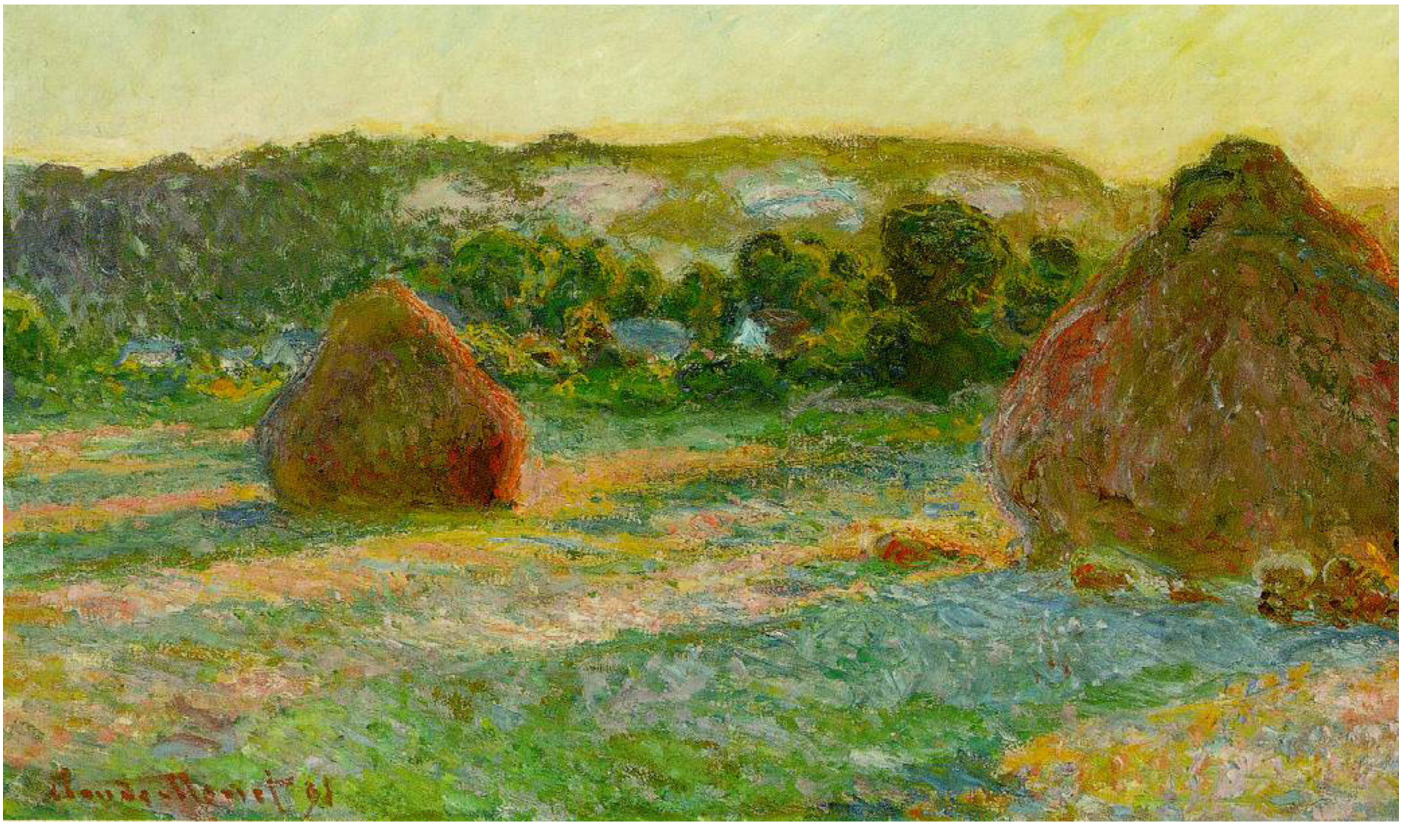
May 2016

MONA LISA'S SMILE

THE ART OF CREATING A HAPPY JOINT VENTURE



Wikipedia: Claude Monet, "Wheatstacks (End of Summer)", 1890-91, oil on canvas, 60cm x 100cm, Art Institute of Chicago
Cover image: Andy Warhol, "Colored Mona Lisa", 1963, silkscreen inks and graphite on canvas, 319.7cm x 208.6cm

'It's smaller than I thought' -- a common phrase overheard in the presence of Da Vinci's Mona Lisa hanging in the Louvre museum in Paris. A wildly undeserving observation, however, when thinking about the impact of the painting and its meticulous execution. Likewise with successful joint ventures.

Joint ventures can be an efficient way to add scale, avoid the risk of an outright acquisition, enter new markets and create new business relationships. But they also bring huge risks and uncertainties when undertaken in the dark. If would-be partners don't think through strategy and execution carefully in advance, they are more likely to destroy value rather than create it. Small partnerships can create disproportionately large and painful problems, whilst large ones frequently fail to create much value at all.

Happily, art provides a compelling framework for bringing light and clarity to the creation of joint ventures, as we explore below.

A plan for all seasons

When Monet set out to create a series of paintings based on the same stack of hay at different times of year, it was neither the beauty of the subject nor the challenge of its execution that interested him most. It was the changing nature of the subject's depiction when captured in different climates that held his focus.

Highs and lows, cuddles and crying – whatever you think you know about the relative benefits of your future joint venture, it is critical to consider the heights of summer and the depths of winter over the long term. Unlike other M&A transactions, 'closing' a joint venture is a dangerous misnomer. Joint ventures are living, breathing relationships in which both partners can win, or both partners can lose. Ask the lawyers who pen the documents and they will tell you that shareholders' agreements are the most heavily thumbed of all the deal documents following financial close.

A joint venture that thinks only of the short term benefits (or downside risks) is incapable of controlling for all four seasons. Strike a hard bargain with your "partner", and they will soon figure out that the deal is not economic for them, dooming the arrangement to disinterest, lack of investment and eventual failure. Parties need to take a destination-led approach to their respective and collective objectives. Stop, reflect and consider things from your partner's point of view. This includes working through and agreeing strategic, operational and governance matters from the perspective of each party, as well as the joint venture, before you start negotiating on financial terms. It involves looking at the good, the bad and the ugly of the business (and the relationship), with a complete understanding of the seasons you will need to weather. Only then can you paint with a full palette and create a venture of lasting relevance.

The joys and pitfalls of abstract expressionism

Standing in front of one of Jackson Pollock's oversized action paintings in the Museum of Modern Art in New York elicits one of two emotions: endless complexity or a banal sense of 'I could do that'. Joint ventures are equally polarising – just like a Pollock, they don't all look the same, irrespective of first impressions.

The artists of the New York school of abstract expressionism of the 1950s to 1970s took delight in excusing themselves from formal subjects. Released from the constraints of reality, object and practice meant more than subject and result. True it is when structuring a joint venture – start first with your long term strategic objectives and how the partnership will work in practice and leave unanchored aspiration as a secondary concern, all too often coloured

Wikipedia: Jackson Pollock, "Blue Poles" (original title: "Number 11, 1952"), 1952, oil on canvas, 2.1m x 4.86m, National Gallery of Australia

by motherhood and apple pie. Choose your spoken and written words with the intent to inform, not to inspire.

When negotiating the terms, be conscious of hidden or ambiguous agendas – don't be fooled by the rhythm of the surface. Take the lead and say what is important to you up front, loudly and clearly. Encourage your partner to do the same. Why waste the time and energy of all involved (including expensive professional advisors) by being unclear in what is important to you? Indeed, when Pottinger advises on joint ventures, we will typically spend as much time arguing the case for our client's partner as for our client, precisely to make sure that all the issues are on the table.

If it's important, write it down

Few sculptures in art history are as prolific as the Rosetta Stone, housed securely in the British Museum in London. Equally as staggering to me as its physicality is the number of people who crowd around its display case to catch a glimpse of a collection of words inscribed on a rock. What is the attraction? In my view, the permanence of intent that comes with etching something in stone. It's the physical embodiment of the popular idiom, 'to set in stone'. The sacred, long-term commitment that comes with writing something down.

When deep in negotiations, there is an inevitable dance to be had in agreeing those decisions which are reserved for the joint venture's senior governance bodies – the board and the shareholders. The relative control rights of the parties need to be balanced against management efficiency to determine what is right and not right for escalation. Push more up and decisions happen more slowly, ruining the agility of your venture. Push more down and parties feel that key decisions are being made without due process, detracting from goodwill.

Just as parties should articulate up front what is important to them in a joint venture, so too should they express their non-negotiables in decision-making in the form of reserved matters lists. If you know that you will want to be involved in signing contracts with suppliers, regardless of the value, say so up front. If you have an existing bank facility that means you must be involved in any extensions of lines of credit for the joint venture, let it be known. Equally, though, before writing it down, be sure to wrap your head around market practice early by seeking advice, thereby saving yourself the pain and expense of horse-trading on immaterial caps and limits.

Build a strong foundation

On September 20th, 1932, 11 workers sat down for lunch while perched on a beam 69 floors above Manhattan. They were building the RCA Building (later renamed

Wikipedia: Unknown, "Lunch atop a skyscraper", 1932, photograph, multiple reproductions

Wikipedia: Banksy, "Swinger", year unknown, aerosol paint, New Orleans

the GE Building in 1986), which forms part of the Rockefeller Center. The photo capturing the moment – one of the most reproduced in history – is both breath-taking and calming. The extreme danger of the sitters' environment is completely at odds with their relaxed dispositions. They look as comfortable as the people sitting on park benches in Central Park seen off in the distance. What holds them up? The strength of the structure they are building together and the people on either side of them.

Whether or not you have a clearly articulated and documented plan for the joint venture is ultimately irrelevant if you have not first built a strong foundation of trust. You can establish trust by building something together – by planning for success over the long term and constructing something from the ground up. But in addition to being a great way to build trust, the best joint ventures – like mateship – are hardwired with pre-existing confidence and good faith. When a gust of wind blows 69 floors up, as it inevitably will, it's the relationships that matter most.

Exit through the gift shop

The invisible yet ubiquitous artist 'Banksy' has spray-painted the world in a way that simultaneously pokes fun at high art while attaining international acclaim – a cosy conundrum. Embedded in this paradox is the commerciality of art and its consumption, and in particular the dichotomy between art on the street and art in a gallery. While Banksy's preferred canvas is the unassuming walls of city-centres, in his first feature length film he takes pleasure in poking fun at the home of institutional art, the museum, by foregrounding the gallery's commercial motive of making you buy things as you leave.

Just as passengers embarking on international travel are herded through perfumeries and liquor stores in duty-free departure terminals, so too are consumers of art museums required to exit through the gallery's gift shop, packed with Monet prints emblazoned on over-priced coffee mugs and hand-made tea towels.

Let's not deceive ourselves – while the ongoing, inward and operational-facing success of a joint venture is in everyone's best interest, in nearly all cases the objective is to achieve commercial and financial objectives for the joint venture partners.

Whilst the best joint ventures will last for many years (think the Cadbury Schweppes/Carlyle distribution business or TNK-BP in oil and gas), it's also important to ensure that the partners can all exit smoothly and profitably if and when the arrangements reach the end of their natural lives, or are disrupted by corporate events. Work hard with your advisors to understand the most appropriate exit strategies relevant to your pro rata interest in the joint venture. Tag, drag or Russian roulette your way out through the gift shop. The trick, of course, is managing the relationship with your partners as you lay out your long term plans for exit. As is the case for other key aspects of joint venture operations, strategy and governance, the key is to be open, clear and early in your communications. Realising value requires more than an impulse decision at the check-out.

Whilst M&A has a chequered record in creating value for acquirors, the history of joint ventures and partnerships is almost certainly worse. In most cases, the seeds for failure were sown at the outset, through how the partners bargained with each other, and the way the venture was brought to life. As we've outlined above, a completely different mind-set is needed, and strategic objectives, operational plans and governance arrangements need to be perfectly aligned for true value to be created.

If you're exploring a potential joint venture (or have one you need to unwind), please do give us a call. Much like art, we've seen the good, the bad and the ugly of corporate partnerships, and have helped a wide variety of companies to create, restructure and unwind them to great effect. P

John Sheehy is a Vice President in Pottinger's Strategy and M&A team. He has lived and worked in Sydney, London, Moscow and New York City advising on complex, cross-border and cross-cultural joint ventures and other M&A transactions with a combined value of over $50 billion. He is also an abstract painter and held his first solo exhibition in 2009 in Sydney. His favourite artist is Cy Twombly.

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Synopsis

- Traditional discounted cash flow methods add a risk premium for risk and uncertainty. This emphasises the short term, leading to “accidental time bias”, and accentuates perceptions of unacceptable risk/return trade-offs

- Pottinger’s approach utilises advanced statistical techniques to quantify explicitly the effects of risk and uncertainties on all project outcomes, and allowing a full range of realistically likely outcomes to be assessed

- Explicit risk modelling allows us to use significantly lower discount rates (as used in conventional optional pricing techniques). Our approach thus avoids accidental time bias and provides a more complete risk/return picture

- This approach thus allows project proponents and investors to attribute proper value to the longer run impact of proposed investments, as well as to take proper account of long run downside risks

- As a result, more informed decisions can be made regarding overall project design, as well as in relation to optimisation of project funding and financing, and associated capital structures

- These methods also provide a more effective framework for assessing social impact, as projects that are beneficial for society frequently translate into economic and financial benefits over longer time horizons

http://www.pottinger.com/24-the-time-is-now.html

About Pottinger

Pottinger is a multiple award-winning strategic and financial advisory firm.

We de-risk M&A transactions and strategic transformations by integrating strategic insight, transaction expertise and data analytics, enabling leaders to make decisions that stand the test of time.

We work with clients who are ready to think differently and act differently. Our assignments typically relate to one or more of:

- Strategy and public policy
- Mergers and acquisitions
- Partnerships and joint ventures
- Restructuring and capital advice
- Risk, sustainability and related decision-making

Together our team has advised on over 200 M&A and financing transactions, as well as many significant strategic advisory assignments. Our experience covers most of the world’s larger economies, and we enjoy the complexity of assignments that extend across borders and cultures.

We are regarded as an industry leader in productivity and as a role model for investment in our people. We have been recognised by the Australian Government’s Workforce and Productivity Agency as a benchmark for effective skills development and for seven consecutive years we have been awarded “Recommended Employer” by the Australian Business Awards.

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