Joint Venture Advisory Practice

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Preparing for a Federated Enterprise

Companies that successfully manage their joint venture (JV) and alliance portfolios recognise the need to adapt to a business model that understands the unique challenges of shared control -- a Federated Enterprise.

In the 2016 KPMG CEO Outlook study, 5 in 10 CEOs planned to create significant partnerships, JVs, or collaborative arrangements with other firms, making it the most popular form of M&A-type deals. Interestingly, less than 2 in 10 ranked managing the ecosystem of partners/alliances as a top strategic priority. Instead, CEOs are more focused on traditional business activities, such as developing stronger client focus and new products. Given that more than half of all JVs fail to deliver value, this lack of attention is somewhat worrying. The hierarchal management model that many corporations have adopted over time, needs serious reconsideration.

A Federated Enterprise, which sees a corporation embrace partnerships as part of its structure, has an advantage over standard structures that endure high overheads, a bias towards the culture of the headquarters and low flexibility. However, a Federated Enterprise still needs a central nervous system to translate its approach into a competitive advantage.

Structuring a business with a portfolio of JVs and alliances

Running a business which relies on partnerships with other businesses is quite different from running a business in which there is full control. Over time, corporate culture, performance metrics, and natural human behaviour to avoid conflict drives a wedge between the subsidiary companies that they can fully influence and the JVs and alliances that they have less influence over. Soon, failure in their collaborative strategy becomes a reality.

It is often the case that the business underlying the JV or alliance is sound. But it is simply the corporate structure and way in which it has been managed that causes the failure. By not changing their operating model to reflect less than full control, these companies simply did not allow themselves the opportunity to succeed in partnering.

The Federated Enterprise

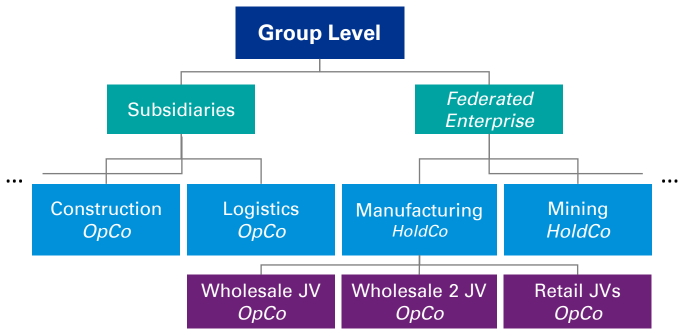
A Federated Enterprise – which is a business structured in a way that clearly separates JVs and alliances – is becoming increasingly popular. Management and governance of the Federated Enterprise is set up specifically to deal with the ambiguity of less than full control, because the performance of these businesses is managed differently.

The role of the Federated Enterprise is balanced against the needs of the JVs and alliances. For example, under some models, parent companies create centralised pools of similar resources (e.g., procurement or logistics) which they charge back to the JVs as services. In other instances, the management is lean and the model is de-centralised, pushing the responsibility to the JVs themselves.

The ultimate design is one which matches the capability of the parent company to its organisational learning and growth ambitions. The most successful Federated Enterprises are not those that are managed by accounting systems or forced to comply with onerous standards and processes, but those in which the partnership comes first.

[1] KPMG research

Federated Enterprise approach - an illustrative example



Benefits of setting up the structure early

Effectiveness of deal teams – Acquiring a company is very different from building a JV. If we were to draw comparisons to a house, M&A would be like buying a new house, whereas a JV or alliance would be akin to asking another family to move into your existing home to live with you. You would look for very different attributes under each situation. A Federated Enterprise relies on a team of JV and alliance specialists to pull it together.

Creating a true bond – A Federated Enterprise is more successful because the original deal makers maintain the relationship created in the deal stage, not roll off and hand it over like a traditional M&A team would. Over time, a strong bond is formed between the parties. This is especially valuable in avoiding issues, and it provides an ideal platform for adapting or renegotiating the terms of the partnership, when this is needed.

True value focus – It is more natural for companies (and their owners/management) to focus on what they can control. It follows that JVs or alliances are therefore ignored in favour of wholly-owned subsidiaries. A career in a Federated Enterprise provides absolute focus on the value of the partnership, de-risking the tendency to ignore what you cannot influence.

Effective management – Companies without a Federated Enterprise model shows that JVs and alliances take up a disproportionate amount of management time, distracting their management from value-adding activities, such as overall corporate strategy or performance enhancement. A Federated Enterprise structure allows management of the ultimate company to assess the business holistically and without bias to either the wholly-owned subsidiaries or the federated business.

Avoid 'managing' a partnership – People in many big businesses are taught to 'manage'. They are given 'assistant manager' or 'business manager' titles, sent on a 'management course' and once experienced, are then promoted to a 'director'. Control is important, but it is not suitable when talking about how to deal with complex business relationships. Mind-sets in a Federated Enterprise platform are encouraged to be more collaborative and focused on maximising shareholder value.

Avoiding financial penalties – When corporations do not immediately adopt a Federated Enterprise model, they often suffer financial penalties. Accounting charges, balance sheet issues, tax liabilities and refinancing costs are some common examples which could lead to disagreements. It is simpler to avoid these issues by getting the structure right from the start.

The Federated Enterprise reflects the new world
Concepts of 'the company', 'the nation state' and 'the industry' are becoming obsolete in our increasingly collaborative world. For example, car companies rely on hundreds of independent suppliers, manufacture in multiple locations and are intertwined with non-traditional partners offering smart phone interactivity, insurance on-the-go, and interconnectivity to healthcare providers in case of emergencies. Trying to manage a business in this modern world is easier under a Federated Enterprise model, as it is a structure made for the world of today rather than one of the past.

The KPMG Joint Venture Advisory Practice can help you assess your current and future needs, and restructure your business to minimise risk and maximise commercial performance, irrespective as to whether you have many partnerships already, or are considering embarking on more in the future.

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