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When failure is not an option: Making joint ventures work for capital projects

Part 1: Joint ventures–Cause or cure for major project risk? In the first of a three-part series, the authors discuss the advantages and challenges of the joint-venture construct.

By Alexander Pease and Richard Westney

Throughout history, joint ventures (JVs) and alliances have been a useful way for disparate entities to join forces and accomplish things that would be neither feasible nor possible otherwise. Consider the Hanseatic League, a trading alliance in Northern Europe in the mid-13th century or the Auld Alliance between Scotland and France during the same timeframe; they are among countless examples that abound in both the political and business context.

JVs today are created for much the same reason, and most major capital projects could not be completed without them. Projects in the energy, minerals, and chemicals sectors have become so costly, complex and loaded with risks that many simply cannot be undertaken by one company alone.

Project JVs often force cooperation between parties that have little in common and whose priorities are quite different. As business ecosystems become increasingly complex, technologies more sophisticated, scale economies more critical and global access more important, joint ventures as a key enabler of transformational projects and business strategies are more important than ever. Nowhere is this more evident than the world of mega-scale projects, where joint ventures have not only gotten more prevalent, but also remarkably more complex, as our three-part series of articles will explore.

Mega-scale project joint ventures getting increasingly complex

As mentioned above, JVs in the world of mega-scale projects have been around for a long time as a mechanism that successfully introduces capital and diversifies risk.

Historically, project developers have relied on the operating versus non-operating partner construct. However, companies are also increasingly leveraging JV constructs as a way to bring broader expertise into the project, build local talent and industries and retain sovereign ownership. In the oil and gas industry for example, a major project is likely to include a “supermajor” international oil company (for whom this project is part of a very large portfolio), an independent (who may be betting the company on this project), a passive investor (with a purely financial

focus), and a national oil company (owned by the government where the project takes place). In the infrastructure sector, public-private partnerships are widely used; in this case government agencies partner with the private sectors to finance, build and operate public facilities such as toll roads, desalinization plants, ports or railways.

On top of the massive scale and obvious technical complexity, these new, multi-operator constructs

- increasingly embody multi-cultural perspectives (both corporate and sovereign),
- frequently represent divergent strategic priorities for the individual owners,
- generally struggle with the governance and performance management challenges associated with any multi-parent structure and
- often lack a single point of accountability for key decisions.

Next, consider that the “new generation” of project JV has multiple layers, as both the owners and contractor teams rely on individual partnerships to deliver the project. As this phenomenon evolves, it should be no surprise that we see an explosion of risk and management complexity, given the sheer number of stakeholders involved and the more sophisticated tools and processes needed to deal with project intricacies.

JVs—A double-barreled risk?

As indicated above, JVs can be a powerful vehicle for diversifying risk, gaining access to capital, building skills and sharing resources. While there is no question that these advantages exist, it is not so clear what the potential downside is. An emerging body of evidence would suggest that complex, multi-layered JV structures actually increase, rather than decrease, the risk profile of a project.

Studies[1] show that about 50 percent of all JVs do not succeed. Moreover, studies of large capital projects[2] indicate that cost overruns from 50 to over 100 percent are common. So, when we consider this double-barreled risk of often-unsuccessful JVs managing often-unsuccessful mega-projects, we recognize that the difficulty project JVs have in aligning and operating effectively is a major reason why large capital projects often fail. Given the strategic importance these projects represent to participating partners, it is clear that JV organizations must be effective if a project is to meet expectations for predictability and performance.

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[1] “Launching a World-Class Joint Venture” – James Banford, David Ernst, David Fubini, Harvard Business Review

[2] “Megaprojects and Risk”, Bent Flybjerg, Cambridge University Press 2003

How, then, do owners and operators improve the performance of their project JVs? Part of the answer can be found in the broad body of knowledge of JVs in general, and part lies within the experiences that project JV participants have accumulated in recent years.

General JV success factors work for projects too

In their seminal article[3] in the Harvard Business Review, Banford, Ernst and Fubini suggest four areas on which to concentrate the early planning and launch of any JV:

1. **Strategic alignment**. This ensures that each partner's disparate goals, priorities and business models are recognized and reconciled.
2. **A "loose-tight" governance model**. This ensures that each partner's needs for accountability and control are met, while at the same time, the project's need for independence and authority is also respected.
3. **The economic interdependencies** between the project JV and each partner. They will impact the extent and means by which human, technical, and other resources are invested in the project.
4. **Building the project organization.** The parent organization should contribute their best people to the considerable challenges a major project presents, overcoming the frequent perception that such assignments are not always the best path to promotion.

These key success factors apply equally well to a capital project JV.

As the economics of capital project investments continue to drive economies of scale, very large projects in difficult locations will continue to demand the very best performance that JV partners can deliver.

In the next article, we will take a deeper dive into the specific challenges of project JVs and how these are being met by the application of these key success factors as well as project-specific techniques. By combining lessons learned from JVs in general with specific recommendations to meet the particular demands of major projects, predictable and profitable outcomes can be achieved■

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[3] "Launching a World-Class Joint Venture" – James Banford, David Ernst, David Fubini, Harvard Business Review