The SENIOR EXECUTIVE *Dedicated to the Financial Services Industry*

DCG Corporation DeHayes Consulting Group

Volume 101
Publication 2

Unlocking Imprisoned Assets With A Restructuring Joint Venture

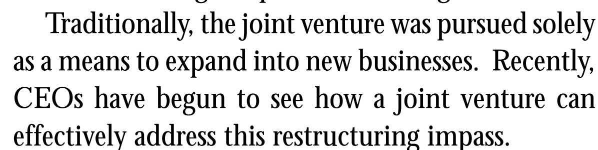
A growing number of CEOs are actively developing and implementing strategies to reposition their organizations for the new realities facing the financial services industry.

Early in such restructuring scenarios, businesses with marketable assets or high-performing non-core operations are quickly closed and sold to the highest bidder. But for many organizations the problem often remains: How best to dispose of basically sound but under-performing units that no longer fit within the organization's repositioning strategy?

Though often suffering from chronic lack of corporate attention (and a similar lack of high quality physical assets), such non-core units entail proprietary systems, skilled and experienced people, demonstrated distribution power, and market identity that would take competitors years to develop. While the restructuring CEO may fully appreciate the embedded values in such units, the investment in capital and human resources necessary to develop them into world-class operations that achieve the organization's goals of differentiation and market leadership is difficult to justify. They are no longer essential to the organization's new strategy.

When seeking to sell such units, the restructuring CEO faces two fundamental challenges:

1. How to convey what the unit is really worth to a potential purchaser. In other words, to make the unknown known, and
2. How to maintain the imbedded values of the unit during the process of selling it.



Traditionally, the joint venture was pursued solely as a means to expand into new businesses. Recently, CEOs have begun to see how a joint venture can effectively address this restructuring impass.

Advantages Over A Conventional Sale

Forming a restructuring joint venture to sell an under-performing but high potential business unit has several clear advantages over a conventional sale:

Stakeholders Stay Engaged and Committed. The announcement that a segment is for sale can be immediately result in a blanket of uncertainty descending upon everyone and everything connected with the unit. Key people depart for other opportunities. Improvement plans are put on hold. Customers and distributors worry about continued support and post sale service. Vendors, suspecting the likely end of their relationship with the unit, tighten credit terms and relax service and delivery standards. Investors unload shares. Disruptions and desertions are felt across the board.

A restructuring joint venture signals to all key stakeholders that the business will be reinvigorated

A restructuring joint venture, on the other hand, signals to all key stakeholders that the business will be reinvigorated rather than permitted to slowly deteriorate or close down all together. While some initial sacrifices (e.g., layoffs, closings, and consolidations) may be involved to set in motion the process of change and improvement, stakeholders know that the goal of the joint venture is to restore the competitiveness and viability of the unit.

The Unknown Becomes Known. A restructuring joint venture allows the buyer to go beyond even the most thorough due diligence to gain an understanding of the business that is largely inaccessible to an outsider. In this manner, the buying partner significantly reduces the risk of acquiring an expensive lemon and is able to assess the real value in intangibles such as brand name, distribution networks, employees and systems, and over time, understand just how the business operates and its degree of upside potential.

The Buyer Receives On-going Technical and Managerial Input From the Seller. The restructuring partner naturally seeks as high an exit price as possible and that price is largely determined by the success of the joint venture. Thus the restructuring partner is motivated to tutor the buying partner in running the business unit.

While an outright purchase usually entails an abrupt cut between the unit and its former parent (with potential trauma to both the unit being sold and other businesses that may be enmeshed with it), a joint venture, on the other hand, allows continuity of access to the former parent's assets, systems, and services. Continual support from the restructuring partner can be pivotal during the difficult process of rejuvenating and streamlining the business.

When Does A Joint Venture Make Sense?

When deciding whether a joint venture is the sales vehicle of choice, executives must address two key questions:

What is the nature of the restructuring problem? Joint ventures have proven to be most effective when the task of disentangling a business from the systems and structure of its corporate parent is likely to be a slow and complex process, particularly in the case of a related diversification or vertical integration.

A joint venture solution is also more advantageous than an immediate sale when several units share systems, personnel, administrative back-up and facilities, and time is needed for a smooth and gradual separation. Similarly, the arguments in favor of joint venturing are considerably less compelling if the unit to be sold is entirely autonomous.

What are the goals of the buying partner? The restructuring joint venture has maximum value and relevance to a potential buyer that plans to apply its own assets and expertise in running the business as it learns more about the partner. In contrast, joint ventures often require a degree of complexity, subtlety, cost and attention that is unappealing to asset strippers whose prime objective is to close down most, if not all, of the acquisition's operations and transfer only the customers or brand name to their own products.

The Management Burden Of Joint Ventures

Not withstanding the benefits of joint ventures, many companies still elect to sell under-performing segments outright, and if they do enter into a joint restructuring venture, maintain the partnership for as short a period of time as possible.

A restructuring joint venture clearly requires more of management's time and energy than does single ownership. Joint venture managers must simultaneously satisfy several corporate executives in what is often an arduous and time consuming process.

To minimize this burden without jeopardizing the effectiveness of the restructuring joint venture, executives need to focus on three primary objectives: insuring goal alignment, bridging the cultural gap, and selecting managers who can perform effectively without an elaborate organizational framework. It is essential that the partners share a clear commonality of purpose. Restrictive procedures and legal documentation designed to force the partners together will not work in the best interest of either party.

Rather, the partners goals must be brought in line by developing and maintaining the right informational links, starting at the top of both organizations. Cultural differences between lower level executives of both parties need to be identified and resolved at the very beginning of the joint venture. In addition, the restructuring joint venture should be staffed with managers who are comfortable exercising responsibility, even though they may have less formal power and have the skill set to foster relationships across geographical, cultural, and organizational boundaries.

Joint ventures have proven to be most effective when the task of disentangling a business is likely to be a slow and complex process

Negotiating The Deal

Requirements for a successful restructuring joint venture may first appear unconventional in philosophy and approach. At the centerpiece of negotiations is an analysis of why the unit

DCG Corporation DeHayes Consulting Group

has not performed up to par and a plan to eventually disengage, or terminate, the joint venture. Rigid management control should be avoided because a solid joint venture is better developed on loose ties rather than on a tightly defined infrastructure.

Acknowledging Under-performance and Estimating Potential. The first clear order of business when negotiating the transfer of an existing business into a joint venture is for the restructurer to inform the prospective buying partner about the unit's under-performance. Since the buyer's primary interest centers on the unit's upside potential, the restructurer should focus on the gap between the unit's current performance and its potential when integrated into the potential buyer's business.

Joint venturing is an effective device for unlocking heretofore imprisoned assets within a company portfolio.

A restructurer's willingness to enter into a joint venture should be construed as a positive sign from the buyer's prospective since it clearly signals the restructurer's confidence in the unit's potential. Conversely, a buyer should maintain a healthy degree of skepticism regarding claims of hidden potential if the restructurer is only prepared to sell the business in a "take it or leave it" deal.

Financial Sharing and Shifting Management Control. In a successful restructuring joint venture, sharing ownership equally with the buying partner, while at the same time ceding management control from day one, is clearly in the restructurer's best interests.

While joint commitment is insured with equal (or near equal) financial stakes, giving the buying partner management control early in the process assures that the purchaser can apply its capabilities and skills to the business as quickly and efficiently as possible.

A potential partner's long term intentions are perhaps most clearly signaled by the level of ownership the buying partner seeks. Potential buyers who are looking for a sizable share of the joint venture will want to become involved early on. In such instances, the restructurer should expect the joint venture to be of short duration and should be prepared to demonstrate the actual potential of the business early in the partnership. A buying partner taking too small a stake, or who may be utilizing the joint venture simply as a low-cost speculative ploy, can create significant problems for the restructurer.

Termination Planning for the Venture. Remembering that a restructuring joint venture is a phased sale and is intrinsically transitory, its ultimate measure of success is best measured by the smoothness with which the ownership of the business is transferred and by the value that is created. Termination of the joint venture is a natural and predictable step in the restructuring process. Therefore, it makes sense to plan in advance for an orderly disengagement.

Conclusion

With today's restructuring challenges, executives should evaluate joint ventures in a new light. A growing list of companies have demonstrated that joint ventures are an effective device for unlocking heretofore imprisoned assets within a company portfolio. The management burden necessitated by restructuring joint ventures can be demanding and the partners must carefully plan the end of the alliance to avoid value destroying conflicts. However, the benefits of such restructuring ventures can yield results that more than make up for the effort required. ■

The foregoing is an executive summary of the article "Use of Joint Ventures to Ease the Pain of Restructuring" originally published in the Harvard Business Review (November/December 1995).

Please return the postage paid reply card if you would like a complimentary copy of the complete article.

DCG Corporation
3300 Douglas Boulevard
Roseville, California 95661
916.782.8321 • Fax 916.782.8325