CORPORATE RESTRUCTURING:
HOW JOINT VENTURES CAN HELP
EASE THE PAIN

by

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Abstract

This paper explores the use of joint ventures as a potentially powerful tool to facilitate corporate restructuring. It argues that forming a joint venture with a prospective future owner who will buy out the business following a transition period has important advantages for both parties, especially where the corporate challenge is to exit a non-core business whose main value lies in under-utilised intangible assets like brands, distribution relationships, business systems and experienced teams. The joint venture process can help the seller avoid the destructive impact of putting a business up for auction and gain some of its future upside potential in a higher, final exit price once the potential for performance improvement has been demonstrated. For the prospective buyer it proves the opportunity to observe the business as an "insider" before making final commitments on acquisition terms, time to disentangle the business unit from its former parent, and the opportunity to avail itself of continued managerial and technical input from the restructurer during the process of hand-over. This joint venture solution does, however, carry the penalty of higher administrative costs. In order to minimise this burden and to reflect their transitory nature, restructuring joint ventures need to be structured and managed differently from their more traditional joint venture cousins.
Since the early 1980s, more and more diversified corporations have concluded that their business portfolios need sharper focus. Their limited corporate resources must be concentrated on fewer battlefronts. But decisions about where to focus and what to cut out often turn out to be the easiest part of the refocusing process. CEOs of these organizations testify that implementing a major restructuring plan is far more difficult than drafting it. At the core of this problem is the fact that the well-oiled mechanisms for making acquisitions creak and groan when refocusing demands that they go into reverse gear. It is very difficult to divest a business without destroying its value in the process. Simply putting a business up for disposal makes potential buyers suspicious. They are bound to ask whether the restrucrurer is trying to get rid of a "dog," and "what weaknesses of the business does the seller know that we don't?" Besides, putting a business on the block can undermine staff morale and paralyze decision making. Consumers, distributors, and suppliers will not make long-term commitments to a business whose future seems uncertain.

Faced with these unpalatable repercussions, corporations tend to drag their feet during the divestment process. Desirable restructuring moves often end up languishing in the "too hard" basket. The businesses in question are imprisoned within the corporate portfolio: unwanted children starved of capital and management attention. Neither can the corporate parent give them up for adoption by another firm nor can it quite bring itself to treat them as entirely lost causes.

Until recently, too few corporations have recognized the potential of joint ventures as a way out of this restructuring impasse. In this article, we show how and when joint ventures can help relieve the pain of restructuring.

Take the example of the Dutch electronics multinational, Philips. When Philips sought to reorganize its diverse portfolio in the late-1980s, it identified the $1.55 billion major domestic appliances division as "non-core" to its future. The division had a history of poor financial performance, needed a huge capital injection to update manufacturing facilities, and was operating with 14,000 employees, many of whom were protected by European legislation on job security. In these circumstances, outright disposal of the business would have fetched Philips only a fire-sale price. Despite the obvious problems that the appliances division faced, Philips management knew that it had valuable assets: pockets of underutilized manufacturing skills within its patchy string of 10 plants spread across five countries, as well as a portfolio of some of Europe's best-known brands, design expertise, and a pan-European dealer network that together placed it number two in market share behind Electrolux. Many basic ingredients for a highly successful business were in place. However, these strengths were imprisoned by an inability to achieve global scale in the design, procurement, and production of components, and by a position near the bottom of the ladder for scarce corporate cash.

Whirlpool of U.S. was the obvious buyer. Whirlpool management were looking to expand overseas. They appreciated the benefits of inheriting a major European position in an industry that was rapidly becoming global. They also sensed that if they introduced practices such as global components sourcing, transferred advanced manufacturing processes, and invested in new plant and machinery, then they could radically alter the cost-structure of the business.

However, they were not as convinced as Philips executives were about the potential of the business. How strong was the consumer franchise behind the nine brands? Would the dealer network remain loyal in the face of massive change? How much time and cost would it take to transform the culture of a divided and demotivated federation of businesses into a lean and focused operation? Both parties ran the numbers, but with their widely different assumptions and market experience, their valuations of the Philips appliances business were not even close. A strategically sensible deal was foundering on the issue of price.
A joint venture provided the solution. In 1989, Philips offered Whirlpool an opportunity to observe the business as an "insider" by selling 53% of its appliances business to Whirlpool, along with an option to buy the remaining 47% within three years. The arrangement gave Whirlpool the opportunity to learn about the reality of the appliances business and initiate improvement plans before taking it on entirely. Both managements would work in partnership over an extended period, and would have the incentives to make the combination a success. Equally important, since the price of the remaining 47% share in the business was linked to future performance, the total cost to Whirlpool of buying the business would depend on how valuable it would find the business to be. For Philips, the joint venture gave it the opportunity to prove to Whirlpool that the business was really as valuable as it claimed, therefore avoiding a distress-sale price. The joint venture arrested the destructive spiral of decision paralysis, defection of the best and the most mobile talent, worker demotivation, damage to consumer franchise, and loss of dealer support. "[Whirlpool] took over a company that had lost its way and reinstated direction," remarked Leif Johansson, rival Electrolux's CEO. Whirlpool subsequently exercised its option in 1991. Philips exited the business smoothly and on substantially more favorable terms – the uplift was estimated at $270 million – than if it had simply put the business on the auction block three years before.

Novel though this arrangement was, it wasn't unique. Although joint ventures have traditionally been viewed purely as an option for expanding into new businesses, the business world has moved on. Today, corporations around the world are increasingly using joint ventures as restructuring tools. This is one reason why in a 1992 issue of International Business magazine, Savona reported from his survey of joint ventures that 70% of these joint ventures had concluded within 3.5 years. Certainly, some of these were terminated because they failed; but others were designed as transitory enterprises used to transfer businesses from one corporate entity to another. A significant proportion, almost 50%, of the joint ventures that were terminated ended with one partner buying the business – the expected result if joint ventures are being used to oil the wheels of corporate restructuring. Below, we show how companies like Corning, Dresser, IBM, SKF, Honeywell, American Express, and Allied Lyons have used joint ventures to restructure, and in most cases, ultimately exit from non-core businesses.

In each of these cases, joint venturing had obvious advantages compared with outright sale in mitigating the pain and value destruction that can accompany corporate restructuring. Had they been denied access to complementary technology, skills, market position and capital investments necessary to realize their potential, the potentially valuable corporate assets would have remained imprisoned inside a corporate portfolio and would have continued to underperform. In several instances, the joint venture solution helped break the impasse.

A partnership aimed at releasing imprisoned assets while easing the pain of restructuring needs to be structured and managed differently from the traditional norm of managing a joint venture. Managers need to change their conception of an alliance, and also depart from conventional ways of measuring its success. While some of the rules of thumb for managing joint ventures still apply, other pieces of conventional wisdom need to be turned on their heads. This is part of the managerial challenge – how to make such joint ventures succeed – that we address below.

A New Kind of Restructuring Pain

In the early 1980s, when several large corporations began to restructure their portfolios in a big way, they focused first on harvesting the proverbial "dogs": businesses with poor market positions and few unique
capabilities. But as the trend toward more focused portfolios has continued, a new type of problem has emerged: what to do with basically sound businesses that no longer fit into the corporation’s future vision?

Since these businesses are non-core, managers simply cannot justify the investment of time and money necessary to restore their competitiveness. Management neglect saddles these potentially viable businesses with aging manufacturing facilities and dated products, contributing to their poor financial performance. Yet, these businesses have often built formidable assets like brands or distribution power. Some of these business organizations include powerful teams of people with unique skills and experience, backed by finely honed systems and well-practiced routines.

One obvious restructuring option is to simply sell these non-core operations. For businesses built primarily with tangible assets, whose value is easily assessable by an outsider, immediate disposal is attractive. However, when the value of a business lies primarily in intangible assets like human resources, systems, distribution power, and brand equity, it is inherently difficult for potential buyers to value. As a result, the price they are willing to offer frequently represents a substantial discount below the value the restructurer claims the business innately possesses. This discount becomes especially large when the business is turning in poor financial results, because the buyer is uncertain whether the assets are simply being poorly managed or whether they are capable of even generating higher profits.

Of course, this discounting problem is not unique to disposal of non-core businesses. For a potential buyer of any business to be attracted by a deal, it must perceive an upside to the business that goes beyond the acquisition price. And in any acquisition involving goodwill, the buyer agrees to pay at least some premium for intangibles, even if it is short of full value in the seller’s eyes. But in disposal of non-core businesses suffering from underinvestment in physical assets and without access to complementary skills, the discount faced by the potential seller is likely to be particularly deep. This is because a high fraction of the total value lies in difficult-to-value intangibles and current performance is much poorer than the unproven but claimed potential.

If the restructurers are convinced that their businesses have substantial underexploited potential and valuable stocks of intangible assets and goodwill, then they are left facing a bind. They are confident that infusion of capital and appropriate skills not available in house can greatly improve its performance; however, they are unable to convince possible buyers to pay for any significant part of the potential they know exists. For instance, when Philips tried to sell its appliances business, it found that Whirlpool wasn’t willing to pay a significant premium for the company’s established brands, distribution relationships, human resources, and systems. Whirlpool’s initial valuation was much closer to the tangible asset value of the business, well below what Philips believed was justified. The result was an impasse that risked undoing the deal.

Even if a restructurer is willing to swallow hard and accept a price it believes is unrealistically low, putting a business on the block poses other problems. An announcement that a particular business is to be eliminated from the corporate portfolio is frequently a kiss of death to the business. A blanket of uncertainty descends on everyone connected with the business. They are no longer sure whether it will remain in its current form, or it will be shredded into several pieces. Improvement plans are put on ice. The business finds it virtually impossible to hire new, high caliber staff. On the other hand, news that a business unit is non-core and does not have a place in a corporation’s future demotivates management and staff. Eyes come off the ball, as their attention is diverted towards polishing up their CVs and renewing contacts with placement agencies. Customers and distributors are also apt to react negatively to such an announcement: their concerns about continuity of aftersales service and technical support, limited possibility of future product
enhancements, and the risk of being lumbered with obsolete stock combine to disadvantage the business in the market. Vendors know that their relationship with the business is likely to be temporary. They tighten credit terms and push it behind other customers in delivery and service queues. A self-fulfilling spiral of retrenchment and plummeting performance often results.

A private sale overcomes some disadvantages of a public announcement. However, if a restructurer takes recourse to a private deal, it places the potential buyer in a position of considerable bargaining strength. Aware that the restructurer doesn't want news to spread that it desires to sell the business, the buyer can make a low offer for the business. The restructurer has to think hard before refusing such an offer and approaching other potential buyers, thereby greatly increasing the risk that what was intended as a private sale becomes public knowledge.

Alternatively, managers of the non-core business may make one last-ditch attempt to prove that it indeed belongs in the corporate stable. In the process, capabilities that may have taken years to develop and long-term opportunities may be sacrificed in an attempt to squeeze out immediate improvements in financial performance. Advertising may be cut back creating long-term damage to the brand franchise; quality may suffer as corners are cut to reduce costs; research projects may be terminated producing a gap in the future flow of new products.

Even if a sale is agreed upon, the new owner just may not have the managerial and technical skills to harness the assets and capabilities of the newly acquired business, quite apart from reaping synergies by integrating these capabilities with the acquirer's own resources and competencies. This is a particular problem when the acquired business is in an unfamiliar country or a new market for the buyer and if the trauma of disposal has led to large scale defections of key managerial and technical staff.

Consider Dresser, a diversified conglomerate with 1985 sales in excess of $4 billion. Dresser embarked on a strategy of sharpening the company's focus and divested more than a dozen "non-core" businesses over the next few years. However, Dresser faced a major challenge in disposing of its International Harvester subsidiary, a business with a widely recognized brand name and a strong distribution network in the construction equipment business. Dresser management did not sell the subsidiary, convinced that direct sale would yield a price that would only be a fraction of its true worth, and news that the business was up for sale would grievously harm employee morale and dealer relations. No longer a core business for Dresser management, the division came to be identified with "a neglected product line, lagging quality, and out-of-date plants." Not surprisingly, the business turned in a run of dismal results.

In 1988, Dresser converted its construction equipment business in Komatsu Dresser Company (KDC), a 50-50 joint venture with Japan's Komatsu Ltd. Komatsu was committed to construction equipment industry - compared to Dresser, it had a much larger global market share and spent 10 times more on R&D. Komatsu was looking to strengthen its presence in the U.S. in order to more effectively compete with Caterpillar, the global leader, on its own home turf. (Komatsu's in-house slogan was "Maru-C" which meant "Encircle Caterpillar.") The KDC joint venture helped Komatsu use Dresser's manufacturing facilities and dealer network in the U.S. Dresser's construction equipment business gained access to Komatsu's total quality systems and lean manufacturing know-how, essential ingredients for restoring its quality standards and improving its efficiency.

Dresser's experience with its construction equipment business is shared by many diversified corporations: there remain businesses in the portfolio that senior executives know do not fit but are loathe to dispose of. These businesses keep performing below their potential, since the corporation lacks the
technologies, skills, and other capabilities necessary to blossom. No longer is headquarters willing to back such businesses unequivocally or invest in them on priority. However, they are acutely aware of the pain that would accompany a process of disposal of these businesses. Such operations become the imprisoned assets of the corporation – fundamentally sound businesses doomed to languish within the corporate portfolio. There may be other corporations that can infuse these businesses with new capital and capabilities which will help them bloom. But ownership transfer of such a business is blocked by the restructurer’s inability to demonstrate the true potential of the business and concern among potential buyers that once the sale is completed the restructurer will walk away without also transferring the managerial expertise the buyer needs to integrate the business into its operations.

Why Joint Ventures Can Ease the Pain of Restructuring

Corporations are now beginning to recognize that forming a joint venture with a potential buyer provides a conduit for releasing imprisoned assets while simultaneously arresting much of the restructuring pain. Forming a joint venture, possibly only as a transitory organizational arrangement, has three main advantages over outright and immediate disposal of an underperforming but high potential business.

1. *Forming a joint venture to undertake the restructuring process can help avoid the destructive impact of labeling a business “non-core” and putting it on the auction block.* Joint venturing removes the demotivating specter of the business being harvested or being asset stripped by financial engineers. Indeed, motivation often improves with the prospects of a partner bringing to the business the resources necessary to restore competitiveness and to the employees new career opportunities. Employees are reassured that the business has a future. Customers and distributors are also less likely to desert the business, since their fears of disruption, obsolete stock, and uncertain future service support are assuaged.

Ciba-Corning is a good example of how a joint venture can be used to maintain business continuity even as ownership is transferred from one company to the other. In 1985, Corning was looking to exit from the medical diagnostics business and Ciba Geigy was seeking to enter the U.S. market. The two companies agreed to convert Corning’s medical diagnostic business into a 50-50 joint venture, Ciba-Corning. Over the three years that the business operated as a joint venture, employees, customers, and vendors stayed loyal to the enterprise and were reassured that the incoming partner was committed to strengthening Ciba-Corning. Ciba Geigy was able to integrate the business into its global operations and Corning was able to demonstrate the intrinsic quality of the medical diagnostics division to Ciba. In 1989, Ciba Geigy bought out Corning’s remaining 50% share in the venture. Upon the termination of the joint venture, Richard Dulude, Group President at Corning, remarked, "I think both parties would say that it was a successful relationship. It allowed us both to do things we wanted to do. It strengthened [Ciba-Corning] significantly – it ended up in the Ciba Geigy fold, and it will be much stronger because of that." The business created an estimated $75 million of value, partly because disruptions through employee turnover and supplier and distributor desertions were minimized. This smooth handover would not have been possible if Corning had put its medical diagnostics business up on the block and then sold it in a one-shot transaction to Ciba Geigy.

2. *The incoming partner is able to observe the business as an “insider.”* The joint venture offers the buyer an opportunity to build an understanding of the business that an external observer cannot hope to gain even through the most thorough of due diligence. The buyer is able to assess the true value of intangible assets like brands, distribution networks, people, and systems through direct involvement with the business over an extended period. For the buyer, this means reduced risk of being landed with an expensive lemon. Joint venturing also gives the restructurer an opportunity to demonstrate to the buyer that the business is no
lemon. As a result, the restructurer is able to negotiate a more realistic premium for goodwill assets than would have been possible through a one-shot sale. Witness, for instance, the fact that in the Philips-Whirlpool deal, Philips's final exit price from its business was significantly higher than the maximum Whirlpool had been willing to offer for a "cut and run" sale.

Even if the joint venture fails to reveal hidden potential ex-post, it may be a better option for the buyer compared to direct purchase. Once a buyer is sold a lemon, it has no recourse. In a joint venture, the buyer can adjust downward the price of buying out the restructurer's share at the back-end of the joint venture to reflect the fact that the business has not done as well as initially expected. The TRW-Fujitsu joint venture illustrates this benefit of a joint venture even if the restructuring is not a success. In May 1980, Japan's largest computer maker Fujitsu entered a 51-49 joint venture with TRW, a diversified automobile parts and electronics equipment manufacturer to manufacture and distribute retail Point-of-Sale (POS) computer systems. While Fujitsu was responsible for product development, TRW executives managed the firm and handled distribution. The blend of Japanese hardware with U.S. distribution and software knowhow was hailed by J. Sidney Webb, TRW-Fujitsu's president, as "the best fit I can imagine." However, the company was unable to effectively communicate U.S. customers' needs to its product developers in Japan. The joint venture failed to produce a profit, and both Fujitsu and TRW admitted that it was not working. "It's better to have a one-sided business decision process, especially in such a fast-moving market," remarked Fujitsu president Takuma Yamamoto. In March 1983, Fujitsu bought out TRW's share in the joint venture at a considerable discount, industry experts claimed, to what it would have paid in 1980 had it purchased the entire business as a total outsider. The business was renamed Fujitsu Systems of America, and eventually became one of the leading suppliers of retail POS systems. Even though the joint venture had "failed," it had effectively helped Fujitsu realize the true "potential" (or in this case the lack of it) of the POS business it was acquiring from TRW part-way through the deal and accordingly reduce the price it paid for the business.

3. A joint venture gives the buyer the advantage of continued managerial and technical input from the restructurer. Many of the businesses that are being transferred rely on the parent for support services and other capabilities – ranging from technical services and market knowledge to IT systems – that they don't have in-house. Such capabilities and expertise are closer to art than science. They can seldom be specified in detail or transmitted by prescription. Continued support from the restructurer may be invaluable, especially during the difficult process of rejuvenating and streamlining the business. Outright purchase generally means that the umbilical cord with the corporate parent is cut abruptly. A joint venture, by contrast, allows continuity of access to the former parent's assets, systems, and services.

Besides, joint venturing facilitates a smooth hand-over of the business to the new senior management team. The reality of many corporate disposals is that the new owner is simply handed a hot potato with little guidance on how to manage the business. Before a sale is consummated, a seller may be reluctant to give too much information away for fear that the buyer will not pay for the value it gets from the information. After an outright sale, a restructurer has little incentive to waste its time hand-holding the buyer. So the recipient of the business is forced to learn both "on the run" and "in the dark." A joint venture means that a knowledgeable tutor is on hand to guide the newcomer through a mine-field of decisions that, wrongly conceived, could very well destroy the value of the business being transferred. In the Ciba-Corning joint venture, for instance, Corning's corporate staff was actively involved in the business, especially interacting intensively with Ciba Geigy's corporate team, during the life of the joint venture.

If there are so many benefits of joint venturing, then why do many companies still choose to sell their businesses rather than joint venture them? Why are several of these joint ventures concluded after some time? A key reason is that joint venturing is intrinsically an administratively costlier organization form
compared with single ownership. Joint venture employees find that satisfying several corporate masters is an arduous and time-consuming task. Communications with senior managers of one partner have to be duplicated and often contradictory signals have to be resolved. The result is that a joint venture, as Richard Dulude put it, "takes twice the management effort compared with a wholly-owned subsidiary." A business is transferred through a joint venture rather than a direct sale only if the benefits discussed above outweigh the additional administrative burden that joint venturing imposes. Further, even if a business is transferred through the joint venturing route, it remains a joint venture only while the benefits discussed above are in the process of being realized. Once these benefits have been achieved, there is no reason to keep the business as a joint venture and incur the extra administrative cost that it implies. Instead, the restructurer typically sells its remaining share in the alliance to its partner and exits.

Deciding When a Joint Venture Can Help in Restructuring

Joint venturing is not a panacea for all restructuring ills. A restructuring firm’s executives need to make a hard-nosed assessment of when a joint venture solution will indeed be effective. In making this assessment, they should address four key questions: what precisely is the nature of the restructuring problem, what are the goals of the buyer, what are the expected administrative costs of joint venturing, and what is the potential for future synergies as the partnership develops?

The nature of the restructuring problem

Joint ventures are most effective in easing the pain of restructuring when the task of untangling the business from the arms of its corporate parent is likely to be slow and complex. This is often the case when a company has to unwind a related diversification or a vertical integration. The arguments in favor of using a joint venture are less compelling if the business is an entirely freestanding unit. If General Motors wished to exit from the information technology services business, it would probably have few problems in separating its EDS subsidiary from its auto interests. Outright disposal would probably make sense. In restructuring Corning’s medical diagnostics business, management confronted the multiple strands of relationships linking the business with the corporate office and with other Corning operations in its laboratory sciences sector. Similarly, when Dresser’s management was trying to streamline its construction equipment business, it faced a fuzzy boundary between the business and the rest of Dresser. The construction equipment business had links with other earthmoving businesses in Dresser’s portfolio, such as shared marketing and distribution. If Dresser had chosen to carve the construction equipment business out for immediate disposal, untidy threads of the severed links would have been left hanging. The more difficult and time-consuming it is to separate the business from its corporate portfolio, the more attractive the joint venture solution becomes. In cases where several businesses share facilities, systems, personnel, or administrative backup, joint venturing provides an extended time window over which to effect a smooth and gradual separation.

The joint venturing solution wins over immediate sale when the most important assets in the business being restructured are intangibles, like consumer franchise, distribution relationships, human resources, and systems, because such assets are difficult for potential buyers to properly value as outsiders. Apprehensive about being sold a lemon, they offer a fair price only for the tangible assets and heavily discount the intangibles. So if the main value of a business is in intangibles, direct sale is generally less attractive. This distinction is aptly illustrated in the restructuring of IBM’s troubled subsidiary Rolm, in partnership with Siemens of Germany. While IBM wanted to exit the thin-margin price-competitive PBX market, Siemens was looking to strengthen its presence in the U.S. telecommunications market. For those parts of the Rolm business in which the primary assets were tangible, as in manufacturing, the parties chose a straightforward
sale from IBM to Siemens. In the downstream customer-related activities, where most of the potential value was locked up in intangibles, transfer through a joint venture was the preferred solution. So, in a concurrent deal, IBM and Siemens formed a 50-50 joint venture to handle marketing, distribution, and service for the Rolm product line. Downstream joint venturing ensured continuity for the dealers and the customers, and also helped Siemens gauge the worth of Rolm’s brand franchise and customer relationships before paying for all of the business. Three years after the joint venture was set up, in 1992, IBM exited the joint venture, leaving Rolm entirely in Siemens’ fold.

For similar reasons, joint venturing is more attractive when the current financial performance of the business to be restructured is poor compared with its potential. Joint venturing allows the prospective buyer and the restructurer to jointly improve performance of the business and share the benefits of this improvement. The Philips-Whirlpool and Ciba-Corning examples described above illustrate this process of joint value creation and subsequent sharing of financial benefits between former and future owners. An outright sale often excludes the seller from sharing in the upside potential because buyers are typically unwilling to pay much for a yet unproven upside.

The incoming partner’s goals

A joint venture makes sense only if the incoming partner wants to develop the assets as an ongoing business. Asset strippers who want to shut down most of the operations and transfer only the customers or the brands to their own products will not be interested in a deal that involves the complexity, subtlety, cost, and management attention that a joint venture is likely to require. They will want to make a fresh start in dealing with all the constituencies unburdened by the former owner’s implicit commitments. So they will want to be free of the constraint of being associated with the former owner over an extended period.

A joint venture is of much more relevance to a potential buyer who is seeking to build on the base of what it buys by gradually infusing its own assets and skills as it learns about the business. Typically, such situations arise with a foreign firm seeking entry into an industry. Rather than set up a greenfield establishment, such a firm often finds it more advantageous to pursue a transitory joint venture with a domestic firm that is looking to exit the industry. The joint venture helps the foreign entrant acquire local assets and develop an understanding of the local market, even as it allows the domestic firm to exit the industry by disposing of its assets at a good price.

Consider the case of Honeywell’s computer business. Honeywell’s share of the U.S. mainframe market had fallen to 2.6% by 1986 and the business was barely profitable. Honeywell management was anxious to exit the business and focus on its global electronic controls operations. Some potential buyers could have viewed Honeywell’s computer business as a bundle of tangible saleable assets – real estate and equipments – and an installed customer base that could be converted to the acquirer’s systems. In such a case, outright purchase of the business would have made sense. But Groupe Bull had different objectives. Bull was looking to develop a global presence beyond its predominantly French base. It wanted to build any business it acquired overseas as a going concern. In 1987, Honeywell’s computer operations were converted into Honeywell Bull, a joint venture in which Honeywell and Groupe Bull took a 42.5% share each. A third partner, Japan’s NEC corporation, took a 15% share, since it saw the joint venture as an attractive marketing vehicle to Europe and the U.S. for its high-performance computers. By 1991, Honeywell had completely exited the business, leaving Bull and NEC with 85% and 15% stakes in the business, respectively. The joint venture served the objectives of all three companies – Honeywell was able to exit the business, Bull was able to enter the U.S., and NEC was able to get an entree into the U.S. and European markets.
Administrative cost of running the joint venture

The higher the extra administrative burden associated with managing the joint venture, the less attractive it becomes compared with outright sale. Recall Corning's Richard Dulude's warning that joint ventures can eat up twice the management effort of a wholly-owned subsidiary. Executives in the aircraft equipment manufacturing industry actually use explicit formulae to estimate the cost of joint venturing compared to the cost of single ownership.

The high degree of management complexity that a joint venture requires raises its administrative cost, making the simpler version of immediate disposal more attractive. Certain circumstances exacerbate this cost. The administrative cost is high if the partners' goals are poorly aligned, demanding endless discussions and debate before compromises are reached. Widely differing corporate cultures and historical experiences also increase communication difficulties.

Haruhiko Umdea, KDC's first COO, was convinced of the sound strategic logic for forming the $1 billion KDC joint venture. "Takara-no-yama," he remarked, "The venture is a mountain of treasure." However, cultural differences emerged between Dresser and Komatsu executives and soon hardened into deep animosity. Former Dresser executives complained that managers from Komatsu were making crucial decisions during Friday evening bull sessions conducted in Japanese. Executives from Komatsu felt that former Dresser executives were interacting with them in a spirit of competitiveness, not cooperation.

Besides guarding against circumstances that may raise the administrative cost of joint venturing, managers can actively work to minimize this cost. The key lies to structuring the joint venture in the right way - a managerial challenge we discuss below.

The potential for future synergies as the joint venture develops

The option of entering a joint venture becomes more attractive if the partnership also has the potential to throw up new synergies as the relationship develops. The history of cooperation between Corning and Asahi is a good example. Asahi had been a refractory materials licensee of Corning since the 1930s, adding a license for Corning's TV tube production technology in 1954. In 1965, Asahi converted its refractory materials business into Iwaki, a 50-50 joint venture with Corning, marrying Asahi's manufacturing and distribution strengths in Japan with Corning's technological know-how. The scope of the joint venture was subsequently expanded when Iwaki also became the local distributor of Corning's household products, blending Corning's production with Asahi's distribution strength in Japan.

Unlike the other joint ventures that we have seen thus far, in this case, Asahi bought out Corning's interest in Iwaki in 1988, confident that it did not need further technological infusion from Corning. Corning transferred Japanese distribution of its household products to a new wholly-owned subsidiary. Here was a restructurer reabsorbing the business after it had gained valuable competencies from its erstwhile partner. Corning also gained from the alliance, since it was able to sell in the Japanese market during the period the alliance lasted, and also book an impressive profit when it resold its share in Iwaki back to Asahi.

However, now the two companies saw an advantage in building a new relationship that blended Corning's strong distribution in Malaysia with the manufacturing prowess of Iwaki - now wholly owned by Asahi. So, as one joint venture was completed, another was spawned.
A year later, when Corning was forced to restructure its TV picture tube operations in the U.S., it again approached its old partner Asahi. Another joint venture was formed – Corning Asahi Video Products – which took on the task of revitalizing Corning’s TV tube manufacturing operations in the U.S. The roles of the two partners were reversed – Asahi providing the technology and Corning contributing its manufacturing facilities.

Such a partnership has much broader objectives than the restructuring joint ventures we are discussing here. Rather than focus only on consummating the transfer of only one business, the partners look for exploiting a stream of complementarities over time. There is little doubt that valuable, but unforeseen, synergies can arise as a successful partnership evolves. The problem is how to assess the potential for new synergies at the outset, when a partnership is being compared to outright sale, or when the partners are contemplating terminating the joint venture. This is especially important since the extra administrative burden of managing a joint venture represents an immediate cash cost whereas the possible benefits are both uncertain and prospective.

There is no easy answer to this quandary. One approach would be to identify circumstances in which partnerships are not likely to survive over the long run. Partners with overlapping markets are likely to discover that competition develops as their relationship evolves. Not surprisingly, we find most joint ventures bring together partners who are not directly competing against each other either in the business being transferred or in other businesses in their portfolios. If companies have very similar resource profiles, they do not want to make the extra effort and incur the additional cost of building bridges across their organizational boundaries to basically duplicate their own assets. If companies have very different resource profiles, a one-off opportunity to exploit a serendipitous complementarity may arise, but the partners are unlikely to cement their relationship into a long-run partnership in anticipation of more such complementarities arising.

The potential for future cooperation is the greatest the more the partners’ capabilities are complementary and the less their markets overlap. Companies such as Corning and Asahi are likely to be pleasantly surprised by frequent discoveries of new opportunities for synergistic cooperation. Ultimately though, the weight given to the potential for future synergies must remain a judgement call.

<table>
<thead>
<tr>
<th>Administrative cost of JV</th>
<th>Can a JV be structured with reduced administrative costs?</th>
<th>Can a partnership uncover new synergies over time?</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>No</td>
<td>Low</td>
</tr>
<tr>
<td>Low</td>
<td>Yes</td>
<td>High</td>
</tr>
</tbody>
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<table>
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<th>Disposal price (Relative to potential value)</th>
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<tr>
<td>Low</td>
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<td>Low</td>
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The chart above summarizes the key tradeoffs that determine whether outright disposal or joint venture provides the best approach to restructuring. When the business to be restructured is easily separable from the corporate portfolio and most of the assets are tangible and easily valued, then the disposal price of the business is likely to reflect most of its value (the right column of the chart). In this case, outright sale is preferred. A joint venture will only make sense if the administrative costs are very low and there are significant potential synergies to be gained by the restructurer and the potential buyer working in partnership.

The left side of the chart illustrates the problem of imprisoned assets: the restructurer knows the business has potential value far in excess of the low price the business would command if it were disposed of in the market. The value that could be released by infusing the business with complementary technology, skills, and capabilities from the right partner remains unrealized unless the two parties can enter a joint venture. The key issue then becomes whether the joint venture can be operated in such a way that the value it creates is in excess of the extra administrative cost it imposes.

**Designing a restructuring joint venture**

Many of the conventional rules of managing joint ventures carry over to their use in restructuring. Trust and mutuality of goals, for example, are necessary to help cement the partnership. And although restructuring joint ventures are usually transitory, cultural compatibility still counts. Restructuring of the Dresser operations, for example, was hampered in the early days of the Komatsu-Dresser joint venture by cultural differences between the U.S. and Japanese managers. KDC was forced to explicitly address this issue by starting classes and organizing trips to develop cross-cultural sensitivity among its employees. In contrast, management on both sides of the Ciba-Corning joint venture took great pains up front to expose Corning's medical division management and employees to Ciba Geigy's values and culture. Initial investments in organizing visits by synergy teams and ensuring multi-level contacts paid off handsomely later, since the business transferred from one parent to the other with minimal disruption due to cultural adjustment.

Hence, some of the conventional ideas about designing a successful joint venture remain operational in restructuring situations as well. At the same time however, the special requirements of restructuring joint ventures dictate that some other generic rules need to be stood on their heads. In a typical growth-oriented joint venture, for example, few would recommend that the centerpiece of negotiations be an analysis of why the business is performing badly, or that a plan to terminate the joint venture should form the core of the contract. Conventional wisdom would also caution against ceding too much management control, or not investing heavily in building an organizational infrastructure that binds the partners together. But as we demonstrate below, these are exactly the design ingredients likely to promote a successful restructuring joint venture.

**Negotiating stance**

When negotiating the transfer of an existing business into a joint venture, the current owner needs to send a clear signal to the prospective partner about where the causes of its underperformance lie. At first pass, this focus on the "negatives" may seem paradoxical. But remember, the buyer's primary interest is in the upside potential of the business. So there is little point in maintaining that the business is shipshape and cruising ahead at full speed. This might make sense if the owner were approaching the stock market or financial institutions to finance additional growth. In negotiating a restructuring joint venture, the sales pitch needs to emphasize the gap between current performance of the business and what it can achieve in the hands
of the right party. Recall that in converting their businesses to joint ventures, neither Philips nor Dresser management glossed over the poor performance of their businesses; what they did highlight to their potential partners were the possible improvements that could be effected by both partners working together to combine existing operations with the incoming partners' assets and capabilities.

What if you are a potential buyer facing the choice of outright purchase of a business versus entering a joint venture with the current owner? What should your negotiating position be? As a potential buyer, your biggest worry is that you may be buying a lemon. You are concerned about paying for intangible assets that turn out to be little more than the seller's window-dressing the business. How do you properly distinguish businesses that are underperforming because they are intrinsically poor from those that have hidden underexploited potential? Are the brands and distribution network, for example, tarnished and weak or simply hampered by outdated products? Are the facilities fundamentally useless or is potentially world-class productivity being undermined by a demotivated or inadequately trained workforce?

From the buyer's perspective, a restructurer's willingness to enter a joint venture in preference to outright sale is a good omen, since it signals the restructurer's confidence that the business indeed has an upside potential that it is willing to demonstrate. On the other hand, if a restructurer is only prepared to sell the business in a one-shot deal, the buyer should look very skeptically at any claims of hidden potential.

Carlsberg, the Danish brewer, faced just such an issue when, in 1991, it got the opportunity to combine its operations with the U.K. brewing arm of Allied Lyons, one of the world's top four spirits companies. Allied Lyons' main reason for seeking the deal was to sharpen the focus of its vast sprawl of businesses principally on wines and spirits. Allied Lyons offer to structure the deal as a joint venture satisfied Carlsberg that the business was not intrinsically a dog. It assessed that since Allied Lyons was prepared to stay with the joint venture rather than cut and run, the business indeed enjoyed a fundamentally strong position in direct sales to the pub trade which would nicely complement Carlsberg's historic focus on wholesalers, although its operations did need rationalization. The two companies formed a 50-50 joint venture, Carlsberg-Tetley, which incorporated Carlsberg's U.K. brewing and distribution operations with those of Allied Lyons. The joint venture focused on effective distribution by trimming its depot network and pushing its brands. By 1993, the 18% combined market share in U.K. of its brands of 18% placed it a close third behind market leaders Bass (23%) and Courage (20%), while its Tetley brand became U.K.'s best-selling ale. Carlsberg-Tetley had reached a turnover of £1.1 billion and profits of £100 million. The joint venture remains intact today, although Allied Lyons management have made it clear that its long-term ambitions exclude beer, and have often remarked that they see Carlsberg as the more natural owner of the business eventually.

Ceding management control

When joint ventures are designed around the partners jointly growing a business over the long term, both parties often vie for majority shareholding and management control. Yet, in a restructuring joint venture, it may be to the current owner's advantage to cede management control to the incoming partner from day one, so that the incoming partner can efficiently bring its own capabilities and skills to bear on the business.

How much initial share the incoming partner is seeking in the joint venture can also signal its long-term intentions to the restructurer. A potential buyer demanding a majority share in the joint venture signals that it is looking to quickly take charge of the business. The restructurer should expect the joint venture to
be of a short duration, and hence, should be prepared to demonstrate to the buyer the true potential of the business very early in the partnership.

On the other hand, an incoming partner taking too small a share and treating the joint venture simply as an uncertain but low cost play among its options can create significant problems for the restrucurer. Ciba Geigy signalled its commitment to Ciba-Corning by investing in 50% of the joint venture’s stock and using it as its only vehicle for entry into the U.S. medical equipment industry. In contrast, Komatsu had two parallel operations in the U.S. – a 100% subsidiary and Komatsu Dresser Company. The Komatsu and Dresser lines were kept distinct and were sold through separate dealership networks. Not surprisingly, the dealers began working at cross purposes. Dresser executives wouldn’t give product information to their Komatsu counterparts, afraid to lose sales to them. Some buyers began to shy away from Dresser equipment, fearing that the product line would eventually be phased out. Eventually, management began to merge the two dealership networks to tackle these problems, but valuable time was lost.

The recent Honda-Rover joint venture termination had some of its roots in the fact that besides having a 20% share in Rover, Honda also had a 100% subsidiary in the U.K. Since 1979, Honda had supported the restructuring of the troubled British car manufacturer, the Rover Group, through a combination of licensing, supply arrangements, and joint development. The relationship was cemented in 1990 with a share swap in which Honda U.K. and Rover acquired 20% of each other’s equity. British Aerospace, the remaining 80% owner of Rover, wanted to focus on its core aerospace and defense activities, and exit the car business. So, in 1993 it approached Honda with an offer to raise its shareholding in Rover to 47.5%, and possibly to 100% later. Given its own operations in U.K., Honda was not interested in raising shareholding in Rover at the price or the pace that British Aerospace wanted. When Honda demurred in raising its stake in Rover, British Aerospace then turned around and approached BMW to buy its share. Attracted by its Land Rover brand and distribution strength in noncompetitive car segments, BMW agreed to buy British Aerospace’s shareholding in the business. Honda and Rover untangled their cross-shareholdings over the next several months amidst bitter acrimony.

When restructuring of the business being joint ventured will take sustained and close cooperation between both partners to extract value, then equal partnership is the operative word. We suggest that in such circumstances the joint venture should initially be structured as a 50-50 partnership. Most successful joint ventures that we have observed, like Ciba-Corning and IBM-Siemens, had both partners taking equal stakes in the business.

Planning for termination of the venture

When a joint venture is used for restructuring, the deal should focus not only on the front-end of the partnership, but on its back-end as well. For most firms entering a joint ventures, writing a termination clause may be quite as much an anathema as writing a divorce clause while entering matrimony. But remember that most restructuring joint ventures are meant to be transitory. Though joint ventures have provided a quarter of Emerson Electric’s total sales over the past five years, not all of these ventures have lasted. “About half of the joint ventures that we have closed down,” remarked C.F. Knight, Emerson’s CEO, “were intended to be closed down.” Success in a joint venture that is transitory by design is measured not by the longevity of the alliance but by the smoothness with which ownership of the business has been transferred while creating value through infusion of new resources. It makes sense, in this case, to plan for an orderly disentanglement right from the outset, recognizing that termination is a natural step in the evolution of a restructuring joint venture. Otherwise, value-destroying conflicts may arise between the partners, with one partner seeking dissolution of the alliance and the other seeking its extension.
In 1989, Komatsu had entered a joint venture with Guenter Papenburg who owned Hanomag, a specialist German manufacturer of wheel-loaders. Komatsu built a 64% shareholding in the joint venture, while Papenburg retained a 32% share. Komatsu infused much needed capital, modern technology, and a broad product line into the joint venture in exchange for Hanomag's manufacturing facilities and market presence in Germany. Upon German reunification, the combination of Hanomag's understanding of the German market and Komatsu's financial muscle helped the joint venture charge into former East Germany and build a strong market presence there. However, when Komatsu wanted to buy out Papenburg's share in the alliance, the two parties could not agree on the appropriate price. Exhaustive negotiations were suspended in February 1993, and the partners remained locked in what had become a reluctant marriage.

Toshiba, regarded by many as a global leader in building and managing alliances, routinely includes the corporate equivalent of a prenuptial agreement in its partnership pacts. This agreement sets out exactly who gets what upon termination of the agreement. Tsuyoshi Kawanishi, Toshiba's senior executive vice president in charge of partnerships and alliances, explained why the company adheres to this practice, "During honeymoon time, everything is great....(but) divorce is always a possibility, and that's when things can get bitter." Both Philips-Whirlpool and Honeywell-Bull-NEC alliances included timebound buyout clauses.

The joint venture between Warner Communications and American Express (AmEx) used a particularly innovative approach to planning for its termination ahead of time. In 1979, AmEx bought a 50% interest in Warner Cable for $175 million, bringing its huge financial resources and marketing expertise to the joint venture. For its part, Warner offered a head-start in the attractive cable TV business with a potential of supporting home banking services in future. Included in the AmEx-Warner deal was a clause that if one party made an offer to buy the other out, then the other party could respond in either of two ways. It could accept the offer as tabled, or if it felt the price was too low, it had the right to turn the tables and force the first party to accept an equal sum for its own stake. This clause made continuation of the joint venture contingent on both parties' wanting to remain in partnership, and ensured transfer of shares at a fair price upon termination.

This intriguing clause did come into play in 1985. The joint venture lost $150 million before taxes in 1983, and AmEx was finding its involvement to be an embarrassment on the Wall Street. Eager to exit the business, it felt that the value of the assets could best be realized by first purchasing Warner's stake and then selling the entire business, and so, it offered to buy Warner out for $450 million. Warner turned the tables and chose buy out AmEx's 50% stake instead. AmEx booked a $140 million profit on the sale and was happy to quit the business. "A big headache and question mark was removed," remarked AmEx's CEO James D. Robinson III. But Warner's sense that AmEx's offer had undervalued the business proved prophetic. Warner was subsequently able to dispose of peripheral parts of the business for $510 million while retaining full control of the core cable operation, which soon came to be valued at $1.6 billion.

Whether a restructuring partnership is successful at creating value or not, clarity about the terms on which it will be concluded helps ensure that value is not destroyed through mutual bitterness at the back-end of the venture. In order to convey their total confidence in the potential of the business, some restructurers leave the trigger for terminating the joint venture entirely in the hands of the potential buyer by offering them an option to purchase the rest of the business within a specified time window.

The joint venture used by Honeywell to restructure its mainframe computer business is a good example of how such an option works. In 1987, Honeywell backed its computer operations into a joint venture in which Honeywell and Groupe Bull each took a 42.5% stake, while Japan's NEC purchased the
remaining 15% share. As part of the original agreement, Bull had the option to buy a further 27% of shares from Honeywell after one year, and the venture was renamed Bull HN Information Systems Inc. Two subsequent recapitalizations of Bull Information Systems culminated in Honeywell exiting the business completely in May 1991, leaving Bull and NEC with 85% and 15% stakes respectively. The option, but not the requirement, for Bull to raise its stake conveyed Honeywell's confidence in the business as well as its willingness to contribute and remain involved with the business to help Groupe Bull build upon the existing business. Honeywell's graduated exit also provided Groupe Bull with an extended period over which it was able to gradually take control of the business.

If an option to purchase is indeed given to the buyer, the purchase price of the remaining shareholding can be made contingent on how the buyer enjoys the "taste" of the business. For the buyer, this means a reduced risk of being landed a lemon. When INDRESCO, the Dresser spinoff that owned the 50% share in the troubled KDC joint venture, liquidated its share in the company, all it received in consideration from Komatsu was the approximate pro-rata book value of the shares.

However, like most types of insurance, this protection doesn't come free. Making the exercise price dependent on performance can also imply that if the business performs significantly above expectations, the buyer must make a much larger payment for the remaining shares. And yet, such a contract also gives the restructurer a powerful incentive to help ensure that prospective synergies with the buyer's capabilities are indeed achieved. In the examples we have cited above, many buyers have judged the benefits of such deals worth the hefty premiums they may have to pay. Whirlpool paid $381 million in 1989 for 53% of Philips's domestic appliances business, whereas it paid $610 million for the remaining 47% in 1992. Corning received $75 million for 50% of its medical diagnostics business when the Ciba-Corning joint venture was formed in 1985; when Corning sold its remaining 50% share to Ciba Geigy in 1989, it netted $150 million.

Limiting investment in durable organizational structures

Once a joint venture has been established, it requires astute management to unlock all of its potential without also incurring astronomical administrative costs. Intensive communication with executives of both partners can consume considerable time of the joint venture management without yielding commensurate benefits. Conversely, running the joint venture as a vertical hierarchy responsible only to one partner is unlikely to release all the potential synergies of the partnership. Effective management of the joint venture demands careful balancing of the cost of incurring administrative overhead against the benefits gained from it. This has important implications for how the joint venture is operated and managed.

Partners in a transitory joint venture should avoid investing in long-lived organizational structures that may outlive their use. In order to remain lean and yet effective, the corporate parents should select skilled executives who can manage the joint venture with minimal structure. Staffing the joint venture with people who rely on persuasion rather than power, who are comfortable with responsibility without complete authority, and who have the capability to nurture relationships across organizational, geographic, and cultural boundaries, keeps administrative costs of formal coordination down while ensuring that synergistic relationships do develop. Ethnocentric executives, comfortable in clear command and control organizations, do not fare well in joint ventures. Instead, as a Corning executive explains, joint venture managers "rely less on formal power and share more information....(and they are) more conscious of the highly interdependent nature of (their) work."

This advice holds true not just at the level of the middle managers from the two firms that are working in the joint venture, but importantly, at the top of the organization as well. James Houghton,
Coming's CEO, for example, remarks that mutuality of purpose can be ensured by the right informal links at the top level, "I make a point of getting together with the top person from each of our major partners once or twice a year, just to have lunch, and look the person in the eye to make sure our strategic visions match."

Managing the lifecycle of a restructuring joint venture

Even if a restructuring joint venture has been designed effectively, the two partners' involvement in the joint venture may wax or wane over its lifespan. Early in the lifecycle of a restructuring joint venture, both partners generally welcome a high degree of exchange and management involvement. The restructurer wants to demonstrate that its business has real profit potential. It wants to unlock some of that potential quickly, especially if its eventual exit price depends on the performance of the joint venture. For its part, the partner buying in wants to ensure that it gets as much support as possible from the former owner in getting the restructuring kick-started.

If the synergies the buyer is looking for are easily gained and the restructurer can easily demonstrate that the business has the potential it had advertised earlier, then the restructuring joint venture is likely to be harmonious and short-lived (the lower left quadrant in the matrix below). Both parties achieve their objectives quickly with minimal administrative cost and separate amicably.

<table>
<thead>
<tr>
<th>High Difficulty of achieving synergy</th>
<th>Low Difficulty of demonstrating the value of imprisoned assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tension:</strong></td>
<td><strong>Joint struggle:</strong></td>
</tr>
<tr>
<td>Buyer wants joint-management</td>
<td>Long-term struggle to extract value from the joint venture</td>
</tr>
<tr>
<td>Restructurer wants minimal</td>
<td></td>
</tr>
<tr>
<td>interaction &amp; rapid exit</td>
<td></td>
</tr>
<tr>
<td><strong>Harmony:</strong></td>
<td></td>
</tr>
<tr>
<td>Short-lived and</td>
<td></td>
</tr>
<tr>
<td>successful joint venture</td>
<td></td>
</tr>
<tr>
<td><strong>Tension:</strong></td>
<td></td>
</tr>
<tr>
<td>Restructurer wants continued</td>
<td></td>
</tr>
<tr>
<td>involvement</td>
<td></td>
</tr>
<tr>
<td>Buyer wants rapid buy-out &amp;</td>
<td></td>
</tr>
<tr>
<td>independence</td>
<td></td>
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</tbody>
</table>

Such joint ventures may be terminated through exercise of purchase options that have been written ex-ante into the contract (as happened in the Philips-Whirlpool joint venture) or through mutual understanding among the partners to continuously calibrate whether to continue or terminate the joint venture. The Philips-Whirlpool and Honeywell-Bull joint ventures took this route. If most benefits have been realized and it makes sense for the partners not to incur the administrative cost, they can mutually agree to terminate the partnership. The Ciba-Corning and IBM-Siemens joint ventures adopted this approach. Three years after setting up the Rolm Company joint venture, IBM and Siemens determined that the benefit of IBM's active support in marketing and distribution no longer outweighed the cost of duplicating administrative functions in finance, human resources, and accounting, between Rolm Company and Rolm Systems, the manufacturing arm that was wholly owned by Siemens. Siemens bought out IBM's interest in Rolm Company in 1988 and merged it with Rolm Systems. Peter Pribilla, president of Rolm Systems,
remarked on the occasion, "The new structure of one organization, one management, and one vision at the top should help efficiency."

Interestingly, in most of the cases of successful restructuring joint-ventures that we have observed, synergies are quickly apparent and the period for which a business remains a joint venture is about three years. Counterintuitively, a long joint venture may actually imply that the restructuring process is especially difficult or is facing problems. The buyer may need time and continued involvement of the restructurer to reap the potential synergies from the joint venture, while the restructurer also wishes to stay involved over an extended period to ensure that it shares in the full value of what is being created as its once imprisoned assets are combined with the buyer’s complementary capabilities (the top right quadrant of the matrix).

The SKF-Matra joint venture lasted for 5 years as the two partners searched in vain for synergies. In 1986, Scandinavia’s two leading special steel producers, Sweden’s SKF Steel and Finland’s Matra group, formed a 50-50 joint venture, Ovako Steel. Their goal was to integrate operations and then rationalize manufacturing facilities. However, the combination of an absence of any real synergies and recession in the world steel industry stalled the joint venture at the integration stage itself. Finally, after five years of trying and incurring severe losses in the process, the two partners dissolved the joint venture in December 1991, each company picking up its half of the business.

Similarly, it took considerable time and ingenuity for Dresser to dispose of its construction equipment business. Having entered a joint venture with Komatsu in early 1988, Dresser tried over the next four years to realize value from the business. Even as Dresser and Komatsu were investing into joint venture, their dealership networks were being merged, and the joint venture executives were being sent on cultural training programs, in 1991 the construction industry entered its most severe downturn since the contraction of 1944. Finally in 1992, unable to staunch losses in KDC, Dresser spun off its shareholding in the joint venture to a separate company, INDRESCO. John Murphy, Dresser’s chairman, remarked on the occasion, "This is the culmination of a program that has been underway for several years..." It took INDRESCO another two years to sell its stakes in the joint venture to Komatsu. Dresser, and subsequently INDRESCO, had waited fruitlessly in the hope that operational improvements in KDC and better market conditions would increase the valuation of their shares in the business.

It is important to distinguish the above cases from long-term alliances that are sustained by a series of exchanges of mutually complementary resources and capabilities. Corning and Asahi’s long-term relationship illustrates this process of continued renewal leading to longevity of an alliance.

The cases discussed above were instances in which the partners mutually agreed that their joint venture should be terminated. Not all restructuring joint ventures enjoy such a smooth relationship between partners. Tensions often arise because one partner satisfies its goals quickly and wants to wind down the alliance, while the other partner has not yet achieved its objectives and wants to continue. This can happen when it is easy for the restructurer to demonstrate the potential of its business but difficult for the potential buyer to integrate the business’ assets with its competencies (the upper left quadrant in the above matrix). The buyer seeks joint management over an extended period to make sure that it has the restructurer’s fullest assistance in generating synergies. But having shown that it has indeed contributed a business with value, the restructurer is no longer be keen to prolong an arrangement that diverts its attention from other priorities and imposes on it the extra costs of managing the joint venture relationship.

The recent unraveling of the Honda-Rover alliance illustrates such a life-cycle mismatch. Honda saw its taking a 20% share in Rover in 1990 as just another step in cementing a long-term relation it had been
nurturing since 1979. As Honda saw it, Rover was becoming a successful restructuring joint venture with further upside potential: Honda offered Rover its manufacturing prowess in exchange for a cheap entry into the European market and a customer for its engines. But whereas Honda wanted to extract further synergies through continuing this relationship, British Aerospace, the reluctant owner of the remaining 80% share in Rover, was clear that it wanted to exit the car business cashing in its share of the benefits from restructuring thus far. A classic joint venture life cycle mismatch was created.

When British Aerospace turned around and sold its shares to BMW, Honda executives reacted with a mixture of disbelief and anger. British Aerospace's decision, they complained "negated Honda and Rover's long-term efforts..." As they saw it, a business they had been carefully nurturing through a long restructuring had been snatched from under their noses by a global competitor. Differences between the two partners on whether to end the joint venture resulted in the dissolution of a longstanding partnership in bitter animosity.

Here, the restructurer's goals demanded a shorter life for the joint venture than the incoming partner, Honda, was aiming for. But sometimes the situation is reversed – it is the restructurer who seeks to prolong the joint venture despite the additional administrative cost burden that the partners need to share, whereas the buyer wants a short-lived joint venture to quickly gain management independence and lower administrative cost of sole ownership (a situation illustrated in the lower right quadrant of the above matrix). Such a situation arises when a business can be easily integrated by a buyer but the real potential of the business takes a long time to shine through, and it creates life-cycle tensions of its own with the buyer accusing the restructurer of dragging its feet and not letting go and the restructurer accusing the buyer of trying to get rid of it cheaply. When the Ciba-Corning restructuring joint venture was formed, it took some years to establish that Corning's medical diagnostics division could form the core of a viable future competitor in the U.S. market. Corning was not interested in a "quick and dirty" joint venture as a disguised sale. Although it wanted to exit the business eventually, it was prepared to wait until the full potential of the business could be realized and then only to sell its remaining shareholding in the business at a price consistent with its demonstrated value. A different sort of partner than Ciba Geigy may well have become impatient. The Komatsu-Hanomag joint-venture faced just such a problem in 1993. Komatsu was eager to buy out Papenburg's 32% share, whereas Papenburg firmly believed that European recession and initial management difficulties had kept the joint venture from realizing its fullest potential. Negotiations between Komatsu and Papenburg stalled on pricing the shares, and the joint venture continued to uneasily trundle along.

The life cycle of a restructuring joint venture must be cut to fit. Tensions frequently arise between joint venture partners because different partner goals may dictate different life span expectations. In successfully avoiding the traps that may arise in managing the life cycle of the joint venture, three points are key. First, recognize that longevity is not a good measure of success for restructuring joint ventures. Some of the most successful joint ventures will be those that achieve clear synergies quickly, with limited drain on managerial resources, low administrative burdens, and short lives. Second, understand what your goals and your partner's goals imply in terms of on each of your expectations about the life cycle of the joint venture. When will the buyer feel that it has learnt enough about the business to want to cut loose? Is the restructurer looking to quickly demonstrate the worth of the business and then exit rapidly, or is it interested in nurturing the business over a longer period and take a greater share of the upside? If you notice a fundamental mismatch between your expectations about the life cycle and your partner's expectations, go back to the drawing board with the partner and rethink the terms of the joint venture or back away. Third, continuously monitor the potential upside to be gained by persevering with the joint venture beyond the current restructuring project. Are there potential complementarities that you can explore? Does cooperation in sunrise efforts of both partners seem feasible and attractive to both? If the answer is no, it may be in both partners' interest to set in motion a process of graceful disengagement.
Conclusions

After more than a decade of corporate refocusing, most corporations have already culled the proverbial "dogs" from their business portfolios. Today's restructuring challenge lies in releasing the value of non-core businesses with real potential. These businesses are not basket cases — they can bloom with the aid of careful management attention and investment of complementary capabilities. But as corporations are forced to put all of their muscle behind a few core businesses in an increasingly competitive environment, it is inevitable that the non-core parts of their portfolios get starved of funds and resources.

Superficially, the solution to this dilemma seems obvious: sell off any business that is non-core. This approach may work for a low-potential business. But putting an inherently sound business up for sale risks destroying much of its value. Announcing that the business is up for sale frequently raises fears that it will be chopped up and dismembered, undermining staff morale and paralyzing decision making. And consumers, distributors, and suppliers no longer make long-term commitments to a business whose future now seems uncertain.

Notwithstanding these problems, if a corporation does place its non-core business on the block, it risks getting very low bids from potential buyers. If the business has been suffering from underinvestment and management neglect, its current performance is likely to be weak. Potential buyers will quite naturally base their valuation on this performance record. Buyers will always suspect a seller's claims that recent financial performance is a poor guide to the future and that the real value of the business is hidden in intangible assets like brands, distribution relationships, systems, and human resources. Arguing that they risk the intangible assets turning out to be lemons, the buyers are likely to bid low.

These difficulties of realizing the value of a non-core business through simple disposal leaves many corporate CEOs with businesses they no longer wish to focus on but are unwilling to sell either. These businesses end up in a corporate limbo for years, their potentially valuable assets imprisoned. Increasingly however, joint venturing these non-core businesses is providing a viable channel to liberating the imprisoned assets.

Using a joint venture as a restructuring tool has several advantages: restructuring through a joint venture can help avoid the destructive impact of putting a business on the auction block; as a partner in the joint venture, the prospective buyer becomes an "insider" enabling it to assess first hand the true value of intangible assets like brands, distribution networks, people, and systems; and forming a joint venture gives the buyer the advantage of continued management and technical input from the former owner.

The joint venture solution is most effective when the task of untangling the business from the arms of its corporate parent is likely to be slow and complex, where the buyer wants to develop the assets as an ongoing business, when the extra administrative burden of managing the joint venture (compared with sole ownership) can be kept low, and where the partnership has the potential to throw up new, perhaps unforeseen, synergies as the relationship develops over time.

A partnership aimed at easing the pain of restructuring a business and releasing imprisoned assets also needs to be structured and managed differently from the joint venture norm. Some of the conventional rules still apply, but managing a restructuring joint venture requires a change in mindset with regards to other rules of the thumb. The current owner should clearly signal to the prospective partner where the business is underperforming relative to its potential, rather than dress up its current performance to look better than
it is. Ceding management control to the incoming partner so that the business quickly realizes its potential can be to the restructurer's advantage. Most restructuring joint ventures are transitory by design, so the terms of separation can be negotiated as part of the initial deal. Creative terms of joint venture termination include performance-related purchase options rather than fixed price equity splits. The partners should avoid investing in costly long lived organizational structures and should instead concentrate on cultivating their partnership through informal relationships. The partners should recognize and actively manage each other's expectations about the life cycle of the joint venture.

Our overall message is clear: while there is no panacea for the problem of restructuring non-core businesses, too few corporations have as yet recognized just how much joint ventures can help. Faced with today's twin challenges of focusing more behind fewer core businesses while realizing maximum value from non-core activities, more CEOs need to make use of joint ventures as a powerful restructuring tool.