AL23 - Simplifying Joint Ventures

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Abstract

More than half Western World production of alumina, aluminium and iron ore, as well as a significant proportion of copper concentrates, zinc concentrates, oil collected in sub-sea platforms, and LNG processing plants is produced by companies in Joint Venture arrangements. Some have been in operation for more than 50 years, are often complex, have not increased production substantially after the initial 20 years. Cash costs are rising.

This paper uses the aluminium industry as an example as this industry was a leader in the use of Joint Ventures.

Circumstances since formation have often changed considerably. These changes include the rapid increase in non-Western world production, usually by single company arrangements, newer technology that is often replicated; larger initial plants; energy availability; type; costs; and some partners are not adding value to the Joint Venture.

This paper builds on previous papers by the author. It starts with a case study on Joint Ventures established by Comalco Ltd. The paper examines ways to characterize a Joint Venture organization, and options for change that will result in simplification and potential refocus and cost reduction. Many issues involve technology, organization structure and management.

Keywords: Joint Ventures, simplification, partner characteristics, exit strategies.

1. Why Establish a Joint Venture

A Joint Venture (JV) is usually established when the parties have a common objective, but each party does not have the resources or ability or appetite to develop, finance and manage the business with associated business risks by itself. At formation the JV is usually structured to carry out a business in a way that leverages the inputs and minimizes the risks to the parties, or at least allocates the risks accordingly to that party best able to manage them.

The JV Participants Agreement allocates tasks and shareholdings to those who are best able to manage. It also seeks to build on the competitive advantage of the parties. It is generally accepted that JVs, on average, create value for parent firms and that value creation is increased mainly due to synergies and common beliefs of individual participants, but decreased by the inherent tension between co-operative and non-cooperative behavior in JVs [1].

1.1. Changes in JV Circumstances

The tension between some of the parties often increases over time, particularly as the initial leaders depart and changes occur. These changes include the rapid increase in non-Western world production, usually by single company arrangements, newer technology that is often replicated, larger initial plants, energy availability, type and costs, changing Government and community expectations, and some parties not adding positive value to the JV.[2].

Working within a JV is challenging and complex. Some observations on strategy and governance structure, change and working in a JV are discussed in [3-9].

One of the main challenges and decision making of JVs is that three or more boards are involved, often with different company cultures, perspectives and interests. These boards have to agree on fundamental matters such as capital calls, development plans, major budgets and capital spend. It is important for JV parties to agree up front on a clear and coherent strategy for the business and to prioritise in the JV Agreement. An effective project governance process, a workable co-operation framework identifying the matters on which each party will have final say, and to embed a binding and uncomplicated dispute resolution process for any matters where all party decision making is critical.

Many aluminium JVs were established half a century ago. Individually they grew over the first twenty years but little thereafter. Costs have risen up the cash cost curve [6-8].

In the current environment of commodity price volatility, larger capital costs for projects than in China, Russia, and the Middle East, restrictions on capital raising and debt finance, enhanced sovereign risk especially in respect of large scale projects, the limited availability of large blocks of hydro power for expansion, and the drive amongst developers to reduce costs generally leads to a need to consider de-risking and simplifying existing JV structures.

JVs are now held back by the complexity and costs of operating within the JV, the absence of a single owner that has the ability to integrate fully within its own mainstream portfolio, optimization of managerial and technology leadership, substantial overheads and the ability to make unilateral decisions on output to fit market realities.

The natural trend has been a reduction over time in the number of parties in a JV. For this trend to be a win-win some Owners need to consider a serious look at their existing JVs.

2. Comalco, CRA and Rio Tinto as a Case Study

2.1. Early History

In 1949 Zinc Corporation in Britain merged with the Imperial Smelting Corporation Ltd to form Consolidated Zinc Corporation Ltd (CZC) and an Australian subsidiary, Consolidated Zinc Pty Ltd (CZP). A world class bauxite deposit was discovered at Weipa, Australia, by CZP in the early 1950s. A deliberate strategy was developed to grow an international business based on the export of bauxite and growth of that business, as well as a domestic integrated business to produce and sell semi-finished products [10].

In 1960 Kaiser Aluminum and Chemical Corp (KACC) and CZP agreed to form a 50/50 partnership, which later became Comalco Ltd (Comalco). Both parties accepted that Comalco would be Australian based.

In 1962 Rio Tinto Zinc Corp was formed by a merger of CZC with Rio Tinto Ltd London, a company with worldwide metals and metallurgical interests. Conzinc Rio Tinto of Australia (CRA) was formed at the same time, by a merger of CZP with the smaller Rio Tinto Mining Co.

CRA tightly controlled the international business, with KACC supplying technology for alumina, aluminium and downstream semi fabrication.

- Sell the entire JV to a (Government) power supplier
- Spin off some JV(s) into another Company and separate from the main company
- Shut.

6. Conclusion

A case study and a range of assessment tools are provided to assess options to simplify complex JVs.

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