



# BITTER-SWEET JOINT VENTURE RELATIONSHIPS

Lessons in doing business with China

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Set up in 1996, the Wahaha-Danone joint venture (JV) partnership helped establish Wahaha as one of China's best-known brands and became a major contributor to Danone's fast-growing business in China. However, despite the success, in 2007 the companies were embroiled in legal battles and a bitter public feud over Danone's attempt to gain a share of the non-JV Wahaha group companies. In Chapter 16 of the OWP Book 2008, "Riding the winds of global change", (to be published in September 2008), Professor Stewart Hamilton and Research Associate Jinxuan (Ann) Zhang outline key lessons from the dispute.

## 1. Think long term from the beginning

Wahaha, China's largest beverage company, considered itself the majority shareholder of the JV, with a 49% stake. But with a 51% stake, the JV was legally controlled by a foreign company: the Singapore-registered Jinjia, which was equally owned by the French food company Danone and Peregrine, a Hong Kong-based investment company.

While Wahaha had insisted on the management control of the JV from the start, it belatedly realized that the ownership was equally important. In 1998, just before Peregrine collapsed following the Asian financial crisis, Wahaha discovered that Danone had bought out Peregrine's interest in Jinjia and so "taken over" the JV. Wahaha felt that Danone had misled it from the beginning, which may have sowed the seeds of future resentment.

## 2. Seek a valid and strong legal basis

The basis for the JV was the transfer of the Wahaha trademark to the JV; however the Chinese trademark authority did not approve the transfer.

The JV should have been contingent on the trademark transfer, giving Danone the right to terminate or restructure the agreement if the approval was not granted. Instead Danone proceeded and gained the JV the exclusive rights to use the Wahaha trademark by getting around the regulatory barrier through a trademark license agreement. Exceptions were also granted that allowed the non-JV products and Wahaha group companies to use the trademark. Had Danone terminated the JV then, the dispute on the trademark ownership could have well been avoided.

### **3. Define your role – “passive investor” or “active majority owner”**

Danone was initially a passive investor in the JV, letting Wahaha run the daily businesses. Zong Qinghou was both the Chairman of the JV and the Managing Director of the Wahaha holding company – notably the non-JV Wahaha companies. It's possible that the dispute outcome may have been more in Danone's favor if it had exercised more control in the JV's daily operations from the start.

### **4. Treat others as you would like to be treated**

One of Danone's claims was that Wahaha had breached non-competition obligations in the JV agreement – yet Danone had partnered with all major industry leaders in China, including taking over Wahaha's closest competitor Robust in 2000, despite strong objections from Wahaha. A fierce price war waged by Robust following the takeover hurt both companies financially.

### **5. Share both risks and growth**

To cultivate a win-win partnership, foreign companies need to share not only the rapid growth of the Chinese market, but also the risks associated with it. Zong maintained that Danone was not prepared to do this, refusing to invest more but then wanting in when new ventures made money.

### **6. Understand and respond to political, economic, cultural and social changes**

To operate successfully in a changing environment, companies need to understand the implications of the changes and mitigate or allocate the associated risks through contractual arrangements.

In this case, China's reform of state-owned enterprises saw Wahaha transform itself from being 100% state-owned to being majority-owned by Zong and Wahaha employees. In addition, the concept of non-competition was almost non-existent a decade ago but by 2003 Zong had extended the Wahaha brand into other businesses by setting up new companies. Danone did not immediately question these changes; however relevant clauses should perhaps have been included in the JV agreement in the event of material changes.

## 7. Ensure you have a legitimate claim

Danone argued that Zong had breached the JV agreement by setting up competing non-JV companies, so it had the right to claim a 51% share of these companies. It is impossible to judge whether the claim was legitimate, but it raises several questions on Danone's contradictable actions. The non-JVs had existed since the day the JV was formed, so why did Danone only raise the issue ten years later? If the claim was legitimate, why did Danone first offer to pay \$544 million for a 51% stake in the non-JVs instead of taking immediate legal action? On Wahaha's side, why did Zong initially sign an "agreement" for this acquisition only to reject it shortly afterwards?

## 8. Be sensitive when handling public relations

While neither Zong nor Danone made the internal discussions public – it was done by a journalist – the story generated a heated public debate, then escalated. Supporters of Zong echoed his sentiment of wanting to protect the national brand against a monopoly owned by multinationals. Critics stressed that the situation should be handled in a purely commercial manner.

Danone's aggressive and hostile approach – which included a personal attack on Zong and his family – served to invoke questions of patriotism and led to questioning of an "unfair relationship." Had Danone instead issued a statement after the story broke to calm things and keep the dispute internal, events might have played out differently.

## 9. Think about the consequences before taking legal action

Danone lost most of the cases it took to court. Not only did it not get what it wanted, but the legal battle had major ramifications. The distributors supported Zong and called for a boycott of Danone products; the labor union joined the legal fight against Danone out of fear of job losses; and the dispute may also have scared other Chinese partners away.

Did Danone have any back-up plans if it did not win? Even if it had won, would it have been able to win the loyalty of Wahaha's employees and carry on the businesses?

## 10. Endeavor to understand both the Chinese and the international perspectives

Western companies need to understand the Chinese perspective, which often goes beyond pure business considerations. Conversely, Chinese executives and managers need to adopt international business practices and a global mindset, and develop good communication channels to increase transparency and avoid unnecessary misunderstandings.

### Summary

There is no magic recipe for a successful long-term partnership, but sticking to simple principles will help. Danone and Wahaha actually laid out these principles in a joint statement released at the end of 2007: “equality and mutual benefits, seek common ground by tolerating minor differences, reach mutual understanding and strive for success...” Had both parties worked with these principles from day one, perhaps the partnership would never have become troubled.

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