Leveraging Kemica

A Case Study in Affiliate Funding via Inter-Company vs. Stand-Alone Financing
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Abstract

Energy joint ventures often are formed by financially strong shareholder groups. When occurs, the preferred financing strategy is for each shareholder to provide "its own share" of venture financing. This strategy allows each company to raise money using its lowest cost options, and to provide those funds to the venture in an efficient, tax-effective fashion. Such shareholder funding strategies thus offer cost advantages over having the venture raise its own financing. At times, however, other reasons suggest that venture self-funding may be advisable. Kemica Pty. offers one such possibility. It is an underperformer of long standing; it also has serious labor issues and a somewhat complacent management. Should FlaglerMissol and its partner surrender the benefits of shareholder fund by "leveraging Kemica" with 3rd party funding?

To assess this case, students will first have to quantify the cost advantage of the shareholder funding strategy. The case provides guidance and assumptions for doing so. The more challenging aspect involves putting a value on the "intangible" benefits of 3rd party funding. The case discusses these in non-quantitative terms. Students will have to make assumptions and devise means to express these benefits quantitatively. The hardest part will then involve comparing known, "hard" shareholder financing benefits with the less certain gains associated with bank funding. Students will want to see such gains amounting to several multiples of the shareholder funding benefits before accepting the risk that these gains might not materialize.

This case is based upon financing decisions made in 2000 for a petrochemical joint venture in Australia.