Joint Ventures

A joint venture (JV) is an undertaking by two or more persons who contribute assets and services to carry on a single business enterprise, which is formed as a separate legal entity, jointly owned and managed by the venturers. A JV is able to combine the strengths, expertise, technology and know-how of separate businesses with the additional benefits of sharing investment costs and risks. Where the JV involves the pooling of resources of two or more enterprises from different national, cultural and business backgrounds, it is referred to as an International Joint Venture. It is JVs of this latter kind that this article will seek to expound on.

A typical JV would involve the following parties:

1. A foreign investor; normally a private multinational company.

2. Local investor; usually a state owned enterprise or private company.

3. Lending agencies; official multilateral or regional lending and development agencies, which may lend or guarantee debt where such facility is required.

Joint ventures are usually entered into due to the following benefits that accrue from them

• The ability to share resources and risks. JVs can be particularly useful in industries where research and development requiring substantial initial costs is to be embarked on,

• The satisfaction of host government requirements,

• To offer assistance in overcoming strong nationalistic tendencies.

• To facilitate quicker entry into a foreign market with which one of the venturers has no familiarity.

However, JVs suffer from the following setbacks:

• Transactions leading to the formation of JVs take a long time and are costly owing to the numerous issues that should be taken into account.

• Operational and management disputes which often arise especially where intricate issues are to be dealt with.

Typical procedure for the creation of a joint venture

Although the issues raised in relation to the creation of JVs vary from one project to another, there are certain basic matters, which generally arise due to the concept of a joint venture. These issues can be classified in accordance with the stages of the venture at which they are bound to arise.

Pre-Contractual Phase

As a first step to a JV, a feasibility study of the proposed project is usually undertaken in order to make definitive findings on marketing, economic and financial viability. The study serves to give important insight on issues relating to capitalisation, financing, investment incentives, and royalty payments for transfer of technology, management and performance requirements.

At this stage initial discussions would normally be held between prospective JV partners. These discussions are not founded on any contract and therefore do not have the character of formal legal negotiations. During this time it is also essential that each prospective venturer carries out a due diligence search on it's co-venturer which sheds light on matters relating to financial and business track records. This phase, if well carried out, will ensure the avoidance of conflict of objectives and interests between parties to a JV. A common instance of conflicts include where a host enterprise is primarily interested in acquiring technology of a foreign co-venturer through licensing agreements while the foreign company views any long term licensing agreement as an irretrievable step towards the surrender or loss of its technology.

Where the pre-contractual phase is well conducted such conflict will be promptly discovered and attempts made to reach a suitable compromise.

Contractual Phase

This marks the onset of full-scale negotiations on the finer aspects of the JV. At this stage the parties will normally reduce their prior agreements into a Memorandum of Understanding by which they will seek to build in a confidential and noncircumvention clause, which will provide an exclusive negotiation period during which the parties are bound to the negotiations and cannot negotiate with any other parties. Careful conduct of this phase is imperative since a successful JV requires precise and unequivocal articulation of common objectives and a mutuality of interest.

This phase also sees a final determination on the structure of the proposed JV. In this regard, a JV may be organised as a corporation where the ownership of capital in the corporation has to be determined and agreed. This is the most common JV and gives rise to an Equity Joint Venture. A JV may also be Non-equity or Contractual Joint Venture which involves an agreement entered into by parties to a joint venture who may be driven by considerations such as taxation implications, which are sometimes adverse to foreigners seeking to invest in a country other than their country of origin.

During this phase, the contract that is eventually drawn up will normally take into account all manner of peculiarities that may be provided by the circumstances of the case. For instance, it is normally the case that where JVs have the government as one of the venturers, directors appointed by the government to the newly established board of the JV will owe their appointment to political patronage rather than to any expertise or competence. Many times they cannot therefore be effectual in management and supervision of the interests of foreign JV partners. In view of this peculiarity JVs will sometimes comprise of a multiplicity of agreements relating to managemnt in addition to the main JV agreement. Other forms of agreements that may seek to cater for peculiarities in a JV are, agreements on marketing, supply of parts and components, technology transfer etc.

In a nutshell a JV agreement should provide for the following:

1. **The major goals of the partners.**
This will state the products or services that are to be dealt in, the markets and customers to be served

2. **Contributions of each partner**. Such contributions may

take the form of capital, product know-how, patents and trademarks, technical assistance and training, management development etc.

3. **Responsibilities and obligations of each partner.**

4. **Equity ownership of the partners**

5. **Capital structure**. This refers to the proportion of equity capital, loan capital, future increase in equity capital etc.

6. **Management.** This deals with issues of the appointment, composition and authority of the board of directors. It also deals with appointment and authority of executive officers. It further deals with the organisation, strategic and operation planning, information system and control procedures.

7. **Supplementary agreements**. These are agreements entered into separately from the main JV agreement owing to peculiarities in a JV.
They may include agreements on licensing and technology, management and technical service etc.

8. **Managerial policies**. This refers to policies in relation to declaration of dividends and re-investment of earnings. It also involves, major marketing programmes including product lines, trademarks, brandnames, distribution channels, pricing, service and expenditures. Other policies include those in relation to export markets and commitments and executive compensation.

9. **Accounting and Financial statements**. This will embody decisions on issues such as the currency to be used in financial statements and the mode to be adopted in their audit and review.

10. **Settlement of disputes**.
Inclusion of Alternative Dispute Resolution in contracts is of great importance particularly in countries like Kenya where litigation via the judicial system is expensive in terms of time and money.

11. **Legal matters**

In this regard the following should be borne in mind:

• Local laws, regulations and policies that will govern the operations of the organization to be formed.

• Government approvals requirement.

• Articles and by-laws of incorporation.

• Anti-trust considerations.
(In the Kenyan context the provisions of the Restrictive Trade Practices, Monopolies and Price Control Act.)

• Tax laws and considerations

• Selection of legal counsel

Once a contract is drawn up taking into account relevant aspects from those stated above, then the intricate part is complete and other aspects of a JV are quite similar to those of normal business enterprises.