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Important considerations when entering into a joint venture

By Geoffrey E. Odongo

A joint venture is a contractual business undertaking between two parties or more where the parties pool, exchange and/or integrate their resources with a view to realizing profit and mutual gain. Parties to a joint venture must consider certain important factors before entering into a joint venture in order to minimize the risk of things going awry.

Below are some of the factors that the parties to a joint venture must bear in mind:

Due diligence

Conducting due diligence on any potential partner is one of the top considerations for any party considering entering into a joint venture. A party's reputation is always tied to their business partners' reputation. The wrong partner can undo several years of goodwill already accumulated by a business. Parties should therefore consider undertaking an investigation of the credentials of their business partners to ensure that there are no hidden surprises that could affect the joint venture adversely. Such investigation may include reviewing financial records, ascertaining the availability of disclosed assets and even human resource that the potential partner intends to bring into the joint venture.

A party that is conducting due diligence on another should also assess their readiness for a joint venture. Meaning that before committing into the joint venture one must gauge their strengths, weaknesses, opportunities and risks in order to ascertain how these will impact the intended joint venture.

Structure of the Joint Venture

The choice of structure is usually driven by tax considerations, purpose of the joint venture, as well as ease of transacting. Depending on the above factors, the joint venture partners may opt to either use a contractual agreement to govern their relationship while retaining their independent status or use a joint venture vehicle which usually takes the form of a limited company, partnership or limited liability partnership (LLP).When properly constituted, a joint venture can be a highly profitable business entity.

Contributions and distribution of profits

Parties to a joint venture generally contribute cash or assets to fund the business of the joint venture and in return receive a proportionate interest in the venture. It is important for the parties to agree on initial mandatory capital contribution as well as the additional contribution that may be needed. If any capital contributions are in the form of assets, the joint agreement should provide for a procedure for valuation of the non-monetary contributions. The joint venture agreement should make provision for mode of distribution of profit arising from the joint venture. The most common method of profit distribution is by way of dividends, loan interest, management fees and license fees.

Management and control of the joint venture

For any joint venture to be successful, the parties must consider how the joint venture will be managed. Management is generally determined by the capital contribution or level of shareholding of the partners in the joint venture.

Documentation and confidentiality

Once the parties are ready to enter into the joint venture it is prudent that they reduce their agreement in writing.Thissafeguards the interest of the parties. Moreover, like any other business entity, records of statutory compliance such as tax certificates, registration documents, memorandum of understanding, financial statements and audit reports must be maintained at all times for both legal and compliance purposes.

This is because accurate records are important in resolving disputes between joint venture partners. Parties to a joint venture may also wish to consider putting in place a system of confidentiality agreements so that any privileged information disclosed in the course of negotiating, setting up, and operating the joint venture are not later used to any of the parties' disadvantage.

Dispute resolution and exit strategy

Breaches are a high probability in every agreement and therefore parties to a joint venture should carefully consider dispute resolution mechanisms.The joint venture agreement should provide for either arbitration or mediation, establish the jurisdiction, applicable law and the venue or forum for resolving disputes. The agreement should also provide for practical means of resolving minor disputes to avoid breakdowns in trust, which can ultimately lead to the dissolution of the joint venture.

If the dispute cannot be resolved,the parties to a joint venture agreement should make provision to cover for deadlocks including the termination of the joint venture or the exit of one partner from the joint venture. The agreement should specify the types of events that will trigger dissolution or a buy-out of the defaulting party's interest by the non-defaulting partner.Usually, a termination done without consent may lead to protracted and costly litigation. The joint venture agreement should also document how and when a party may transfer its interest and if there are to be pre-emptive rights that allow an existing partner the opportunity to purchase the interest of the exiting partner.A neutral valuer can be used to evaluate the leaving member's fair share of the business if the parties are unable to agree.

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Geoffrey E.Odongo is the Managing Partner at Ameli Inyangu & Partners Advocates specializing in Company Law, Employment & Conveyancing