

23 February 2009

Series on Intellectual Property Issues: Part 35

What are the advantages and disadvantages of participating in a joint venture with another company?

Joint ventures

Joint ventures can prove to be a useful and necessary way to enter new markets. In some markets that restrict inward investment, joint ventures may be the only way to achieve market access. Within joint ventures, clear equity positions are usually taken by the participants. Such holdings can vary in size significantly, although it is usually important to establish clear lines of management control over decisions in order to achieve success. A lesser form of participation, which may or may not involve equity participation, is that of strategic alliances. Joint ventures do tend to have a relatively high failure rate. Nonetheless, they also enjoy a number of specific advantages.

Advantages of joint ventures

- ❑ Joint ventures enable companies to share technology and complementary IP assets for the production and delivery of innovative goods and services.
- ❑ For the smaller organization with insufficient finance and/or specialist management skills, the joint venture can prove an effective method of obtaining the necessary resources to enter a new market. This can be especially true in attractive markets, where local contacts, access to distribution, and political requirements may make a joint venture the preferred or even legally required solution.
- ❑ Joint ventures can be used to reduce political friction and improve local/national acceptability of the company.
- ❑ Joint ventures may provide specialist knowledge of local markets, entry to required channels of distribution, and access to supplies of raw materials, government contracts and local production facilities.
- ❑ In a growing number of countries, joint ventures with host governments have become increasingly important.

These may be formed directly with State-owned enterprises or directed toward national champions.

- ❑ There has been growth in the creation of temporary consortium companies and alliances, to undertake particular projects that are considered to be too large for individual companies to handle alone (e.g. major defence initiatives, civil engineering projects, new global technological ventures).
- ❑ Exchange controls may prevent a company from exporting capital and thus make the funding of new overseas subsidiaries difficult. The supply of know-how may therefore be used to enable a company to obtain an equity stake in a joint venture, where the local partner may have access to the required funds.

Disadvantages of joint ventures

- ❑ A major problem is that joint ventures are very difficult to integrate into a global strategy that involves substantial cross-border trading. In such circumstances, there are almost inevitably problems concerning inward and outward transfer pricing and the sourcing of exports, in particular, in favour of wholly owned subsidiaries in other countries.
- ❑ The trend toward an integrated system of global cash management, via a central treasury, may lead to conflict between partners when the corporate headquarters endeavours to impose limits or even guidelines on cash and working capital usage, foreign exchange management, and the amount and means of paying remittable profits.
- ❑ Another serious problem occurs when the objectives of the partners are, or become, incompatible. For example, the multinational enterprise may have a very different attitude to risk than its local partner, and may be prepared to accept short-term losses in order to build market share, to take on higher levels of debt, or to spend more on advertising. Similarly, the objectives of the participants may well change over time, especially when wholly owned subsidiary alternatives may occur for the multinational enterprise with access to the joint venture market.
- ❑ Problems occur with regard to management structures and staffing of joint ventures.
- ❑ Many joint ventures fail because of a conflict in tax interests between the partners.