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Joint Ventures for Business Growth

by **Seanna Mulrean**

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Are you seeking to develop and grow your business?

Perhaps there are certain roadblocks or barriers preventing your business from moving to the next stage. In this article we explore how a joint venture might work as a mechanism in assisting businesses to achieve their growth goals.

What is a Joint Venture?

It's not a legal term of art but can be defined as:

An arrangement between two or more parties who pool their resources and/or existing know-how and collaborate in completing a project or carrying on a business activity with a view to achieving a particular objective.

A fundamental feature of a joint venture is collaboration between the participants. Each participant is bringing something to the party, whether that is know-how, skilled employees, assets (for example, intellectual property or infrastructure) or simply funding.

Why would a company consider a joint venture?

There are many features of joint ventures which make them attractive to businesses. These include the following:

- A joint venture arrangement can offer a more cost-efficient means of expanding the scope of their business activities allowing them, for example, to expand their customer base.
- A joint venture can facilitate diversification, enabling participants to enter new and emerging markets by collaborating with a party which has the relevant skills or an existing customer base within that market.
- Joint ventures can be a driver for innovation. Parties may use a joint venture arrangement to collaborate in research or the development of new technology.
- The benefits of being able to share the costs of and risks associated with a particular business activity or project.
- There can also be legal and regulatory advantages where international businesses partner with existing local companies.

Types of Joint Ventures

There are two main categories of joint ventures:

1. Incorporated joint ventures.
2. Commercial alliances or non-incorporated joint ventures.

The key features of each can be summarised as follows:

Incorporated

A separate legal entity is created. Typically, in Ireland this entity will be a private company limited by shares. The joint venture participants hold shares in the joint venture entity in the agreed proportions and the arrangements and legal relations between the parties will be governed by a Shareholders' Agreement and Constitution. Other legal documents such as an asset transfer agreement, subscription or loan agreements may also be required at the outset. This will depend on what initial funding and/or assets each participant shall contribute to the joint venture and how the joint venture is to operate its business once established.

Unincorporated

No separate entity is created. The terms of the joint venture arrangement are simply documented in a commercial contract. Examples include the following:

- Research and development agreement
- Joint marketing agreement
- Joint manufacturing agreement
- Consortium agreement

There are several factors which should be considered when choosing which type of joint venture to proceed with.

An **Incorporated Joint Venture** would be more appropriate in the following circumstances.

- The business objectives require a high degree of integration and commitment. An incorporated joint venture provides a firmer basis for an internal management and employee structure.
- The intention is to establish an ongoing business. The joint venture company survives as the same legal entity irrespective of changes in share ownership, so for example, if one of the shareholders were to exit the joint venture, the business could continue with the remaining shareholder(s) and with no disruption to the business or its customers.
- The joint venture requires flexibility as to how it is financed and may seek funding from third parties. As an incorporated legal entity the joint venture can hold assets in its own name and give security.

An **Unincorporated Joint Venture** might be more appropriate in the following circumstances.

- A lesser degree of integration between the parties is required. It is easier to unwind and terminate an unincorporated joint venture agreement than it is to wind up or exit from a shareholder arrangement.
- In the context, for example, of a development or infrastructure project where the parties are coming together to tender for and complete a specific contract, such as a large-scale infrastructure project, it might be more appropriate to form a consortium (a form of unincorporated joint venture). This is particularly important during the period where it is still uncertain as to whether the joint venture will be successful in its tender for the relevant contract.

Key to Success?

Carefully constructed joint ventures can be very successful and there are a number of these which are well known globally. Examples include Sony Ericsson, or Google and NASA collaborating to develop Google Earth. Ideally joint ventures are born out of a relationship of trust and confidence, where both parties are equally committed and jointly motivated to act in the best interests of the joint venture.

There are of course certain inherent risks with entering a joint venture arrangement. There is always the risk that one party may seek to act opportunistically in its own self-interest. The degree of each partner's reliance on the other's skills can change significantly over time, sometimes eliminating the need for a shared management joint venture or indeed for any venture at all. The learning process can naturally weaken the desire of companies to retain their joint venture arrangements. The frustrations in sharing power may no longer be balanced by the view that despite such difficulties the venture is worthwhile.

These risks can however be managed and reduced. It is important that they are considered at the outset and carefully addressed in the relevant shareholders' or joint venture agreement. The following are examples of protections that are typically incorporated into a joint agreement:

- Clear delineation of the parties' contractual responsibilities.
- Restrictions and protections against the misuse of confidential information.
- Non-compete and non-solicitation of employee's provisions.
- Appropriate contractual remedies for breach of joint venture obligations such as:
    - Rights of termination.
    - Default remedies and mechanisms to ensure a clean exit if one or all of the parties find themselves in a position where the joint venture arrangement is no longer workable or commercially viable.

At LK Shields Solicitors LLP we regularly advise clients on the structuring and establishment of joint ventures. Joint ventures are becoming increasingly significant as a form of strategic business alliance and growth. We expect this trend to continue as more companies consider them as a means of leveraging their expertise and resources and to achieve business goals. If you are interested in learning more about how a joint venture might work for your business, please do not hesitate to contact Seanna Mulrean at smulrean@lkshields.ie.

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