JOINT VENTURE CONSIDERATIONS

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Joint Venture

WHAT IS A JOINT VENTURE?

The term "joint venture" is more a term of art than a legal concept. Joint ventures have been described by the courts as an association of two or more persons, in the nature of a partnership, to carry on a business enterprise for profit. A joint venture is not required to be a legal entity. Consequently, the variety of forms through which joint ventures are conducted runs the gamut from implied contracts to more formal partnerships, limited liability companies, and corporations. The choice of form is dependent on several factors including liability and tax considerations.

The general attributes of a joint venture are as follows:

- The joint participation of two or more entities in a specific activity with a common strategy involving the pooling of some of their resources for mutual gain
- The retention by the participants of their individual identities
- Either an arrangement by contract or the formation of a legal entity that serves as the vehicle through which the joint venture is conducted

WHY FORM A JOINT VENTURE?

Joint ventures are entered into for many reasons. In the establishment of a new product, a joint venture may be a good way to share the costs and risks. For example, a company with a new product or technology may lack the resources for manufacturing or distribution. Additionally, a company looking to expand may seek out a joint venture partner with existing platforms in new geographic markets. In the entertainment industry, joint ventures are often used to marry content with distribution.

ADVANTAGES

Joint ventures offer a flexible operational structure that can be tailored to the participant's needs. Often, limited liability companies are used as the joint venture entity because they offer a very flexible governance and capitalization platform. Limited liability companies have legal personality.

Joint ventures offer a way to achieve strategic goals with less risk to one individual party, and unlike an acquisition, a joint venture may offer significantly lower cash or equity exposure.

DISADVANTAGES

As with most business arrangements where risk is shared, in a joint venture the upsides and opportunities are shared along with the downsides and risks. Control is also generally shared, although to what extent is determined depending on the relative bargaining power of the parties.

A potentially sizeable disadvantage of forming a joint venture is the inherent agreement to restrict future activities. This, to an extent, goes with sharing the upsides, but most joint venture agreements also limit co-venturers from competing with the joint venture entity. The parties also typically agree that they will only conduct the business (as defined) through the joint venture entity, and that if any business opportunity is brought to their attention that fits within the scope of the business, the opportunity must be offered to the joint venture. Typically, the joint venture agreement will allow the entity a certain time period to decide whether to take up the opportunity and may allow the party bringing the opportunity to the joint venture the right to pursue it on a standalone basis if the co-venturer passes up the opportunity.

STRUCTURAL CONSIDERATIONS

As mentioned earlier, there are a variety of forms that can be used in the joint venture context. Separate and apart from the form are the mechanisms for control over the entity and the allocation of responsibility for day-to-day management. For example, if a limited liability company is chosen, the members will decide whether the company will be “member managed” or whether one member will be the “managing member.” If a managing member is appointed, the members will then determine the extent of the powers given to that office and whether the parties will want veto power over certain decisions.

It is also important to clearly establish the purpose and scope of the venture. This will clearly delineate the activities that fall within the venture. It also may serve to avoid later conflict if a party’s business objectives change over time.

Care must be taken in preparation of the joint venture documents. Joint ventures require mutual trust, and the disclosure of commercially-sensitive information may be required in order to further the aims of the joint venture. The mechanics of disclosure must be discussed early in the negotiations leading up to the relationship. The goals of the venture must also be clearly identified to avoid an unpleasant discussion should the parties discover that they have divergent goals.

Individuals within each organization must be identified as responsible for ongoing issues. At the outset of a joint venture, there is typically a great deal of interest within each organization. It is not uncommon for the interest level to decline with time, leaving the joint venture managers with unclear reporting lines. When this occurs, the entity is unable to cope quickly with unexpected occurrences.

A joint venture can be an effective way to increase growth in a business when one does not have the capability to achieve a goal or goals on a standalone basis. It is essential to find a joint co-venturer with complimentary capabilities and a similar vision. As in all business alliances, the benefits must be carefully weighed against the challenges of operating under such a business model.