JOINT VENTURES: AN OVERVIEW OF INTERNATIONAL AND INDIAN SCENARIO

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"You can get into any business by leveraging Joint Ventures"

-Ehab Atalla

Introduct

Joint Venture is a popular method to enter a country whose legal and business environment is unknown. A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity. In a joint venture (JV), each of the participants is responsible for profits, losses and costs associated with it. However, the venture is its own entity, separate and apart from the participants' other business interests.[1]

A joint venture (JV) is a business entity created by two or more parties, generally characterized by shared ownership, shared returns and risks, and shared governance. The concept of "operating joint ventures" has come to be accepted which can be defined as a partnership through which two or more firms create a separate entity to carry out a productive economic activity in which each partner takes an active role in decision making.[2]

Joint Venture requires a community of interest in the performance of the subject-matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses.[3] According to Words and Phrases[4], a joint venture is an association of two or more persons to carry out a single business enterprise for profit. Based on these definitions, essential features of Joint Ventures are:

- An agreement between parties on common business objectives.
- A pooling by parties of their resources.

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[1] http://www.investopedia.com/terms/j/jointventure.asp
[2] Hanigan, K.R. 1988. Joint Ventures and Competitive Strategy. Strategic Management Journal, 9: 141-158
[3] Black's Law Dictionary, 6th Edn., p. 839
[4] Permanent Edn., Vol. 23, p. 117

- A characterization of the pooled assets as capital contributions.
- Pursuance of the agreed objectives through management different from that of the parties.
- Sharing of profits between the parties.

Many companies find it profitable to use Joint Venture as a method to expand their business to counter governmental barriers. These barriers could be characterized as trade barriers, investment barriers, restrictions on repatriation of earnings and regulatory and tax barriers. As a result, there is a massive emergence of Joint Ventures globally.

The term "joint venture" has not been defined under any Act or legislation for the time being in force in India. However, the Hon'ble Supreme Court of India, in the case of *Faqir Chand Gulati vs. Uppal Agencies Pvt. Ltd. and Anr.* [(2008) 10 SCC 345][5] dealt with the issue of whether an agreement under which the builder agreed to make a housing construction for the land owner was a "collaboration agreement or a joint venture", or the activity of the builder squarely fell within the trappings of the definition of "service". It was observed by the Hon'ble Supreme of India that the title or caption or the nomenclature of the instrument/document is not the determining factor as regard the nature and character of the instrument/document and the true purpose of a document has to be ascertained with reference to the terms of the document, which express the intention of the parties. As such, the Apex Court made an attempt to define the term "joint venture" and held that the expression "joint venture" connotes a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit or an association of persons or companies jointly undertaking some commercial enterprise wherein all contribute assets and share risks.

Therefore, the use of the words 'joint venture' or 'collaboration' in the title of an agreement or even in the body of the agreement will not make the transaction a joint venture, if there are no provisions for shared control of interest or enterprise and shared liability for losses.

Further, the nature of Joint Ventures will depend to a great extent on its own underlying facts and characteristics and on the resources and wishes of the involved parties. Overall, a Joint Venture

[5] *Faqir Chand Gulati vs. Uppal Agencies Pvt. Ltd. and Anr.* [(2008) 10 SCC 345]

may be defined as a systematic business alliance between two or more entities whereby they put to use, their pooled sources.

From the point of view of organisation, joint ventures can be established in two forms:

- Equity Joint Ventures.
- Contractual Joint Ventures.

Background

Global proliferation of commerce and business has given an international dimension to Joint Ventures. Companies across the world seek cross-border alliances to share the resources, opportunities and potential to deliver competitive performance. Let us now examine different aspects of Joint Ventures under respective heads.

A. Motives Behind Forming Joint Ventures

Joint Ventures yield benefits to the Joint Venture partners by offering them a platform to achieve their business goals which would have otherwise been difficult and uneconomical to do independently. The changed international business scenario has opened up a lot of challenges and opportunities. Many enterprises enter a Joint Venture due to the following reasons:

I. Sharing Liabilities

In a Joint Venture, two or more enterprises pool their resources to attain a pre-determined purpose. Therefore, what would have been difficult for one entity to afford can be afforded jointly by pooling of resources of two or more enterprises.

II. Countering Barriers

There exist different categories of barriers while conducting a business and it is for this reason why enterprises prefer Joint Venture. In a Joint Venture project, the enterprises are able to avoid governmental barriers. These barriers could be characterized as trade barriers, investment barriers, restrictions on repatriation of earnings and regulatory and tax barriers.

III. ***Market Access:*** Joint Ventures are efficient for gaining access to different markers. In the case of a cross-border JV, where it is difficult for a foreign company to penetrate the market or where the local law limits the ownership structure by foreigners, JV is desirable**.**

IV. ***To Access Skills and Capabilities***

In a Joint Venture, different enterprises have access to the manpower, skills, capital resources of each other's enterprises. Further, Parties to a JV may have complementary skills or capabilities to contribute to the JV.

V. ***Fulfilment of Complementary needs***

Joint Ventures are appropriate when complementary needs exist between firms and when partners' strategy are compatible, thereby ensuring an effective degree of co-operation and commitment when a company wants to expand into a field or market alien to it.

Therefore, these are the various possible motives behind establishing joint ventures. However, in any case, a joint venture is formed because of mutual need of two or more enterprises.

B. Kinds of Joint Ventures

While forming a joint venture the entities shall recognise their needs and how they need to govern with each other in future or how their entities should run for that they should have a decisive plan and formalise the collaboration with great intent and knowledge on what form of their joint venture would be beneficial for them.

Joint ventures take many different forms and structures. AS 27 identifies three broad types –

1) jointly controlled operations
2) jointly controlled assets
3) Jointly controlled entities - which are commonly described as, and meet the definition of, joint ventures.

The first 2 type of joint venture are those in which different entities join forces and work accordingly to the contractual agreement, but they do not join hands to form a new entity having a distinct legal personality with its own name and to govern its own functions.

- ***Jointly Controlled Operations***

In this type of joint venture, the venturers come together with specific aim and goal to increase their profit and they function accordingly to that goal only.

This type of joint venture does not have too much risk and the profit maximization is also comparatively low than jointly controlled entities and jointly controlled assets, about which we will discuss later.
In jointly controlled operation's companies increase their financial capacities and production usually more than normal for particular aim which is in accordance with the contractual agreement between the parties .These venturers operate on their own with their own resources ,own assets and incur liability separately which represents their own obligations towards the joint venture.

The agreement spells out in what manner would the venturers pool in their resources and how they would entail the profit .Although for the interest of joint venture every venture should make a separate financial statement about its assets and liabilities that it has incurred and secondly the expenses that has been accrued for the share of income that has been earned from the joint venture. However, separate accounting records may not be required for the venture and financial statement in turn need not be proper as these are not to be filled with competent authorities.
An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise in order to manufacture, market and distribute, jointly, a particular product such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venture bears its own cost and takes a share of the revenue from the sale of the aircraft, such share being determined in accordance with the contractual agreement.

- ***Jointly Controlled Assets***

When entities agree to come together into a joint venture but in turn do not find a valid reason to form a new entity for the sole purpose of joint venture, then they can also use this type of joint venture.

In this the entities pool in their resources either to buy assets or pool in their existing technology ,machinery and other inventory which is required for work .So in this the entities pool in their resources for assets upon which they rely to increase their turnover and for functioning as per needs of the company.

Venturers receive agreed output from the assets which is in question and they incur a certain amount of expense on it which is agreed upon by the contract. This joint control over assets or their ownership of the assets either by 1 or more by different entities help the Venturers deriving economic benefit for their own.

An example of a jointly controlled asset is an oil pipeline jointly controlled and operated by a number of oil production companies. Each venture uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two enterprises jointly control a property, each taking a share of the rents received and bearing a share of the expenses in respect of its interest in jointly controlled assets.

- ***Jointly Controlled Entities***

This type of entity is different in some manner to the previous mentioned types and similar in other sense as well the similarity and differentiation will be clear after following passage:

In this type of joint venture the entities form a new corporation and this establishment is done after agreement parties on the account of different stakes the entities would have in the new incorporated company. As this joint venture pertains to incorporation of new entity, the entity would work according to the contractual agreement between the entities on how to govern the company, control its assets, and incur liability and any expense incurred on the name of the joint venture so as to accomplish the sole motive which is to earn income from it.

The new incorporated company may enter into contract on its own name, as well as raise finances for working of joint venture and through this each joint venture gets an entitlement. It is similar to jointly controlled assets and operation, as they may also transfer formerly controlled assets into the entity and similarly jointly controlled operation are also there for establishment of assets, marketing and distribution. Example of a jointly controlled entity is when two or more enterprise commences business in a foreign country in conjunction with the government or other agency in that country, y establishing a separate entity which is jointly controlled by the enterprise.

C. International Joint Ventures

International Joint Venture is the creation of a new legal entity by two or more partners of different nationalities. As the globalization of world markets continues unabated, international enterprises seek to explore and develop capabilities to internationally source or distribute goods, services or intellectual property. The recent economic downturn has only made taking advantage of strategic opportunities through international alliances more appealing.

While the rate of return from a joint venture can be very high and therefore enticing to prospective partners, approximately 50% of all joint ventures fail. The possibility of initial difficulties is high. Their continued survival and success after "hitting the wall" requires ownership flexibility and long-term support. In fact, flexibility and evolution are the keys to successful international joint ventures.[6]

Although legal agreements are required to create and sustain international joint ventures, International Joint Ventures must be rational, living and evolving relationships. Continued positive interaction and dialogue between the business decision-makers after the formation of the joint venture is critical.[7] Circumstances change and the joint venture must be capable of changing with them.

The existence of an International joint venture "may be based upon a rational consideration of the acts and declarations of the parties, warranting the inference that the parties understood that they were co-adventurers and acted as such."[8]

The enterprises in an International Joint Venture owe to each other duty to disclosure, joint liability and fiduciary duty. It was held by the New York Court of Appeals in *Meinhard v. Salmon*[9] that

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[6] BenDaniel, David J., Arthur H. Rosenbloom, et al. 2002. International M&A, Joint Ventures, and Beyond: Doing the Deal. Wiley; 2nd edition.
[7] Wolf, Ronald Charles. Effective International Joint Venture Management. 2000. M.E. Sharpe.
[8] Davis v. Davis, 58 N.C.App. 25, 30, 293 S.E.2d 268, 271 (1982) (citing Eggleston v. Eggleston, 228 N.C. 668, 674, 47 S.E. 2d 243, 247 (1948)

[9] 164 N.E. 545 (N.Y. 1928)

partners in a business have a fiduciary duty to inform one another of business opportunities that arise.

The formation of International Joint Ventures is not a unitary process. It is composed of many components. Joint Ventures in international projects are orders of the day. Forms:

- ***Acquisitions***

An acquisition is the purchasing of an interest in any legal structure. It can be for the totality of the equity interests of another entity or only a part of its equity. Acquisition constitutes the kernel of equity joint ventures.

- ***Subsidiary Formation***

Subsidiary formation is the most frequent method of forming a joint venture. Forming a subsidiary means establishing a new company. Subsidiary formation involves the creation of a local subsidiary, whose legal outlines, structure of capital and managerial aspects are negotiated between the parties.

- ***Partnerships***

Partnership can be defined as a contractual relationship wherein two or more entities are working together. It is an equity joint venture because the individual partners form it with a capital by a contribution of assets. When the enterprises are not seeking a relationship for indefinite period, it is practical to do it through this method.

- ***Consortium***

Consortium is an unincorporated joint venture.[10] It is a joint venture based solely on contracts. Funds and resources are contributed by each participant. Since it involves a temporary relationship, it is suitable for short term projects which involve specialisation, massive capital expenditure and multiple technical services.

[10]Wolf, Ronald Charles. Effective International Joint Venture Management. 2000. M.E. Sharpe.

- ***Management Contracts***

A management contract is on the frontier line between traditional joint ventures and contract rights. At times, it has the features of joint ventures and at other times, that of a typical contract.

- ***Mergers***

Although most mergers have different objectives than an average joint venture, mergers are an effective method of entering into International Joint Ventures. There are two typical types of mergers: mergers by incorporation and mergers by fusion. Under mergers by incorporation, one or more enterprises disappear into another whereas in mergers by fusion, two or more enterprises disappear to form a third entity. However, an average entity seeking a JV in another country is highly unlikely to use merger as a method to do so.

International JVs promote much faster and economical access to foreign markets than can be achieved by purchasing an existing company in the jurisdiction or starting a new venture. IJVs provide quick access to channels of distribution, and they provide access for the non-resident partner to knowledge of the local marketplace, which increases the probability of success for the venture.

D. Joint Ventures in India

India is being looked upon as an attractive option for joint venture with strategic benefits and commercial advantages. Apart from this, India offers a massive market for various products and services. In India, Joint Venture companies are the most preferred form of corporate entities. There are no separate laws for joint ventures in India. The companies incorporated in India, even with up to 100% foreign equity, are treated the same as domestic companies.

In *New Horizons Ltd. V. Union Of India*[11], dealing with the question whether a particular company is a joint venture or not, Apex Court of India, rejecting the view of the High Court that a company cannot be called as joint venture when there is only a certain amount of equity participation by a foreign company, held that when apart from having equity participation, the Indian group of companies and the foreign based company have pooled together their resources and all the

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[11] 1995 SCC (1) 478

constituents of the company have thus contributed to its resources which shows that the Indian Company and the foreign based company is an association of companies jointly undertaking a commercial enterprise wherein they will all contribute assets and will share risks and have a community of interest, is a joint venture company.

All the joint ventures in India require governmental approvals. The approval can be obtained from either from RBI or FIPB. In case, a joint venture is covered under automatic route, then the approval of Reserve bank of India is required. In other special cases, not covered under the automatic route, a special approval of FIPB is required.

In general sense, any non-resident entity can set up an equity based joint venture in India. However, some entities face restrictions under FDI Policy[12] of India.

The restrictions are as follows:

1. Citizen or entity of Pakistan can invest only after Indian Government's approval in sectors other than defence, space, atomic energy and sectors prohibited for foreign investment.

2. Citizen or entity of Bangladesh can invest only after Indian Government's approval. However, there are no barred areas as in the case of entities from Pakistan.

3. NRI residents in Nepal and Bhutan as well as citizens of Nepal and Bhutan can invest on repatriation basis subject to investment coming in free foreign exchange (USD or EURO) through normal banking channels.

4. Press Note No. 7 of 2015, Government of India has permitted investments by NRI's (non-resident Indians) to be treated on par with resident investments. Companies, firms and trusts owned (more than 50%) and operated by NRI's are also permitted to invest in the same way as resident Indians. (Press Note no. 12 of 2015)

5. A Foreign Institutional Investor (FII) can invest only under the Portfolio Investment Scheme which limits the individual holding of an FII to 10% of the capital of the company and the aggregate limit for FII investment to 24% of the capital of the company. This "aggregate limit of

[12] Consolidated FDI Policy (Effective from 12 May, 2015), Department of Industrial Policy & Promotion, Ministry of Commerce and Industry, Government of India.

24%" can be increased to the sectoral cap / statutory ceiling, as applicable, by the Indian Company concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body. The aggregate FII investment, in the FDI and Portfolio Investment Scheme , should be within the above caps.

The Hon'ble Supreme Court has held that a Joint Venture agreement is between partners and does not bind the entity unless its terms are included in the AoA of the Joint Venture Company.[13]

This was an overview of Joint Ventures in the Indian context.

E. Joint Ventures and Competition Law

There is no clear cut provision of joint ventures in the Competition Act, 2002. There is an urgent need for the Indian Government to clarify the manner of assessment of Joint Ventures under the Competition Act, 2002.

'Acquisition' & 'control' are mentioned under Section 2(a) and Explanation (a) to Section 5 of the Act. If these terms are read along with global practices, it is found that joint ventures are within the purview of Section 3 and 5 of the Competition Act. However, there is still ambiguity as to whether a joint venture would fall under the term 'combination' of the Competition Act.

F. Advantages of Joint Ventures

Joining of hand of 2 or more enterprises bring forth a joint venture, when two forces are working together they are bound to produce something which would be or could beneficial for the parties. As partnering up with an organization the entities would benefit from each other by following ways. Following are the advantages of Joint Ventures:

I. ***Transferring Of Technology***The sharing of research and development by companies with other companies are integral and quite good for the companies as they help them grow and become more efficient with the new shared resources.

II. **To Cut Cost**
Cost cutting is also an advantage of joining force with another company, as they share knowledge and equipment's for the development or betterment of product to cut costs.

[13] *VB Rangaraj v. VB Gopalkrishnan* and Ors 73 Comp Cas 201 (SC) (1992)

III. Helps The Foreign Entity

A foreign company who does not have an insight into the local market can greatly benefit from the joint venture to see how the working is done in the new country and to gain foothold in the new market a joint venture with a local company is sometimes seems a pivotal to the foreign company.

IV. Increase Market Share

To increase market share, companies come together to form a joint venture. Although it could be subject to certain limitation of how much market share companies can share when they join forces so not be seen as of monopolistic character but if its permissible the venturers could greatly benefit from this.

V. To Comply With Local Laws

Sometimes the local law cause hindrance of foreign entrants in the country and put certain amount of restrictions, these restrictions can be tackled with the help of joint venture as foreign company join hand with the local force or player to comply with the law.

VI. Cuts The Need Of Borrowing

Financial constraints are there sometimes and there is also sometimes risk in the investment on a particular object. So by the way of joint venture a company can get additional investment it so desires and the other parties also agrees on the risk and the matter to which it is getting into. This in turn cuts the need of lending from a lending house which puts a good amount of inters on the principal amount. With the burden of paying off the land lifted a company can work better in somewhat safer environment and the new venture can also share profit if it's accrued.

VII. Helps Smaller Companies

It helps smaller companies also as to help them become more competitive, increasing their name and goodwill in the markets and also to learn the functioning of big market player as well as share some high level technology.

VIII. Accessibilty

With the formation of joint venture the company get benefited with data transferring between the companies and one company can user data of the other, so as to have greater access to massive market and existing distributing networks.

IX. New Opportunity

A company can engulf itself into new opportunity and can work in other fields which are not I the core business of the company, as they might know little about the new business getting help from other company who has some knowledge in the field would be highly beneficial.

Therefore, these were the advantages of joint ventures.

G. Disadvantages of Joint Ventures

The saying united we stand and divided we fall holds true for joint venture too, with the new embarkment of joint venture many venturers should also be vary of the pitfalls that are ever-present in a joint venture if due consideration or thoughtful process is not there in the minds as well in contractual agreement between the parties big problems can be seen.

a) Reduced Profit

With joining of hand the profit is usually seen as decreasing in starting years as the party share the same equity but increase in production can be used as countermeasure to ensure that profits remains high.

b) Miscommunication

Sometimes there is miscommunication between the parties about their intent, purpose and several other things which can cause hindrance, as sometimes this miscommunication which cause a blockage in driving company forward.

c) Cultural Difference

Sometimes in international tie ups the cultural difference became a disadvantage to the JV as the work ethics, language and other cultural differences come in the way.

d) Legal Dispute

Since incorporating and running business involves complex legal issues, these are more so when it is done internationally. Sometimes legal disputes are unavoidable therefore legal counselling is almost necessary. An arbitration clause is usually seen as pivotal in the contract as to see where the dispute will be adjudicated and laws of which country would apply.

e) Management Problems

This is an area which creates friction in the venture. As sometimes the managers of one company come in to loggerhead with the manager of the other company leading to tension and lack of co-operation. Projects don't work well when there isn't any concrete definite decision making process.

f) Unsuaitable Partner

Sometimes joint ventures come into existence with unsuitable partners. As venture come into agreement sometime quite hastily therefore they realise it later on that the partners which they have chosen have different style of working , ideas or management style rendering their partnership not so fruitful.

Conclusion

India's competition regime will need to suit the particular business needs of its economy. However, there is benefit in ensuring that the regime is not so out of sync with the competition principles and practices around the world. The last decade has seen a lot of multinational companies investing in India, often through joint ventures, either by choice or because this is required under sector-specific FDI rules.

Consequently, to the extent that uncertainties about the treatment of joint ventures can be cleared-up, this would benefit both Indian businesses and the FDI community. The US and EU regime had its own uncertainties in dealing with joint ventures, and addressed them.

India has the ability to avoid such uncertainties, and Indian and international business communities would do well to encourage the government to address the issue.

There is also a great need for clear cut definition of joint venture plus the ambit within which a joint venture comes. Joint ventures are increasing in the modern Indian economic change and to bring certainty as well confidence in foreign investors the government of India needs to come with some changes.