# An Introduction to Legal Forms of Joint Venture

Business Information Factsheet
BIF240 · September 2015

## Introduction

Joint venture arrangements, where separate firms come together to achieve mutual goals, can be extremely effective, particularly for small enterprises hoping to succeed in a competitive marketplace.

Joint ventures enable firms to pool their resources, skills, expertise or finance to achieve results that would have been difficult to achieve individually. They can be long-term arrangements (when developing a new product, for example), or much shorter arrangements made when entering a new market. Small firms can team up with partners that have complementary skills or specialist knowledge to help exploit new opportunities or undertake fresh challenges.

This factsheet explains what a joint venture is. It outlines the benefits of entering into a joint venture and describes different types of agreements as well as the legal framework that surrounds this type of agreement. It also provides some useful tips on how to manage the relationship and how to avoid common pitfalls.

## What is a joint venture?

Often abbreviated to JV, a joint venture is an agreement formed between two or more parties to carry out commercial activity together. It can be set up for one specific project or a continuing business relationship.

A JV is often a formal arrangement, where the parties agree to create a new legal entity with each party contributing equity and then sharing the revenues, expenses and control of the enterprise. Before entering into this type of legal arrangement, the advice of a solicitor should always be sought.

## What are the business benefits of entering into a joint venture?

The overriding benefit of developing a JV is to obtain access to the extra resources brought by the other partners in terms of assets, skills and expertise. This can enable a business to achieve goals that would not be possible if working alone. Other advantages include:

- The ability to share risks and spread costs.
- More chance of winning a large contract by partnering with another organisation, as a JV may be seen as more secure and reliable.
- Being in a stronger position to combat the threats posed by competitors.
- Opportunities for firms to diversify in ways that would not be possible solely with their own resources.

If the other partners in a JV are in an overseas market, there can be additional benefits of access to international customers or new products to import.

## What are the disadvantages of entering into joint ventures?

Relationships with business partners can be complex and time consuming to develop. Problems can arise when:

- The partners have clashing management and business styles.
- The partners have different objectives.
- There are unequal levels of investment or expertise introduced by the partners.
- The partners fail to communicate the objectives of the venture to all stakeholders or fail to provide adequate leadership in the early stages of the venture.

Such problems can lead to disagreements, lack of a clear direction and, ultimately, the failure of the venture. Successful JVs are based on a thorough understanding of aims and objectives, trust, equality in the relationship between the partners and effective, continuing communication of the business strategy to everyone involved.

## What form should a joint venture take?

Once firms have established the aims and objectives of entering into a JV, they need to decide which legal structure to adopt. It is possible to have an informal partnership, but for legal and tax reasons it is sensible to have some kind of legally binding agreement.

JVs are usually structured either as contractual JVs, where the parties work together as independent contractors under a JV agreement, or as 'JV vehicles', where a separate business (typically either a partnership or a limited company) is set up in order to manage the venture. The decision usually depends on various considerations, such as whether or not the venture is a one-off or time-limited project.

Options for working together as independent contractors include:

- Contractual JVs. This is the most straightforward option, setting out the basis on which the participants intend to co-operate to achieve their objectives, each acting as independent partners. This means a new legal entity is not being created, as is the case when forming a company. This kind of arrangement is particularly useful if the JV has been set up to work on a one-off project.
- Risk- and revenue-sharing arrangements. This is another type of contractual JV that is particularly appropriate where there will be considerable development expenditure. Under this arrangement, the minor partner agrees to make a contribution to the development and/ or manufacturing costs of the principal partner. The principal partner is primarily responsible for developing and marketing the product or service, and eventual revenues are shared in agreed proportions.

Options for setting up a separate business via a JV vehicle include:

- Partnerships. This usually happens when two or more individuals or firms engage in a continuing business relationship rather than a one-off project. A partnership agreement will set out the distribution of profit and loss as well as the rights and obligations of all of the partners. Limited liability partnerships (LLPs) provide the same flexibility as ordinary partnerships, but with the added benefit of limited personal liability for debts, fraud or negligence, so may be worth considering when entering into a JV. See BIF 28, Setting up in Business as an Ordinary Partnership, and BIF 365, An Introduction to Limited Liability Partnerships (LLPs), for more details.

- JV companies. A new company is established, which, as a separate legal entity, holds assets and contracts with third parties in its own right. This is commonly regarded as the most appropriate legal structure for JVs in the European Union. However, this will depend largely on the type of venture into which the firm is entering, how formal the agreement needs to be and how long it needs to last. Such companies are typically set up as private limited companies that have a separate legal identity to that of the owners, providing them with limited personal liability, as in the case of LLPs. See BIF 167, A Guide to Setting up a Private Company Limited by Shares, for more details.

Firms must seek advice from an experienced solicitor on the advantages and disadvantages of each option to determine which is most appropriate for a particular JV.

## Due diligence

Once a potential JV partner has been identified and a positive response has been obtained from them, firms must make certain checks as part of a formal process of 'due diligence' before a commitment is finalised. It is essential to check:

- That there are no court judgements against them or indications that they are financially insecure. This should include checking their annual accounts.
- That they are reliable, have no credit problems and pay suppliers promptly. Ask for credit references where possible.
- That they have a good customer service record and an excellent reputation in the marketplace.
- That they have a good management team and performance record in relation to marketing, employment and production.
- The contacts, contracts, intellectual property rights or technology they will contribute to the venture.
- How much time and money they will contribute.
- What their expectations are with regard to the potential profitability of the venture and what will happen if this is not achieved.
- Whether they are already involved in other JVs, or have been in the past, and if so, how well these have worked.

## What does a firm need to do to formalise a joint venture?

A formal written JV agreement should cover the objectives of the collaboration and how it will operate, including:

- The legal structure of the JV. Will it be a separate commercial entity?

- The aims and objectives of the project. What will the firm's trading principles and activities be, and is there a business plan in place?
- Terms preventing the JV partners from competing with the JV itself.
- Who will be responsible for the various management and control processes, including day-to-day running of the project and longer-term strategic decisions.
- What financial contributions will be made by each partner, including purchasing, expenses and any investment in joint training.
- Whether funding will need to be raised from external sources. If so, who it will be raised from, and who will borrow and guarantee it.
- How profits will be shared (as well as liabilities and losses).
- Whether any assets or employees will be transferred as part of the JV.
- Who will own any intellectual property rights created by the JV.
- Whether the parties will be free to carry on other business activities while engaged in the venture.
- How any disputes will be resolved and what happens if agreement cannot be reached in relation to major issues.
- How long the arrangement will last and whether one partner has the right to take over the entire project if the other wants to pull out.
- How to end the arrangement if either party wishes to terminate it early, and what the general exit strategy is.

It is essential to seek professional legal advice when drafting the formal JV agreement. Firms may also need to sign other legal agreements, such as confidentiality and non-disclosure agreements.

Formal documents typically required to establish a JV (depending on the particular circumstances of the venture) include:

- Contracts relating to the supply of goods and services.
- Management agreements.
- Marketing and distribution agreements.
- Service and secondment agreements.
- Loan notes.

Other important points to remember when formalising a JV agreement include:

- When negotiating a deal, firms must try to obtain an agreement to extend the relationship in certain circumstances. For instance, firms should seek agreement at the start that if the pilot project goes well the JV will extend for another 12 months.
- Firms must make clear provisions for any intellectual property issues that arise. Joint product development, especially technological development, could leave both parties in joint ownership of a design, patent or copyright. Joint ownership may be problematic when

the JV comes to an end, so firms should ensure that arrangements for dealing with this are included in the formal agreement.

## How do firms end a joint venture?

If the JV is no longer viable, or either partner wants to end the agreement, it makes good business sense to terminate it with minimal animosity so that the partners may be able to work together in the future. The formal agreement will need to make clear provision for ending the JV. It will also be necessary to ensure that all suppliers are paid, all orders to customers are fulfilled and all profits and assets are divided up in accordance with the terms of agreement.

## Hints and tips

- Firms should get legal advice when drawing up the formal JV agreement to minimise problems later and to ensure that all parties to the venture are clear about the objectives and limitations of the project from the outset.
- It is important for firms to avoid approaching a business similar to their own when considering entering into a JV. It is better for a firm to team up with one that offers complementary skills and services so that both firms can contribute without being in direct competition.
- Informal links with other local business owners may develop into JVs, but it is important that firms do not rely on informal, verbal or otherwise non-legally binding agreements. Any JV or partnership decisions should always be recorded in writing.

## Further information

BIF 145 An Introduction to Commercial Contracts in England and Wales
BIF 194 Sources of Public Sector Tenders and Contracts
BIF 238 A Guide to Methods of Entering Export Markets
BIF 400 A Guide to Setting up an Affiliate Marketing Programme

### Books

'Strategic Partnerships: An Entrepreneur's Guide to Joint Ventures and Alliances'
Robert L Wallace
2004
Kaplan Business

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