Department of Management Studies
University of Rajshahi
Master of Business Administration (Evening)
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Lecture

Joint Ventures

A joint venture is a business agreement in which parties agree to develop a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses, and assets.

Joint business ventures involve two parties contributing their own equity and resources to develop a new project. The enterprise, revenues, expenses, and assets are shared by the involved parties.

In a joint venture business model, two or more parties agree to invest time, equity, and effort for the development of a new shared project. Joint Venture is a business preparation in which more than two organizations or parties share the ownership, expense, return of investments, profit, governance, etc. To gain a positive synergy from their competitors, various organizations expand either by infusing more capital or by the medium of Joint Ventures with organizations.

Example

Sony Ericsson is a joint venture between Swedish telecom corporation Ericsson and Japanese electronics manufacturer Sony to develop cellular devices.

Characteristics of a Joint Venture

1. Creates Synergy

A joint venture is entered between two or more parties to extract the qualities of each other. One company may possess a special characteristic which another company might lack with. Similarly, the other company has some advantage which another company cannot achieve. These two companies can enter into a joint venture to generate synergies between them for a greater good. These companies can work on economies of large scale to give cost advantage.

2. Risk and Rewards can be shared

In a typical joint venture agreement between two or more organization, may be of the same country or different countries, there are many diversifications in culture, technology, geographical advantage and disadvantage, target audience and many more factors to overcome. So the risks and rewards pertaining to the activity for which the joint venture is agreed upon can be shared between the parties as decided and entered into the legal agreement.

3. No Separate Laws

As for joint venture, there is no separate governing body which regulates the activities of the joint venture. Once they are into a corporate structure, then the Ministry of Corporate Affairs in association with Registrar of Companies keep a check on companies. Apart from that, there is no separate law for governing joint ventures.

Advantages of Joint Venture

1. Economies of Scale

Joint Venture helps the organizations to scale up with their limited capacity. The strength of one organization can be utilized by the other. This gives the competitive advantage to both the organizations to generate economies of scalability.

2. Access to New Markets and Distribution Networks

When one organization enters into joint venture with another organization, it opens a vast market which has a potential to grow and develop. For example, when an organization of United States of America enters into a joint venture with another organization based at India, then the company of United States has an advantage of accessing vast Indian markets with various variants of paying capacity and diversification of choice.
At the same time, the Indian company has the advantage to access the markets of the United States which is geographically scattered and has good paying capacity where the quality of the product is not compromised. Unique Indian products have big markets across the globe.

3. Innovation

Joint ventures give an added advantage to upgrading the products and services with respect to technology. Marketing can be done with various innovative platforms and technological up gradation helps in making good products at efficient cost. International companies can come up with new ideas and technology to reduce cost and provide better quality products.

4. Low Cost of Production

When two or more companies join hands together, the main motive is to provide the products at a most efficient price. And this can be done when the cost of production can be reduced or cost of services can be managed. A genuine joint venture aims at this only to provide best products and services to its consumers.

5. Brand Name

A separate brand name can be created for the Joint Venture. This helps in giving a distinctive look and recognition to the brand. When two parties enter into a joint venture, then goodwill of one company which is already established in the market can be utilized by another organization for gaining a competitive advantage over other players in the market.
For example, a big brand of Europe enters into a joint venture with an Indian company will give a synergic advantage as the brand is already established across the globe.

6. Access to Technology

Technology is an attractive reason for organizations to enter into a joint venture. Advanced technology with one organization to produce superior quality of products saves a lot of time, energy, and resources. Without the further investment of huge amount again to create a technology which is already in existence, the access to same technology can be done only when companies enter into joint venture and give a competitive advantage.

Top 4 Types of Joint Venture

There are mainly four types of joint venture which includes –

- **Project-based joint venture –** where the joint venture is done with the motive of completing some specific task.
- **Vertical joint venture –** where the joint venture takes place between the buyers and the suppliers
- **Horizontal joint venture –** where the joint venture takes place between companies having the same line of business
- **Functional-based joint venture –** where the joint venture is done with the motive of getting mutual benefit on account of synergy

- **Project-Based Joint Venture**

Under this type of Joint Venture, companies enter into a Joint Venture to achieve a specific task, which can be an execution of any specific project or a particular service to be offered together, Assignment, etc.

Such collaboration is usually undertaken between companies for an exclusive and specific purpose only and, as such, ceases to exist once the particular project is completed. In other words, these types of Joint Ventures are bound by time or a particular project.

For Instance Axon Limited, an industry pioneer in the development of Residential Project entered into an exclusive Joint Venture with Trump Industries, an industry pioneer in the Marketing and Sales of Residential projects for their New Project “Living Rise”. Under the said Venture, Axon Limited will construct the Project “Living Rise,” and Trump Industries will be the exclusive sales and marketing entity. Such types of Joint Ventures, which are undertaken for an exclusive project, are examples of Project-Based ventures.

Example

Another example to understand this type of Joint Venture is reproduced below:

Cipla is a traditional pharmaceutical manufacturer and wants to enter the booming business of biotech. On the other hand, Biocon is a biotechnology firm. Cipla intends to utilize the research and development resources of Biocon to develop a particular drug for the treatment of some ailment. Now one way to achieve this objective is to buy Biocon. Still, in that case, Cipla indirectly is buying many other areas in which Biocon cater to, in which Cipla may not be interested, and this will also result in an expensive way of gaining the research capability that it intends to gain from Biocon.

In order to make it a fruitful and synergize Joint Venture, the two companies, namely Biocon, which has research capabilities, and Cipla, which has in place a widespread marketing network, can come together and enter into a project-based joint venture in which the two businesses come together for this one activity and may not necessarily do anything else together in the future. By doing such a venture, both can gain from each other’s resources.

- **Functional Based Joint Venture**

Under this type of Joint Venture agreement, companies come together to achieve a mutual benefit on account of synergy in terms of functional expertise in certain areas, which together enables them to perform more efficiently and effectively. The rationale companies focus on before entering such a Joint Venture is whether the likelihood of performing better is more together than doing it separately and more effectively.

Example

Company A specializes in the formulation business and has various patents trademarked under its name but due to lack of funding company is unable to put such formulation of commercial usage. On the contrary, Company B is a cash-rich Pharma company that lacks in-house patents but holds experience in commercial success and also has adequate funding capacity. Together these two companies can mutually benefit and can complement each other by entering into a Functional Based Joint Venture.

- **Vertical Joint Venture**

Under this type of Joint Venture, transactions take place between buyers and suppliers. It is usually preferred when bilateral trading is not beneficial or economically viable. Normally in such Joint Ventures, maximum gain is captured by suppliers, while limited gains are achieved by buyers. Under these types of Ventures, different stages of an industry chain are integrated within to create more economies of scale. Usually, Vertical Joint Ventures enjoy a higher success rate and also deepen the relationship between the Buyers and Suppliers, which ultimately help benefit the businesses in offering quality products and services to customers at reasonable prices.

Example

Let’s understand the same with the help of an example:

Lincoln Corp has made investments in certain machinery and capital instruments required to produce Buyer specific products. Since the investments are made by Lincoln exclusively to meet the needs of the buyer (let say, Prawn International). By entering into a Vertical Joint Venture with Prawn International, Lincoln Corp can avoid the uncertainty associated with contracts, which are usually for a specified time period only and can lead to discontinued business.

- **Horizontal Joint Venture**

Under this type of Joint Venture, the transaction happens between companies that are in the same general line of business and that may use the products from the Joint venture to sell to their own customers or to create an output that can be sold to the same group of customers. Managing a horizontal joint Venture is usually cumbersome and often results in disputes as the alliance is between partners, which are into the same line of business. Also, these types of Joint Ventures suffer from opportunistic behavior between the partners due to being in the same general line of business. Under such types of Joint Ventures, the gains are equally shared by both parties.

Example

Let’s understand the same with the help of an example:

Base International is an Indian company specialized in the steel extrusion business and caters to various industrial units. Frank LLC is a US-based firm specializing in the molding of steel frames which has application in Industrial Units. The two companies decided to enter into a Horizontal Joint Venture under which Frank LLC, the foreign partner, will offer technical collaboration and foreign exchange component while Base International, the Indian counterpart, will make available its site, local machinery, and product parts and together with a new steel extrusion product will be offered by the two companies to its existing clients. Thus by this type of Joint Venture, both firms were able to sell the product in multiple markets and also gain from each other expertise, thereby putting resources to better usage.

International Joint Ventures

As companies look to expand their reach globally to enter new markets or find savings, a common strategy is to find a local partner in another country and form an international joint venture. When done well, international joint ventures can dramatically shorten the timeline and expense in developing an international market or supplier base. However, if not correctly executed, an international joint venture can be an expensive misadventure that can potentially damage the home company's operations and brand.

Risks of Joint Ventures

Equity joint ventures pose both opportunities and challenges for the companies involved. First and foremost is the challenge of finding the right partner—not just in terms of business focus but also in terms of compatible cultural perspectives and management practices.

Second, the local partner may gain the know-how to produce its own competitive product or service to rival the multinational firm. This is what's currently happening in China. To manufacture cars in China, non-Chinese companies must set up joint ventures with Chinese automakers and share technology with them. Once the contract ends, however, the local company may take the knowledge it gained from the joint venture to compete with its former partner. For example, Shanghai Automotive Industry (Group) Corporation, which worked with General Motors (GM) to build Chevrolets, has pursued plans to increase sales of its own vehicles tenfold to 300,000 in five years and to compete directly with its former partner.