

Technology Transfer through Joint Venture
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Lecture – 11
Formation of Joint Venture Agreement

I welcome to 11 lecture regarding Technology Transfer through Strategic Alliance and Joint Venture. In this module we are generally discussed about joint venture agreement and more specifically in this lecture I will discuss with you relating to the formation of joint venture agreement.

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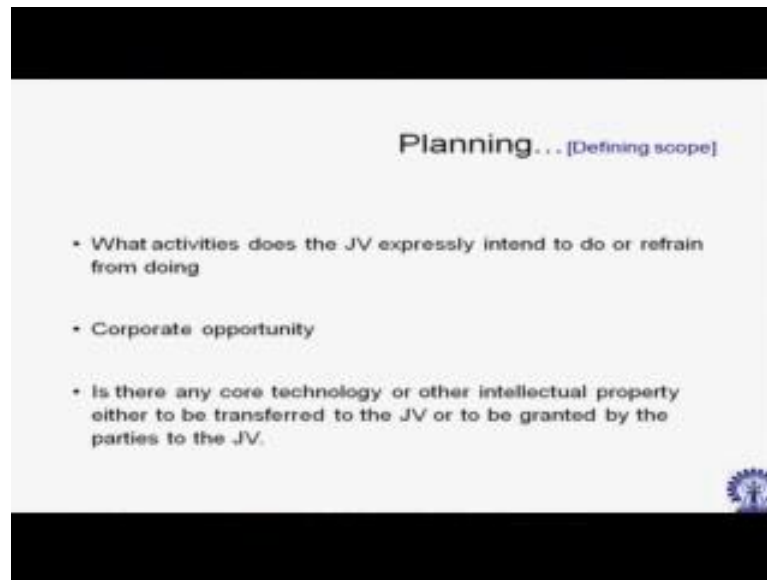


In the last module I have talked with you relating to the joint venture options, types of the joint venture, issues frequently arise during the negotiation, key compliance and governing laws. So, in this particular model I will take you through how you are going to frame the conditionality in joint venture agreement and what are the things you should keep in mind while you are doing so.

So, I have divided the lecture in the different parts. So, that it is easy for you to understand that what are the matter you should include in joint venture agreement and how you should frame those particular issues. These issues are indicative, I am going to talk more on generic issues which are common to almost all the joint venture, but there might be some issue which is very sector specific or deal specific. So, in that

circumstances you should create your own key list or the terms which you wanted to include because it is very specific to that particular business deal or particular sector itself.

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So, the first thing which I like to draw your attention that you should do some planning after the negotiation, and also after deciding the choice of laws. Now, this planning in somewhere in internal in nature because you need to take this understanding in or develop this understanding within the venture firms that means, those who are promoting this particular venture. And I believe I have told you before also that in case of the joint venture it can be two venturers or it can be even more than two venturers. So, whatever the number of venturers in that particular joint venture they should do kind of own preparation before they really go for framing the conditionalities of the agreement.

So, the first thing which I will request you to do is defining the scope. In defining the scope you should talk about what are the activities that the joint venture presently intended to or refrain from doing, this is very important, because as I have told you that if you are bringing the outcome of the joint venture as a company then in that case you need to specify that what are the matter it should include within the objective clause of the company. Now, if you are not incorporating a company if you are simply going with some other business firm like partnership or limited liability partnership then in that case is also it is advisable that you should have some kind of defined activity list. And if you

are again going for the cooperatives or society then you might require to even spell out that what are the objective of this particular organization.

Now, defining the objectives is also important because it might happen that the co-venturers that means, the companies who are promoting or the partners who are promoting this particular joint venture they might be doing the business in the related domain. So, you should be careful that you know while you are defining the activities of the joint venture it should not going to have a conflict with the existing business of the venturers. Now then you need to talk about the corporate opportunities, corporate opportunities mainly you know to restrict or to remodel - like you know if you think that well the joint venture company or the joint venture organization is going to do a certain thing then it is advisable that the venturers or the people who are doing the business on a particular domain they should restrain themselves from carrying that particular business.

Now, you know this matter also differs in the types of the joint venture like you know, if you are doing the joint venture with the foreign partners or if you are doing inbound or outbound joint venture transnational or national joint venture then in that case situation might be different. But in that case there might also be a restriction relating to the export right which I have explained in my last lecture. Like, you know your venturers might do this same kind of a product or manufacture same kind of product in another market and they are interested to manufacture the same product in this new market where they have found a partner for the joint venture. Now, if that is the circumstances then they might potentially restrain the venture company or venture organization not to export the same product in the market where they are manufacturing in that particular product.

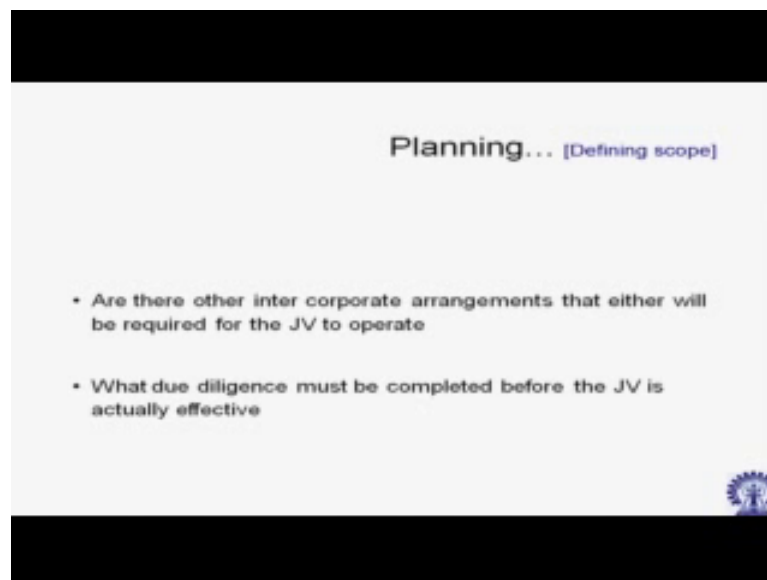
So, when we are talking about the corporate opportunity we are basically talking about the boundary conditions, which the venture companies or venture partners as well as the joint venture firm which is coming out of this particular joint venture company you will going to define very carefully.

Now, the next issue is that if you are generating any intellectual property or if you are transferring any core technology then how you are going to transfer that, are you going to license that particular technology to the venture company or you are giving it some kind of a propriety right to the venture company. And then what will be outcome once if this particular venture company is developed further intellectual property on that

particular issue, or you know if new property has been developed then who will have a right over that particular property.

So, these particular issues need to be further defined, because otherwise at the time of the exit or if one of the partner want to reduce is you know ownership or the capital in a venture then, in that case this might be one of the issues for a dispute. So, I will advise to you that you should keep clarity or define this particular matter clearly on the issues of intellectual property and that is how somehow planning you need to do before you really hit on framing the conditionalities or the terms of contract of the joint venture agreement.

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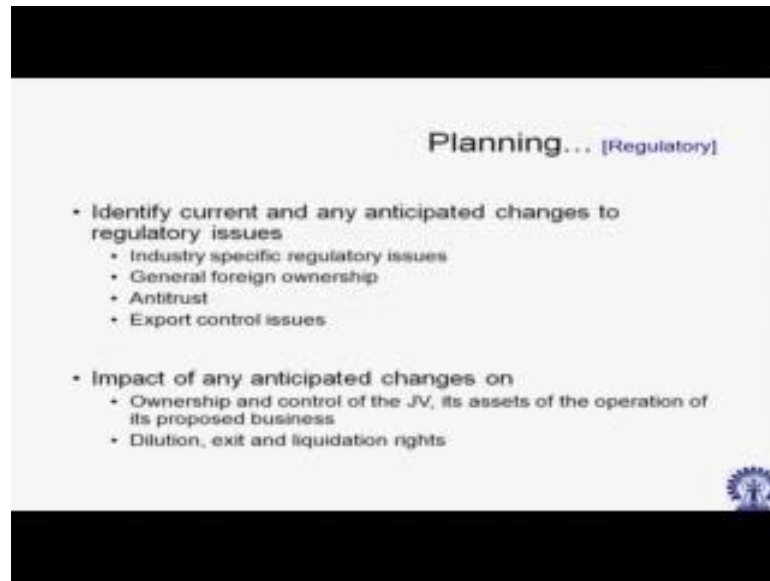
Now, the next issues which you should define day in the planning itself is, is there any inter corporate agreement that will require a permission for joint venture operations. That means, if you have taken some kind of loan from somebody or the debtor has some kind of a negative right created over activities of the venture organizations. Then in that circumstances there might be clauses wherein it says that if the company, or if the firm is going for any joint venture then they need to take unnecessary permission from the debtors or the creditors or the bank or the financial institution from where they are taking the loan. So, you need to look into that is there any other inter corporate arrangement that will require a permission for joint venture to operate and many of the time you might find everything is in place, but you have forgot to look into this particular matter and that might become a important (Refer Time: 10:03) for your venture to go ahead.

Now, you know what kind of due diligence you must complete before the joint venture is actually effective, and I told you before also and now also that you should have a team constituted for the due diligence for the different aspect. Like, you know in the past picture I have said that in case of due diligence you can broadly divide this particular matter into three category - it can be legal due diligence, it can be the operational due diligence and it can be a strategic due diligence. But whatever or you might have a further category for the purpose of the due diligence.

And I have also told you that there is a no as such starting point and the ending point of the due diligence. But in generally before you go for negotiation you start your due diligence process because you want to know more about your partner with whom you wanted to create a relationship and you wanted to continue unearthing the information even during the negotiation, even during the formation of the agreement and even you know once a agreement is crystallized, signed and when you are in operation stage. Because you know it is quite common and if the organization is very big and if the organization is operating in the different market many of the time the organization itself will not have a very structure source of information or one window system of the information.

So, in those particular circumstances there is no other way, but to go ahead with this particular due diligence to unearth the information which is crucial for this particular deal. Because if you do not have a transparency on some of the issues which might be the matter of potential dispute tomorrow or it might expose to a huge liability in the futures, or because of this non transparency even it might break this particular you know joint venture deal. Or, even you might think that because of this lack of clarity on certain of the issues you need to take the protection of warranties from your other partners who are participating into this particular joint venture. So, whatever the situation is due diligence is important and you should keep on continuing doing this particular thing even though here I said that you know the due diligence should complete effectively before the JV is actually effective. But, you know I should suggest that you should continue the due diligence even at the operation stage too.

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Now, I had a long talk with you relating to the regulatory planning because I have preferred this particular matter in different phases of my lecture in the previous module. But nevertheless I thought to talk more about this particular issue because regulatory issues is one of the biggest difficulty for any joint venture and you know sustenance of any joint venture.

You should be careful about that what can be anticipated change in the regulatory issues and this is very crucial when there is a change in the government, when there is a restructuring in the government itself in the different ministries or if there is any important event happened within a country relating to passing of the legislation or one or other thing. So, in those particular circumstances you should always calculate that if there is a kind of a change happen in hard law as well as the soft law or in the regulatory frame or even the policy or even in the guideline then what kind of an impact it might have or potentially what kind of impact it might have on the joint venture.

And these issues may be clubbed like you know industry specific regulatory issues. General foreign ownership it might be relating to the antitrust or the competition issues, it might be relating to export control issues so on so forth. But this list is not exhaustive it can be a long list. Now sometimes this changes has a lot of impact over the ownership and even dilution or liquidation or exiting of this particular joint venture. Like you know there might be a change relating to the general for an ownership all of a sudden or a

government decided that they will promote more indigenous companies in a particular domain and they will ask all the joint venture company's foreign partner to reduce their stake. And it has happened in India before like in 1970s you will find there is many examples of this kind of you know foreign policy changes.

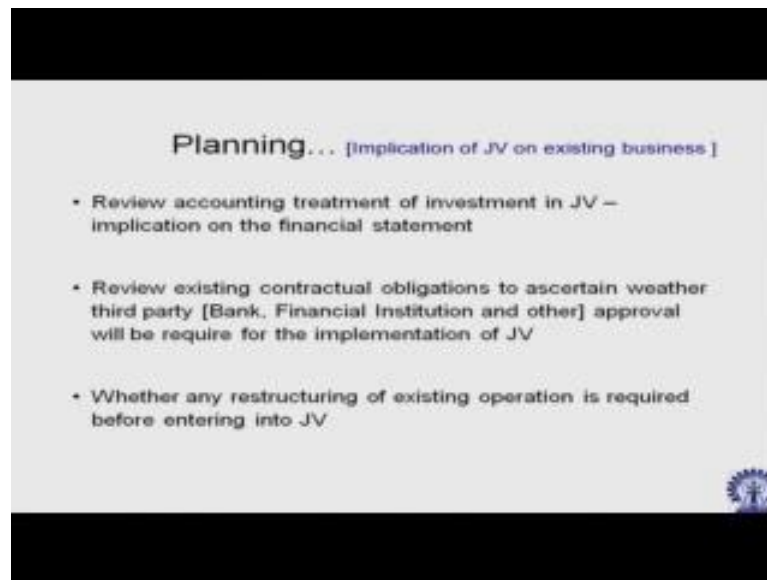
So, if you get kind of you know intimation before or if you can have a potential hunch for this kind of a changes or you know you get kind of filler from the market or maybe regulator or some other places, you should also have your plan b relating to this particular issues. Because it might ask you to dilute your stake and if you want to dilute then in that case what are the route you are going to take it through, should sell your stake to your existing venture or the partner. If your partner is not interested to take your stake what are the options available with you to sell that particular thing or how you are going to do that. And you know why I am telling this particular thing this exit or dilution of further matter of the liquidation right should be spell out specifically in agreement itself. Because if it is not provided in the agreement itself and you know if you are having a particular type of organization then in that case it might create a difficulty.

Like let me give an example - if you joint venture agreement lead to incorporation of a private limited company then, in that case law provides kind of a protection to a partner or to the promoter of a private limited company that if somebody is diluting a stake then he should be offered first, because there is a kind of a it does exist in that case. So, in those particular circumstances unless you define this is what should happen in these particular circumstances and AOE you might find a potential difficulty even to dilute. Or sometimes even you know if you are diluting the stake, the general law or maybe sector law will state you that you really cannot take that as back. Because even though the government says that you have to dilute your stake, but they might at the same time through the other regulation might say that you cannot take the money immediately out of the market, out of the domestic market.

Then in that case what are the options available with the venturers and you know how they should handle this particular scenario or what are the parameter they should follow it is advisable that you should decide that and you should put it into your joint venture agreement itself.

So, let me take you to the next issues.

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Next issues is relating to the implication of joint venture on existing business. Now, once you start you know having new venture then it might potentially impact on your financial issues. Like, you know when you are making an investment in new venture then you need to show that what is this type of investment - is it that you are investing in the equity, you are doing some kind of a consolidation, or you have you know invested through equity as well as other debt or you have you know invested and then you have raised the those particular equity in some financial institution and then you have taken a potential loan to finance this particular venture.

So, what I am trying to talking about you need to spell out very clearly what is the implications of this particular you know investment and how you should figure into the financial statement. Please do remember, how it is figuring the financial statement do impact on the venturer businesses itself. So, sometimes if it is not really cleverly you know placed into the financial statement and the venturer is a public firm, public listed company they might get a hit into the market. So, it is strategy you need to decide that how you should reflect into your financial statement as venturer.

Now, you need to review the contractual obligation to ascertain whether the third party approval is required which I have told you before. But for that matter let me repeat it again. You know, you need to sometimes nowadays the financial institutions are whenever they are extending the loan, they are basically interested in micro management

of (Refer Time: 20:34) and this became more and more common because you know financial institution do not want to caught or unaware because it might so happen that some of the region management has taken which might lead to potential (Refer Time: 20:55) creation of potential, like you might have heard about the present controversies which is going on around this kingfisher airlines because financial institutions are extended a huge amount of debt to this particular organizations and then they found that they are unable to recover this particular money.

Because please do remember the financial institution whatever the money they infuse this is nothing but a public money that means, they have basically taken our deposit or life savings from the public at large. So, they have not only the legal responsibility, but moral responsibility to recover this particular money from the potential from the debtors.

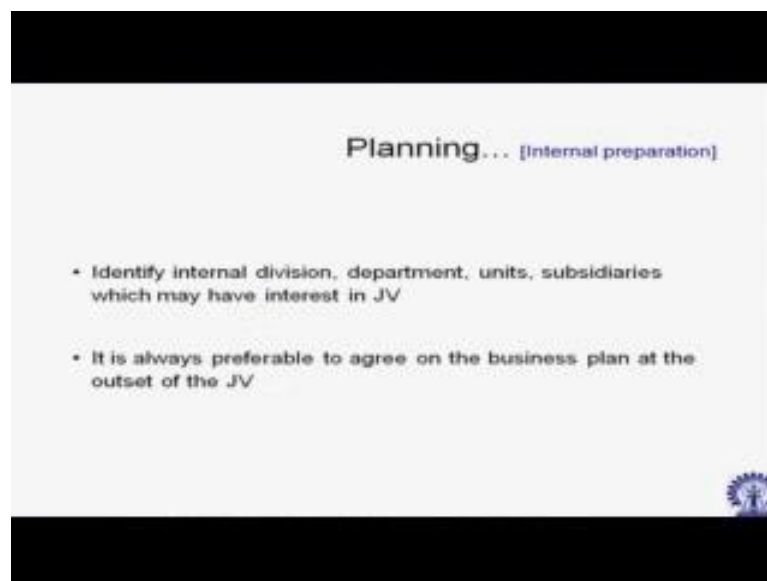
So, you know in these circumstances the potential you know process which is developed at present is that they try to control the actions of the corporations. And which I have mentioned before it is generally popularly known as a negative right and if you look into the judgment from the different regulatory agencies or the applied tribunal or the court at present they do reaffirm this particular kind of action by this you know financial institutions or the banking institutions. So, this is a potential issues which you need to plan and if you have that kind of clauses then you need to comply this particular clauses before you go ahead with this you know joint venture agreement.

And even you might need to have in person discussion with your financial institution, or if it is a consortium of the bank or consortium of the financial institution then in that case you might need to hold a general meeting and convince them about your future plan, or the business plan which you wanted to pursue through this particular joint venture, and what kind of a growth you are expecting out of this particular joint venture or the financial returns you are expecting out of this particular joint venture. So, this is very important on this particular important issue you need to look into.

Now, next important issue might be do you need for restructuring, restructuring the existing operation, operation before the joint venture. Like you know, until now you are operating in that particular domain where you are thinking that joint venture company will go to operate. Then in that circumstances either you have to transfer that line of business to the joint venture company or you need to potentially you know withdraw

yourself from that particular business itself, because you cannot do the parallel business in the same market in a different name because it will create a confusion or it might even create some kind of a regulatory barrier, it might be even objected by the fair market regulator. Or if you think that well you are going to allocate the geographical market then in that case also it might create a difficulty because you know the fair market regulatory might come into the play and they say that this is not really acceptable behavior on your part.

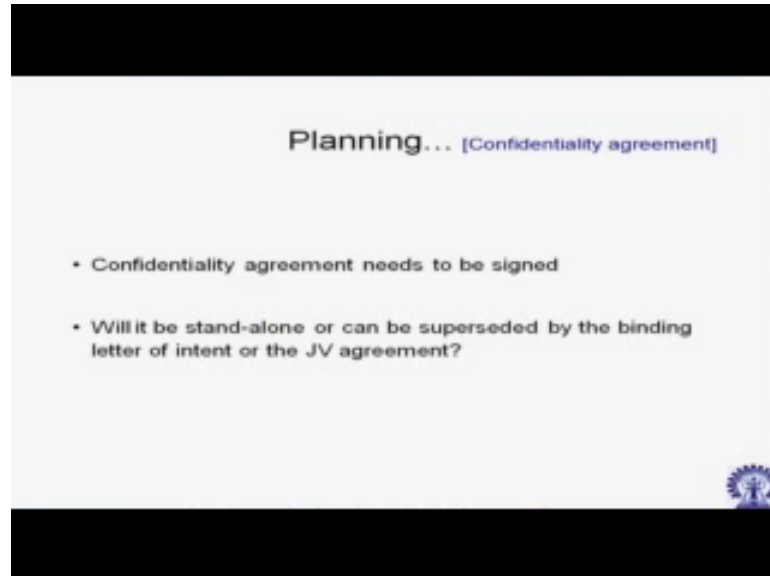
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Now, I will talk about the internal preparations which you should do in the planning. You need to identify the divisions department; you need subsidiaries which may have interest in the joint venture. Now in the joint venture, you are developing a particular product and for that particular product some of your department or subsidiary or the unit might supply the input material. So, your own department that means the venturers own department or subsidiary might be interested in the joint venture and if they show in what are the issues in that you need to identify that. And then you have to adequately protect the interest into the joint venture agreement itself, joint venture agreement itself. You know at the same time you need to talk about that you know if there is any business plan. So, in those particular circumstances it is advisable that your business plan should incorporate that particular issue on the outset itself so that it will not create a difficulty in future relating to these particular issues.

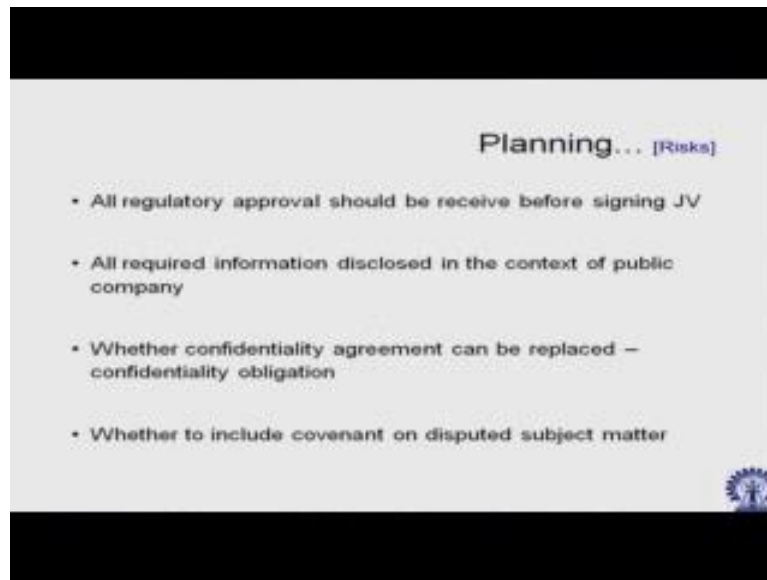
Now, I have talked with you relating to the confidential agreement in my previous lecture.

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So, you need to find out that, what are the issues to be incorporated into the confidential agreement because you are exchanging the information which you do not want that potential you should go into the public domain. At the same time you should also think about will you able to change this particular confidential agreement by the letter of intent and if you do, how you should what are the procedures you should follow in doing so. Because sometimes even this you know confidential, breaching of the confidential agreement or some information if it is spill over to the market then it might be a potential conflict between the venturers or the partner who are putting the joint venture.

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Now, I talked about the risks with you in our last lectures, but nevertheless let me structure it a little more and you know as I have told you that regulatory risks is one of the risk show, what are the approvals which you need to have before you start your operation you should take that. Now, some people told me that in India more difficult thing today is to create a environment regulatory approval. So, sometimes you know it might take a long time, like some people were telling it might take you 2 years, so this kind of if you find that well the approval take. So, long time it might upset any ventures. So, it is better that you should start planning this particular regulatory approval a long or what type of procedure you should follow who will take the responsibility of taking the regulatory approval it should be you know planned properly or maybe will be part of your joint venture agreement itself.

Now, you need to disclose all the information. If you are planning that you are going to put up the joint venture as a public company, because there is a lot many disclosures you need to do if you are incorporating a public company. And if it is a public listed company then in that circumstance you need to keep the information not only to the usual process of incorporation, but you need to keep a continuous disclosure into the stock market. This process is now well defined and before you start doing the business you need to go for lot of disclosure not only under the listing agreement not under the several regulatory law which were subjected to. So, it is advisable to do the checklist and

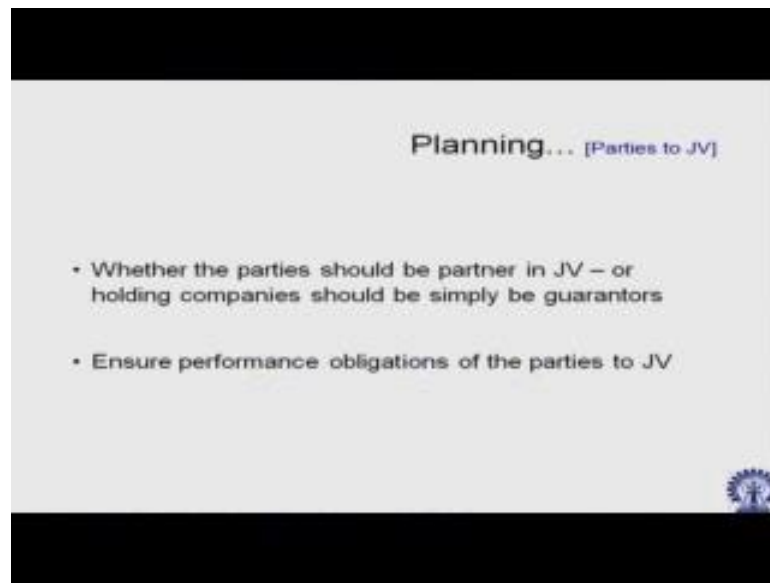
see that who is going to take this particular responsibility or what kind of mechanism you are going to follow to you know deliver this particular information in the public domain.

Now, whether the confidential agreement can be replaced by confidential obligations, which I have discussed in the last this thing, but you know sometime people think that you know you need to have a kind of policy relating to your confidential obligation too. It is not only the non disclosure agreement is sufficient, but if there is an infringement then how you are going to handle that particular circumstances and who is going to give the warranty and who is going to under write the losses which one suffered in this particular process so on so forth. So, you should do a kind of understanding or develop kind of understanding of the process for this particular purpose and advisable to have this particular provision into your JV agreement.

Now, whether to include a covenant on disputed subject matter, and I will suggest you should do that because many of the time because of the disputed subject matter it might create a potential difficulty for the new venture. Because you know it might so happen that the dispute is running between the venturer and its creditors and because of that there is several law in operations and when that particular company is further starting a joint venture that might create a problem for the joint venture itself.

In those particular circumstances, it is as well advisable that you should you should have a provision relating to you know covenant or sort of a warranty which you should take it from the promoters of the venturers. So, that if there is any future dispute arise there is somewhere mutually handled and taken care of.

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So, in the parties of the joint venture you also required to decide that who is going to be a part in the joint venture, where there is you know holding company and there is a subsidiaries and if the subsidiaries are parties in the joint venture or venturer then in that case what is the role of a holding company. Are they coming as a potential guarantor or they do not have any role or what kind of control they are going to have into this particular venture.

Now, ensure the performance obligation of the parties because many of the time parties do agree on some of the issues then you know when the matter of performance comes you will find the parties are not really delivering whatever they have you know agreed upon. So, there should be some mechanism relating to you know performance obligations. Many of the time you will find the performance obligation might be governed by the existing law, maybe it is existing applicable contract law or maybe law which you have chosen to be governed this particular joint venture agreement, but they might not be sufficient to cover this kind of a scenario.

Thank you.