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BEST PRACTICES FOR JOINT VENTURES: ISSUES AND CRITICAL SUCCESS FACTORS

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ABSTRACT: Project-based joint ventures are often used in the construction industry to assemble an organization that meets a client's project needs and matches or exceeds the capacities of competitors. The joint venture / partnerships provides the means for a firm to quickly add resource, political, technical, or other required strengths that will increase project acquisition. This paper sets out to study the types of joint ventures, different issues or problems while having joint ventures and the critical factors that contribute to successful joint ventures. A questionnaire was designed and administered to survey the issues and present practices of joint ventures in the South Florida construction industry. Along with the questionnaire, personnel interviews were also conducted to get first hand knowledge about the subject matter. The results are presented in the paper. These results specifically identify the overall practice of joint ventures in South Florida as well as indicate the most significant factors leading to failure or success of these ventures.

Keywords: Joint Ventures, Issues in Joint Ventures, Critical Success Factors, Best Practices

1. INTRODUCTION

Joint ventures (JVs) facilitate the combination of economic resources, skills and knowledge required for projects. The use of the JV set-up in the construction industry has become necessary in order to secure large scale projects or those that are beyond an individual firm's capabilities. JVs offer the opportunity for an organization to acquire new technology and expertise. They also minimize the competition and improve the chances of securing a project.

More often than not, foreign construction companies are encouraged to enter the local market in the form of a JV with a local entity. In Singapore, for example, a preferential margin scheme was introduced to provide an incentive for foreign-local JVs. Malaysia set a target of 30% ''Bumiputra'' (refers to people of Malay origin) share-holding in the public sector in the National Economic Policy. The Indonesian laws require a foreign participant to enter a JV with a local partner. Thailand restricts foreign ownership of construction companies up to 49%. The Philippines gives more freedom, but incentive is given to JVs with local partners. In Vietnam and China, foreign construction companies tendering for projects must have at least one suitable local partner and are required to obtain a license on a project-by-project basis (Balachandran 1995).

International joint ventures (IJVs) can be of particular benefit to less-developed and developing areas. Trans-global economic developments offer an opportunity to develop products using the most up-to-date expertise and knowledge in a cost-effective manner (Bing and Tiong 1999). However, researchers have found that a large number of cooperative ventures fail to achieve the goals and objectives that were originally established (Geringer and Hebert 1991). In developing countries in particular, the number of JVs that failed is significantly high, >50%, (Makino and Beamish 1998). This is because international construction is much riskier than domestic construction. The complex international environment is affected by diverse variables that are not part of the domestic markets and that create risks never encountered in domestic conditions. The complex variables that affect the performance of construction companies in overseas markets need to be considered in this decision. Furthermore, the threats and opportunities associated with target countries should be well understood (Hastak and Shaked 2001). IJVs are frequently plagued with high degrees of instability and poor performance (Parkhe 1993). The core concepts of IJV operation and of the relationships between its partners are still not well understood (Parkhe 1993). This largely stems from the inherent complexity of IJVs involving a mixture of different cultures (Swierczek 1998).

From a risk point of view, the risks involved are shared among the parties involved in a JV. By studying the critical issues that contribute to successful JVs and the risk factors associated with JV operations, it should be possible to identify potential areas of disputes, or high risk factors; which drives the main purpose of this study. The core objective of the study presented in this paper was to assess the issues and critical success factors (CSFs) associated with JVs. A questionnaire survey was administered to US construction companies that have established JVs amongst themselves as well as with foreign partners in order to assess he issues and CSFs.

2. RESEARCH METHODOLOGY

Research work began with literature review of different types of JVs and different factors involved in the success or failure of JVs for construction projects. A questionnaire was then designed to identify and to find the different types of JVs, reasons for establishment, failure and success of JV construction projects. Data was also gathered for most common steps required for successful JVs and the key issues involved. Questionnaire was administered by postal and email communication to professionals in construction industry. Stakeholders who participated in survey belonged to construction industry of South Florida working in JV construction projects. A total of 36 questionnaires were returned for data analysis. Respondents were required to rank different critical factors involved in JV practices. Respondents including clients, consultants and contractors were asked to identify these factors significant for construction projects on a preference basis.

3. TYPES OF JOINT VENTURES

During research it was found that the term partnership and JV has some difference in application. Partnership is defined as casual, short time agreement between two parties. In partnership there is no exclusive relationship between parties; whereas a JV is defined as formal written agreement on a long term basis. In JV, parties must share resources, outcomes, goals, risks and benefits. In JV set up parties must have exclusive relationship.

The three most common formats of JVs, are:

Separate Entity: Creation of a separate entity venture in the form of a corporation, a Limited liability Company, or a limited partnership is accomplished by a filing with the state.

Consortium Agreement: A consortium is a non-entity venture that is formed by contractual agreement. The supply agreement may be issued in one or more of the participants' names.

Master Subcontract: A master subcontract is also a non-entity venture that is formed by contractual agreement. The supply agreement is granted to only one of the participants, but all Participants agree in advance in the venture agreement as to work distribution and to the allocation of risks normally assumed by a general contractor alone.

4. FINDINGS

A total of 36 completed questionnaires were received for data analysis from stakeholders (clients, consultants and contractors) involved in JV construction projects. In addition, a total of five personal interviews were also taken, which made a total of 41 responses. Table 1 shows the number of participants from different fields who participated in this survey.

Table 1. Respondent Profile

Respondent Type	Number
General Contractor	14
Construction Manager	8
Design Consultant	7
Civil Engineer	5
Architect	4
Electrical/ Mechanical Engineer	3

5. ANALYSIS AND FINDINGS

After careful examination of data collected from the stakeholders, analysis was made to find out the critical factors in JV practice in construction industry.

In this section, analysis of various data collected from the survey regarding practice of JV projects in the South Florida's construction industry is illustrated. For ease of interpretation and connectivity, these data have been divided into the following subsets:

1. Preference of Joint Venture agreements
2. Types of Joint Venture in Practice
3. Main Reasons to Establish Joint Ventures
4. Major Reasons of failure of Most Joint Ventures
5. Benefits of Joint Ventures
6. Key requirements for a Successful JV
7. Best Method for Accounting for JVs
8. Most Common Mistakes in JVs
9. Steps Required to Establish Successful JVs
10. Key issues in the practice of Joint Venture

5.1 Preference of Joint Venture Agreements

Table 2 shows the preference of the participants to the JV agreements. 86% participants would like to have formal agreement and only 14% like to have informal or verbal agreement. This shows that joint venture should be established with formal contract with defined rules.

Table 2. Preference of JV Agreements

Preference of Joint Venture Agreements	Response (%)
Joint Venture With Formal Agreement	86
Partnership with Informal Agreement	14

5.2 Types of Joint Ventures in Practice

Table 3 shows the types of JVs in common practice in south Florida Construction Industry. As per survey findings, 81% of the companies form joint venture for Design-Build (DB) projects and 14% of the companies form JVs with similar businesses, like a general contractor forming a JV with another general contractor. 24% construction companies make joint venture with material suppliers. The majority of JVs are for DB projects because in DB projects not all the companies have all the expertise to perform. Usually architects or consultants have only design knowledge to offer and on the other hand contractors have experience to execute the design. All these different experiences and expertise when come together make the required team.

Table 3. Types of JVs in Practice

Types of Joint Ventures in Practice	Response (%)
Joint Venture for Design Build Projects	81
Joint Venture with Material Suppliers	24
Joint Venture with similar Business	14

5.3 Main Reasons to Establish Joint Ventures

There are many objectives to form joint ventures. Table 4 shows the main reasons to establish Jvs in construction industry. The top most objective is to share the risk with partner in joint venture. Since the construction is highly risk prone business, the stakeholders are mostly worried about he potential risks in construction projects. There are other reasons such as, to share technical expertise, to share tools and equipment, to accelerate revenue growth, to perform better in unfamiliar market and to share people resources as shown in Table 4.

Table 4. Major Reasons to Establish JVs

Main Reasons to Establish Joint Venture	Response (%)
To share or eliminate the risks	57%
To share technical expertise	38%
To help diversify your businesses	38%
To accelerate revenue growth	29%
To share tools and equipment	24%
To share people resources	24%
To perform better in unfamiliar market	19%

5.4 Major Reasons of Failure of Most Joint Ventures

As identified by the survey findings, the most common reason for failure of joint ventures is the lack of coordination and communication during the execution phase. The second most common reason is the lack of planning while forming the joint venture. Table 5 shows different reasons for failure and their relative scores in percentages.

5.5 Benefits of Joint Ventures

Companies form JVs to achieve multiple objectives or benefits. As per survey results, the most important benefit of JV is to reduce the potential risk which is 15% among all the benefits. The second most important benefit is to target other potential markets which is 14% among all. Table 6 shows most of the benefits one can achieve from JVs and their relative importance in percentage.

Table 5. Major Reasons of Failure of Most JVs

Major Reasons of failure of Most Joint Ventures	Relative Score (%)
Lack of Coordination/communication	17%
Lack of Planning	14%
Difference in Management Style	11%
Not Knowing your Partner	10%
Cultural Difference	10%
Friction and lack of cooperation	9%
Change in strategy	9%
Partner’s Finances	8%
Partner's inability	7%
Regional Restrictions	5%

Table 6. Benefits of JVs

Benefits of Joint Ventures	Relative Score (%)
Reduce the risks	15%
Target other potential markets	14%
Increase your credibility	12%
Save money on business operating costs	12%
Save valuable time	12%
Increase sales	9%
Enhance your image and reputation	9%
Reduce your taxes	7%
Enhance technological capabilities	7%
Outsourcing	2%

5.6 Key Requirements for a Successful Joint Venture

Mutual trust is most important in JVs. Table 7 illustrates the key requirements for a successful JV and their relative importance in percentage.

Table 7. Key Requirements for a Successful JV

Key Requirements for a Successful JV	Relative Score (%)
Mutual Trust	22%

Clearly defined business objectives	19%
The degree of participation/ management	19%
Sharing of the profits and losses	13%
Confidentiality	13%
A Dispute Resolution System	7%
Provision for Termination/ liquidation of JVs	6%

5.7 Preferred Method of Accounting for JVs

Preferred way of accounting for Joint Ventures is separate set of accounting books for both parties (Table 8).

Table 8. Preferred Accounting Method for JVs

Best Method for Accounting for JVs	Response (%)
Separate set of accounting books	76
Combine set of accounting books	24

5.8 Most Common Mistakes in Joint Ventures

In JV projects the most common mistakes are shown in Table 9 with their relative importance. The most common mistake, which creates a major risk is the lack of coordination in execution phase between parties of JVs.

Table 9. Most Common Mistakes in JVs

Most Common Mistakes in JVs	Response (%)
Lack of coordination	67%
Simply handing over your client list	52%
Lack of Resource allocation	43%
Friction and a lack of cooperation	38%
Offering your partner too small of a deal	38%
Lack of management Control	29%
Not Knowing your Partner's Reputation	19%
Long Term Commitment without Proper Homework	19%
Combine Set of Accounting for both the parties	14%
Not devising an exit strategy	10%

5.9 Steps Required to Establish Successful Joint Ventures

To form successful Joint Ventures different steps are required. Table 10 shows these steps in terms of their relative importance levels. The most important is to prepare a comprehensive plan before going into a formal contract.

Table 10. Steps Required to Establish Successful JVs

Steps Required to Establish Successful JVs	Response
Prepare a comprehensive plan	67%
List all of your goals to achieved	62%
Analysis of target market	52%
Prepare a formal contract	48%
Determine the required budget	38%
Establish a joint venture format	29%
Identify potential partners	29%
Detailed communication with the potential partner	19%
Establish a joint venture format	14%

5.10 Key Issues in the Practice of Joint Ventures

In the practice of JV projects there are several issues to be considered before going into a JV. Table 11 shows the key issues involved. The most important of all these is the coordination between two parties in implementing JV projects.

Customer Demands:

The choice of format will be greatly affected by the policies and demands of the customer. When possible, participants should first agree among themselves as to the most beneficial format and should then be prepared to defend the chosen format if the customer challenges it.

Table 11. Key Issues in the Practice of JVs

Key issues in the practice of Joint Ventures	Response (%)
Coordination	90%
Patents/Intellectual property rights(IPR)	67%
Assignment of Responsibilities	62%
Information flow	62%
Financial Strength	52%
Liability of Parties	52%
Customer Demands	48%
Dispute Resolution	48%
Insurance	38%
Responsibilities Participants	38%
No Control of Participation	38%
Escrowed Funds and Allocation of Payment	38%
Inter-party transactions	38%
Profits/income	33%
Tax	29%
Bonding	29%
Payment of Costs	29%
Risk of Late Payment and Nonpayment	29%
Confidential Information	29%

Liability to Parties:

Separate Entity. A customer will often insist that the participant named on the supply agreement be a single, well-known entity with substantial financial capacity. The reason for this insistence is that customer prefers the simplicity of having a single source from which accountability and performance can be obtained.

Tax:

Separate Entity. If a partnership, corporation, or limited liability is used, the separate entity must obtain a separate tax identification number and file a separate tax return. If a partnership or limited partnership is established then income, credits and deductions pass through the entity, directly to respective participants. If a limited liability company is established, then the venture generally has the option to elect corporate level or pass through treatment.

Insurance:

Insurance will be required in all Joint Ventures. If a separate entity venture is formed, the venture must be covered under appropriate policies. The question of who is responsible to obtain such coverage and pay the premiums must be addressed in the venture agreement.

Financial Strength:

Participants must be concerned with one another's financial strength. Each participant must be able to finance its portion of the work, if not the other participants may be forced to complete the work assigned to the undercapitalized participant.

Bonding:

A customer will sometimes require a "performance" bond to ensure the financial ability to complete the work for the approved contract price if there is any doubt of the contractor's financial condition or its capacity to manage the work. In such cases, consultation with a bonding agent will be required to discuss (i) bid, (ii) performance, (iii) payment, and (iv) warranty bonds. Similar to insurance, the issuance of bonds in favor of a separate entity venture can be time consuming and expensive.

Assignment of Responsibilities:

Each participant will be assigned specific responsibilities under all joint venture formats. It is very important to properly understand and assign all of the work required by the agreement. Additionally, the venture agreement must provide for change orders. The questions that must be addressed are (i) which participant has authority to negotiate and make a decision on the claim of "extras" by the participants, and (ii) what deference must be given to the other participants? If these responsibilities are not defined, then the burden of such unassigned or uncompensated work demanded by the customer will fall on the participant or entity that received the supply agreement from the customer.

Responsibilities of Participants:

It is important to determine how participants will make decisions and who will handle the venture's administration with the customer. The participant in control of the venture may be liable for damages caused to the venture or participants by poor management. Thus, it is necessary to disclaim or limit such damages. This additional responsibility and risk often justifies payment of an administration fee, percentage of final venture revenues, hourly fee, or any other mutually accepted arrangement.

No Control of Participation:

The venture agreement will delegate the participants to perform their work properly and to assist each other by providing information, attending meetings, etc. The venture agreement may allow or compel participants to appear in meetings with the customer.

Payment of Costs:

There must be a comprehensive system on the payment of general costs, such as insurance, legal fees, taxes, licensing, etc.

Escrowed Funds and Allocation of Payments:

The participant to whom the supply agreement is awarded will be responsible for providing payment to participants for their work. A Joint Venture agreement may require the general contractor to have its bank act as an escrow agent to receive monies and send pre-determined percentages or amounts to the subcontractors. The instructions for payments to participants can provide for equal percentage payments throughout the work or varied amounts, depending on such items as projections or schedules of values. Regardless of whether an escrow is used, the venture agreement must detail how payments from the customer will be distributed among the participants.

Risk of Late Payment and Nonpayment:

The schedule of payments and allocation of risk of late payments are both serious issues, which must be addressed in the Joint Venture agreement.

Dispute Resolution:

Arbitration is common in all venture formats although it is not required. The venture agreement should permit consolidation of the related claims against any participant or against the customer into a single arbitration.

6. CONCLUSIONS

This paper identifies different key issues in the practice of the joint ventures, as well as the common mistakes in JV practice.

The survey findings show that the most important factor in the best practice of JVs is coordination of the parties for Joint Ventures. Among all other critical factors the coordination is at the top priority. Best coordination can be established by having a comprehensive communication plan in place. Weekly or biweekly meetings and review of the project should be in practice.

Survey further shows that comprehensive plan for JV must be made in the plan and all key issues must be addressed before undertaking the JV. In implementation of JV plans, partners must share their knowledge honestly.

By avoiding mistakes and addressing key issues before time in a proactive approach, one can establish the best practices of JVs.

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