



**A White Paper from Chiron! the business doctor.™**

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# **THE CHIRON FREE JOINT VENTURE CHECKLIST**

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# The Chiron Free Joint Venture Checklist:

## 22 important issues & about 80 questions for you to think about:

When you and your company seek equity capital through a program managed by Chiron! the business doctor.™, one of the less common outcomes is that a manufacturing company may become aware of your company's products, confirm the products marketability and make an offer to your company for a joint venture arrangement. Typically, the manufacturing company would offer to accept all the costs of tooling up, production, marketing and distribution in return for payment of royalties to your company. In effect, the manufacturing company is offering to do what you and your company were originally seeking equity capital to do.

Although this is not a common outcome, it is nevertheless an outcome that occurs frequently enough for companies embarking on an equity raising program to consider as a possible option or alternative should such an offer be made to them. Guided by the old adage that 'a stitch in time saves nine', companies seeking equity capital should prepare themselves in advance for the possibility that a joint venture proposal may be offered.

Of course, such a proposal may never be offered, but if it is, it's a good feeling to have that you are prepared to respond positively and confidently with a firm policy position that provides a practical basis for discussion about the joint venture proposal. After all, you don't want to be caught short like a rabbit in the spotlight, standing mute and not being able to think of a thing to say. Not only is that unprofessional, but it places you and your company in a very weak negotiating position if you want to enter into discussions on the joint venture proposal.

Accordingly, Chiron! the business doctor.™ has prepared this checklist to identify specific points that you and your company need to take into account to be prepared to respond in a practical way to the receipt of a joint venture proposal. The reality of business today in a very competitive business environment is that for safety's sake, you need to dot your 'Is' and cross your 'Ts' early so that you are not gazumped by the unexpected right hook from left field.

In practice, that means that pretty much, all the terms and conditions for a future joint venture arrangement must be identified, agreed and committed to writing before the parties do anything at all.

It's too late to cry over spilt milk if some months down the track something untoward happens that wasn't discussed in the joint venture formative stage, and the whole project goes downhill, perhaps into oblivion. You have to do your homework; you have to enter into joint venture negotiations with your eyes wide open and with some appreciation of all the things that can go wrong. The one thing that does go wrong will undoubtedly be the one you did not review before the joint venture negotiations commenced and what's more, it will be the one thing that causes the greatest degree of pain.

## The Chiron Free Joint Venture Checklist

- 1.** The first and most obvious thing you must do is identify exactly who your joint venture partner is. Is your joint venture partner an independent company that stands alone, or a subsidiary of a larger company or a holding company? Is the joint venture partner a proprietary company, a public (unlisted) company or a company listed on a stock exchange, or some other form of legal entity? Does it form part of, or belong to a national or transnational group? If so, what are the implications of such a situation for you and your company? Is your joint venture partner a foreign company? If so, what is its' country of domicile? If so, will that create any managerial, diplomatic or political difficulties for you and your company? Will managerial and professional staff be brought to Australia to work in the joint venture? Who will bear the cost of this?
- 2.** In a joint venture agreement, you and your company will be providing the product manufacturing designs and other relevant information for the production process. Are these product designs and their related information protected in any way, perhaps by design registration or patent? If so, you must decide whether the circumstances will require you to insist that your joint venture partner signs a strong non-disclosure or confidentiality agreement as a pre-condition to the commencement of any discussions or negotiations leading to the joint venture agreement because you will be expected to disclose this information during the joint venture negotiations.
- 3.** Continuing on this theme, the joint venture partner may ask that the ownership of the product manufacturing designs and other relevant information for the production process be transferred to the joint venture. Any consideration for this, either in cash or in kind, will be a subject for discussion within the wider joint venture negotiations. The important point however for you and your company is whether agreement to this request will be in your company's and your shareholders' best interests.
- 4.** An important component of a joint venture arrangement is that there should be no duplication between the joint venture partners of actions, functions and responsibilities. The specific actions, functions and responsibilities of each joint venture partner should be clearly delineated and set out in the formal joint venture agreement. Before discussions or negotiations commence, you must determine what you want your role to be within the joint venture, because this be a base negotiating point.
- 5.** Consideration must be given to the scope of the joint venture proposal. What will happen where you want the scope to be national in nature, while your joint venture partner wants the scope to be global in nature? Does your joint venture partner have the manufacturing capacity to cope with global production and distribution? Has your joint venture partner got the marketing, sales and distribution network to adequately service a global market? What are the contractual arrangements the joint venture partner has with marketers and distributors in each export market? Are these marketers and distributors willing to deal with the new joint venture company of the same terms and conditions? Are these terms and conditions suitable for the new joint venture company or will they require re-negotiation?

6. Has your joint venture partner pre-prepared a draft business plan for the joint venture activities for discussion or is the preparation of a business plan something that the joint venture partners will have to jointly prepare from scratch? Have you pre-prepared a draft business plan for the joint venture activities in anticipation of an approach from a manufacturer? Will the business plan be prepared before or after the joint venture agreement is signed? If the latter and the joint venture agreement is signed first, what happens if the parties cannot agree on certain matters that are essential elements within the business plan?

7. Has your company pre-prepared a draft licensing agreement to permit your joint venture partner to manufacture, market, sell and distribute your products? Your company must do this in advance of any joint venture negotiations. You must not permit your company to negotiate a licensing agreement based on a draft prepared by the joint venture partner.

8. Do the products or the production process, require a federal or state government or local council licence or permit for their manufacture or sale? If so, who will hold the licence or permit: the joint venture, your joint venture partner or your company? What will happen in the export markets? Are licenses or permits required for manufacture or sale?

9. Having regard to what is in your company's best interest, you and your company will have to decide what is the most appropriate legal structure for the joint venture. Should the structure be a simple joint venture contractual arrangement, a proprietary company or a public (unlisted) company, or something else? This is a very important issue with some serious tax implications.

10. Once you decide the most suitable legal structure, you then have to determine a policy position relating to the division of the joint venture company's Ordinary Shares between the joint venture partners. Will it be a 50-50 split or will your joint venture partner receive a higher allocation of shares perhaps because of the financial commitments it has incurred from the joint venture. On the other hand, will your company receive a higher allocation of shares as a consequence or outcome from the initial joint venture bargaining. There is a myriad of permutations in the resolution of this aspect of the joint venture. These permutations also include the possibility of the issue of different classes of shares; for example, your joint venture partner could receive an allocation of non-voting preference shares in part compensation for the financial commitment incurred in respect of tooling up for production.

11. Also related to the above question, you next have to determine a policy position relating to the Board of Directors. There are a number of issues here: how many directors will constitute the Board? How many directors will be full-time executive directors working in the joint venture? How many directors will be part-time non-executive directors? How will directors be nominated, approved and appointed? How will the Chairperson or President be appointed? How will the Managing Director or Chief Executive Officer be appointed?

Who will determine their remuneration and other conditions of appointment? How much time will the non-executive directors be expected to contribute to the project?

**12.** Following this theme further (it is after all a critical element in the joint venture arrangement), what happens if one of the joint venture partners wants to get out of the arrangement? What happens if one of the joint venture partners wants to sell part or all of their shares in the joint venture company? What conditions will apply in those circumstances? How will any transition from a retiring joint venture partner to a new joint venture partner be managed? Will the remaining joint venture partner have a right of first refusal to purchase the retiring partner's shares?

**13.** Should the joint venture have a clearly defined life span with a fixed date sunset clause? Will the nature of the joint venture operations mean that its' life is open-ended? Will the retirement of the manufacturing partner mean the automatic death of the joint venture? If the joint venture dies, what formula should be adopted to distribute the assets and liabilities? Will you ensure that the patent and design rights revert to your ownership if the joint venture ends for whatever reason? What circumstances, if any, will cause or force the premature ending of the joint venture?

**14.** What about shareholders' rights if one of the joint venture partners retires? How should the value of shareholders' shares be calculated? Should the new incoming shareholders have the same rights and obligations as the existing shareholders? Should there be a right of veto against particular shareholders?

**15.** Here is a sensitive issue that may or may not be controversial, but will be crucial to the success of the joint venture: How are profits to be distributed? In normal circumstances, profits in the form of dividends will be distributed pro-rata with the number of ordinary shares held. However, in certain circumstances companies can distribute profits using alternative methods.

**16.** You and your company will have to determine an attitude to the joint venture company's regulatory compliance. Although the joint venture company is naturally responsible for its own actions, regulatory compliance must be monitored. Should your company seek this responsibility? Or should it be a shared responsibility?

**17.** You will have to ascertain whether your joint venture partner has sufficient funds available from internal sources to implement the joint venture or whether the joint venture company will be required to raise short-term development funds. Is the recruitment of another company as investor/shareholder a possibility?

**18.** You and your company must consider whether or not you will seek to prohibit the joint venture partners from competing directly with the new joint venture company.

19. The joint venture partners must determine the reporting and monitoring systems of the joint venture company so that the joint venture partners are comfortable with the degree of information disclosure and sharing.

20. You and your company must develop a policy position as to who will own any intellectual property rights that the joint venture may acquire, perhaps through new product developments or new manufacturing developments that result in patentable processes or novel designs. While such intellectual property rights would, *prima facie*, belong to the joint venture company, that is not an automatic position. More importantly, will the intellectual property rights revert to any particular party if the venture is dissolved or fails?

21. You will have to accurately determine how many employees and supervisors will be required. These numbers will be influenced by the organisational structure that you consider is the most appropriate to achieve the joint venture's objectives. This is a critical issue as the employment of staff not actually needed is a cash drain. Are your human resource policies and practices consistent with those of the joint venture partner? If not, how will this conflict be resolved or contained?

22. There are some management issues to consider: will the joint-venture board have complete autonomy or will there be some subjects that will require approval from the joint venture partners' own boards before action can be taken. Will the joint venture board be required to have unanimous consent for all decisions? What happens if the joint venture board and a partner board disagree? Will the joint venture board budget need the prior approval of the partners' boards before action can be taken? Can the joint venture board select and appoint its' own professional advisers?

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