*IOSR Journal of Mechanical & Civil Engineering (IOSR-JMCE)*
*ISSN: 2278-1684PP: 60-65*
*www.iosrjournals.org*

# Joint Venture in Construction Industry

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**Abstract -** The joint venture company (JVC) is the most common form of organizational structure where the parties wish to establish and operate a jointly owned business. The JVC, unlike a partnership, will have a distinct legal entity and also have the certain time limit. Joint venture provides strength in term of achieving goals to construction companies. It will offer a unique opportunity to combine the distinctive competencies and the complemenry skills of participating firms. The option such as risk reduction, sources of finance, access to market can make joint venture more attractive option. However problems could occur due to lack of trust between the partners and lack of strong and effective leadership. Paying great attention to the management of human resources and facilitating team building exercises was considered critical for success.

## 1. INTRODUCTION

A joint venture (JV) means; "An enterprise, co-operation or partnership, formed by two or more companies, individuals, or organizations, at least one of whom is an operating entity that wishes to broaden its activities for the purpose of conducting a new, profit motivated business of permanent duration. In general the ownership is shared by the participants with more or less equal equity distribution and without absolute dominance by one party."

An "operating joint venture" is a partnership through which two or more firms create a separate entity to carry out a productive economic activity in which each partner take part in decision making. Each party to the operating joint venture makes a substantial contribution in the form of capital and technology to marketing experience, personnel and physical assets. An operating joint venture is also different from interfirm arrangement which does not creat a separate entity.

## 2. TYPES OF JOINT VENTURE

***2.1 Integrated joint venture:***

Primary characteristic is that it can represent a true partnership, in that the parties share profit and losses. The interest may be 50:50% or some other division and there may be two or more members. The members share the profit and losses in proportion to their interest in joint venture. The parties combine resources and personnel in an agreed upon manner. This type of joint venture is used in projects which are of immense size and task of splitting the work is very difficult. As a result planning and programming can become complicated and required highly structured and authoritative central management.

***Typically used:***

- Strong, lengthy relationship between parties.
- Non-linear, complex projects.

***2.2 Non-integrated joint venture:***

Primary characteristic is that it is not a partnership in that there is no sharing of profit and losses. Each member is taken for specific scope of work and is responsible for the profit or losses associated with that scope of work. Each member is solely responsible for the resources necessary to perform its specified scope of work. The advantage of this type of joint venture is that for the contractor entering in to the joint venture, each can complement the others skills. But the disadvantage is that some contractors have put more efforts than others, thus leading to internal conflicts. This type of joint venture is used in projects where total work can be divided in to different sections. These sections can be subcontracted out to separate partners, who are responsible for technical and administrative element of those sections.

***Typically used:***

- Limited relationship between parties is desired.
- Linear projects with distinct work scopes.

***2.3 Combination joint venture:***

They present a combination of an integrated and non-integrated joint venture. Each member takes on specified scope of work and responsible for the profit or losses associated with that scope of work[19]. But the member also agree to act as partners with respect to a portion of the necessary work, which may include sharing the preliminaries and general condition necessary for each member's separate scope of work, as well as the actual performance of portion of the work of the project. This type of joint venture is used in larger and complex projects.

***Typically used:***

- Becoming popular; more closely reflects the likely spread of specialist as well as general work required on the larger, more complex projects.

**2.4 *OTHER TYPE OF JOINT VENTURE***

Joint ventures can be classified and described as follows:

**a.** Equity joint ventures.
**b.** Contractual joint venture.

***a. Equity joint ventures:***

Equity joint ventures involves the participation of two or more partners in the creation of a new corporate entity in which each partner owns a given share of the equity capital, or in the redistribution between the parties of the shares of an existing company is shared with and transferred to the other party in the joint venture. In equity based type, the inputs can be of capital, staff, plant and other resources and need not be on equal basis. The furnishing of bonds and sharing of profit has to be agreed upon.

***b. Contractual joint ventures:***

There is no equity participation between the partners and their relations, rights and liabilities, as among themselves and in respect of third parties, are principally governed by contract or agreement. Contractual JVs have their drawbacks. First, since all contractual JV contract details need to be negotiated, establishing a contractual JV can be time consuming and expensive. Indeed, contractual JV negotiations can derail potential ventures as parties discover that they cannot reach agreement on every detail. Second, contractual JVs are sometimes not the most appropriate business structure for the project.

## 3. REASONS TO FORM JOINT VENTURES

In practice, joint ventures are not the easiest forms of organizational entities to manage and operate, largely on account of the fact that the parties have to accept frequently a new set of working relationships, which, while proving difficult to define a manner satisfactorily to all parties involved, must take on the form of realistic, workable machinery. In contrast, the more usual main contractor association is a straightforward proposition, relatively free of ambiguities and generally less expensive to administer. Hence, there must be very compelling commercial reasons before parties to a construction enterprise resort to the formation of a joint venture. Some of these reasons are as follows:

***3.1 Technology transfer:***

The technology aspect is the overwhelming argument in favor of JVs. Timesaving technologies that help in reducing project costs result in incalculable economic benefits. In the construction industry, new techniques of construction, including the use of ready mix concrete, use of new material, like high – strength cements and updating the skills of the project team across the board, from the designer to the mason, have all resulted in superior quality.

***3.2 Sharing of political risks:***

A typical situation, which prompts a contractor to enter a joint venture with other firms, lies in the sphere of international construction. Political risks such as expropriation may be minimized if the interests of some indigenous party, perhaps contractor are tied in a joint venture. A significant local equity participation in any venture may be necessary for expediting local recruitment, import licenses and other commercial transactions.

***3.3 Sharing of commercial risks:***

Joint ventures also lend themselves as vehicles for the sharing of commercial risks, an important consideration in the case of a substantial construction project that may easily entail huge financial commitment over fairly protracted periods. These commercial risks include those posed by the vagaries of labour and material shortage, technical and design and changes in government legislation and regulations. The most obvious advantage in this regard stems from the fact, from the viewpoint of the individual firm, because of the joint venture, the capital requirements for a large construction project is low.

***3.4 Competition strategy:***

Consider the situation of a series of projects which involves a specialized form of engineering and management expertise in respect of which there are only half a dozen organizations which available at a given time to bid for the project. From the point of view of the bidders, the ideal approach may be to consider the use of joint venture vehicle that will have the effect of creating and strengthening the conditions in a new territory. Such a joint venture may aim firstly to force other competitors out of the market, secondly to allocate market or work volumes and thirdly to ensure the preservation of some price margin.

***3.5 Tax implications:***

Finally, a good case for participating in a joint venture may be raised on the premise of tax advantages. An opinion on the tax status of the joint venture should be obtained from a tax consultant who is familiar with the tax laws of the relevant jurisdiction before it is admitted as a consideration in the decision to proceed with a joint venture.

***3.6 Other reasons:***

Taking on a project that is larger than the contractor normally would undertake, with a view toward spreading the risk.

- Combining two contractors to generate bonding capacity that each contractor would not have individually.
- Teaming up two contractors with special expertise (a civil and mechanical contractor teaming up to construct a power plant).
- Teaming up a foreign contractor with a local contractor that may have political or other valuable relationships in the country where the project is.

## 4. LIFE CYCLE OF JOINT VENTURES:

The first stage of the life cycle of joint venture begins with exploratory stage. During this stage the prospective partners start making:

- Alliance
- Project collaboration
- Feasibility study

After making alliance, the growth phase of joint venture takes place. If the interest of the parties varies at this stage, they will lead to collapse of the joint venture in this phase itself. If partners work together, this phase leads to stability phase of joint ventures. Even in the stability stage, the joint venture may collapse. If not, the changed interest of parties forces them to renegotiate regarding their interest and shares. If the renegotiation is not successful, the joint venture may collapse. The reason for collapse includes:

- Entry of new competitors.
- Change in Business Environment.
- Change in partners strengths.
- Today’s partners may become tomorrow’s competitors.
- Change in partner’s interest.

Following figures 1. shows the life cycle of joint ventures:

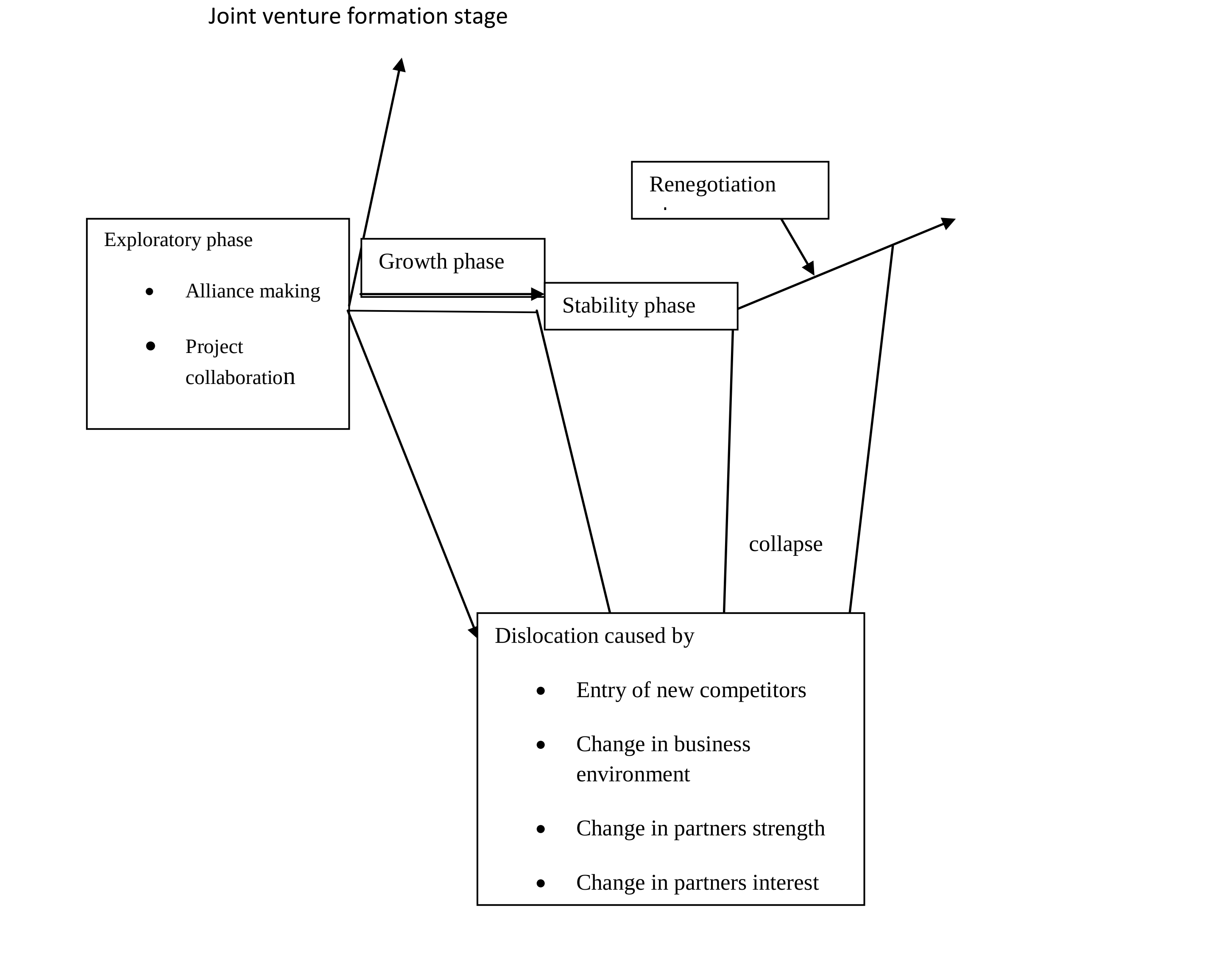


**Figure 1 Life cycle of joint venture**

## 5. STEPS TO MAKE JOINT VENTURE SUCCESSFUL

It indicated that joint ventures mostly fail due to potential problem and cultural variation. Following are some steps, which can make joint venture successful.

1. Do not accept joint venture agreement too quickly.
2. Get to know a partner by initially doing smaller and limited project together.
3. Companies with similar cultures and relatively equal financial resources work best together; keep in mind when looking for an appropriate partner.
4. The joint enterprise must fit the corporate strategy of both parent firms.
5. There should be proper legal agreement between both firms.
6. Keep the mission of joint enterprise small and well defined, ensure that it does not compete with parents.
7. Give the joint enterprise autonomy to function on its own and set up mechanism to monitor its results, it should be separate entity from both parents.
8. Limit the time frame of joint enterprise and review its progress frequently.

## 6. PROBLEMS IN JOINT VENTURES

***6.1 Unclear partner roles:***

A lack of clarity about how closely the two sides intend to work together is a common problem[5]. Some ventures require the active participation of both parents to be successful, while others do not. In a venture that has a clear majority owner, the minority partner may be contributing money, brand name, or rights to a technology and have no interests in the day to day decisions. A willing passive partner is the key to the success of a majority-minority venture. Matters are more complicated in a venture structured to be 50-50 or when the minority partner wishes to participate actively in the decision-making. In a 50-50 joint venture, the companies are expected to make roughly the same effort. But the key to a 50-50 operation is bringing together unique skills sets; so defining what constitutes an equal contribution of work can be tricky. The parents of a proposed partnership must articulate their assumptions and involve key people during the negotiations to define the contributions they will make and the benefits they expect.

***6.2 Unequal sharing of risks and benefits:***

An important issue to resolve before finalizing any deal is how the value generated by the venture will be distributed between the parents. Ensuring an equitable risk-benefit ratio is crucial to the longer-term health of the alliance

***6.3 The inevitable crisis:***

If a joint venture gets off to a successful start, it will settle into a normal pattern of operation and stable relationships. Effective day to day routines will be established and life will be somewhat predictable. The test of the joint venture will invariably come, however, when something out of the ordinary happens. The most difficult events are those that have the potential to pit the parents against each other. The key is to involve the original architects; upon whom the responsibility of being the problem solvers would be ideal.

***6.4 No exit mechanisms*:**

When conflicts escalate beyond a certain threshold and the parties no longer feel they can work with each other, it is vital to have a formal exit mechanism in place so that costly and time-consuming litigation can be avoided.

Given the short life span of joint ventures, it is surprising that many founders of joint ventures do not seem to pay enough attention to managing partner relations. Traditionally, the negotiating managers see the potential of a joint venture as *“the sky’s the limit,”* while underestimating the amount of partner coordination that is necessary after the deal is signed. To avoid having to exit a venture that is by one measure or another failure, they need to step around the minefields.

***6.5 Inadequate training:***

Inadequate JV training is an obstacle to implementing joint venture. Inadequate staff training is the essential reason for JV failure; the participants do not fully understand the concept of JV and hence are not able to implement partnering successfully. Since partnering facilitators play a significant role in the success of partnering ventures, inadequate training or expertise of the facilitators could also be a crucial reason for JV failure.

***6.6 Misunderstanding of partnering concept*:**

A thorough knowledge and understanding of the JV process is essential to create partnering success; misunderstanding the JV concept is thus a major problem for partnering implementation. Some project participants failed to understand how the partnering relationship could provide a competitive advantage. It is noted that limited experience in the partnering approach affected the understanding and knowledge of project participants. Also the fair profit motive, like the concept of JV, was not fully understood and supported by the project participants. Unfamiliarity or misunderstanding of the partnering concept by the project participants could cause a failure in partnering.

## 7 BENEFITS TO PARTNERS FROM JOINT VENTURE

***7.1 Benefits to foreign partners from joint venture:***

Competitive strategy such that foreign partner will get higher initial profit margins and they can reduce margins subsequently. Entry with a weaker partner gives them high profit margins, thus controlling the joint venture. They can enter later as an independent entity with possibly superior technology. They can gain the working knowledge under local conditions. Bidding strategy incorporates the preferential margin scheme, used to promote local industry. Also, they may not initially qualify alone due to lack of past experience in host country but they will qualify after formation of joint venture with local company who has past experience in host country.

***7.2 Benefits to Indian partners from joint venture:***

They will get the prequalification to participate in international contracts. They will share the risk such as political risk, legal risk, financial risk, operational risk with more experienced partners. They will get access to better technology, quality and safety standards. Projects completed as joint venture improves their track record in next bid. They will know how the modern site management is done. The increment is take place in contacts with necessary financial institutions, government authorities and marketing knowledge.

## 8. ADVANTAGES OF JOINT VENTURE:

Government's increased involvement in the private business environment has created more opportunities for companies to engage in domestic and international joint ventures, although they are still legally limited in what they can do and where they can operate. Nonetheless, more and more companies are involving themselves in joint ventures, and the trend is to increase their participation, since the advantages outweigh the disadvantage. Some of advantages are as follows

1. Joint venture provides large capital funds they are suitable for major projects.
2. They spread the risk between or among the partners.
3. Different parties to joint venture bring different kinds of skills like technical skills, technology, human skills, marketing skills which will help in planning, time saving and quality improvement.
4. Joint venture make larger project feasible and possible.
5. Joint venture provides synergy due to combined efforts of varied parties.

## 9. DISADVANTAGES OF JOINT VENTURE

1. Joint venture is not only collaboration of two companies but also collaboration of peoples from different culture, different attitude, so due improper communication conflicts may take place which result in collapse of joint venture.
2. Decision-making is normally slow down in joint venture due to involvement of number of parties.
3. Scope of collapse of joint venture is more due to entry of competitors, change in business environment in two countries, change in partner’s strength etc.

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