

Joint Ventures in China Unstable Structures?

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Joint ventures in China

- What does the future hold for joint ventures in China?
- Are they stable structures?
- What can a company do to protect itself?
- What are the remedies?

A bit of history

- Gradual realisation of China's industrial backwardness prior to 1979
- A number of remedies were tried:
 - Import of equipment
 - Introduction of technology through licensing
 - Turnkey plants
- **FAILURE**

Search for alternatives

- Open door policy in 1979
- Joint ventures
 - Limited shareholding for foreigners
 - Lack of a legal basis
- 1980 Beijing Aviation Food Co.

Location of early joint ventures

- No confidence of success
- Outlying provinces
 - Guangdong
 - Zhejiang
- Low risk in the event of failure
- Unintended consequences!

Joint venture drivers - Chinese view

- Regulations and the approval process allow the government to maintain control
- Implementation risk is transferred to the foreign partner

Joint venture drivers - Chinese view

- Joint venture structure provides a learning process for Chinese industry:
 - Transfer of technology and know-how
 - Management skills
 - Access to foreign markets and distribution channels
 - Modern equipment
 - Capital
- Opportunity to realise value of assets

Joint venture drivers - Foreign view

- Legislation
- Lack of market knowledge
- Market access and distribution channels
 - Domestic and foreign
- Access to raw materials
- Low labour costs
- Lower capital costs
- Lower standard of regulation

Joint venture drivers

- Neither partner has sufficient knowledge or experience to go it alone in the market
- Alignment of interests
- Win-win situation

When might a joint venture become unstable?

- As time passes interests become misaligned
- The learning exercise is complete
- Both partners have the capability to go it alone

Forces driving a joint venture apart

- Chinese partner
 - Difficult foreign partner
 - Government pressure
 - Knowledge gained
 - Lack of capital
 - Autonomy
 - Greed

Forces driving a joint venture apart

- Foreign partner
 - Legislative changes
 - Difficult Chinese partner
 - Market knowledge
 - Market access
 - Management problems
 - Protection of intellectual property
 - Partner problems
 - Autonomy
 - Greed

Any joint venture contains the seeds of conflict

- Between the partners
- Between the joint venture and its partners
- What will happen when the joint venture overtakes the Chinese parent?
- Will the Chinese parent permit the cannibalising of its customer base?
- Chinese partner may not part with its best staff
- Chinese partner may not part with its best assets

Any joint venture contains the seeds of conflict

- In a deadlock situation, there will be pressures to get as much as possible out of the joint venture:
 - Cash
 - Expertise
 - Technology and know-how
- Give nothing at all in return

Joint ventures can also be destroyed by external forces

- Competition
 - From industry
 - From government
- Singapore government's project in Suzhou
 - Authorities set up their own development zone in competition
 - Were able to give concessions and privileges not available to the Singapore joint venture
 - Eventually Chinese zone took over Singapore zone

Remedies

- A company should not enter into a joint venture without considering the possibility of divorce
- A future buyout of a partner will be expensive
 - In essence it will be buying its own goodwill
- A divorce may introduce a new competitor into the market

Remedies

- The prospect of divorce may introduce a “moral hazard” into the joint venture
- How can you be certain that your partner is not being deliberately obstructive to enable him to buy out his partner cheaply?
- Should the foreign partner deliberately manage the joint venture to fail?

Remedies

- What can a foreign partner do to protect itself?
 - If you do not need a joint venture, then do not enter into one!
 - Scrutinise the joint venture agreement very carefully
 - Plan ahead for divorce
 - Liquidation clause
 - Valuation
 - Triggers - unacceptable performance
- Liquidation will still require ratification by the board of directors & department in charge

Remedies

- What can a foreign partner do to protect itself?
 - Multiple partners
 - Product limitation
 - Less advanced technology
 - Geographical limitation
 - Offshore company
- Act sooner rather than later

Two examples of unstable joint ventures

- Nokia China
- China's motor industry

Thank you

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