(ii) Decisions of the Thirtieth Session

The Sub-Committee complimented the Secretariat for preparing an excellent guide for promoting industrial joint ventures in the Afro-Asian region and decided to adopt it in its present form. Member States were urged to publicise it in their respectivre countries so that it could be brought to the attention of the parties intending to negotiate and conclude joint venture arrangements. The Secretariat was, however, requested to keep on updating the Legal Guide in the light of the amendments that might have been effected in the National Laws pertaining to joint venture arrangements and appending thereto texts of laws specific to joint ventures and models of joint venture contracts in use in the Afro-Asian region. These recommendations were subsequently approved by the Plenary of the Committee.

The guide on Legal Aspects of Industrial Joint Ventures as prepared by the Secretariat has been reproduced in the following pages.

(iii) Secretariat Study
Guide on Legal Aspects of Industrial Joint Ventures in Asia and Africa

A. Introduction

Historically, foreign direct investment in the developing countries had generally been in the form of wholly-owned subsidiaries and branch offices of foreign companies based in the industrialized countries of the West. However, in the sixties, the attitude of the developing countries towards foreign investors underwent a significant change following the adoption of the first United Nations Development Decade in 1961 which brought about a shift in their economic objectives from aid to trade. Soon thereafter, the clamour for self-reliance and economic independence in these countries paved the way for the passage of legislation limiting the foreign equity participation with a view to protecting themselves from equity encroachment of foreign investors in certain specific areas of economic activity, such as the exploitation of natural resources, land-holdings and public utilities. Consequently, the wholly-owned subsidiaries of foreign corporations were asked to dilute their equities and on their refusal to do so, they were usually subjected to nationalization on unfavourable terms.

This situation provided an impetus for the initiation of new contractual modalities aimed at safeguarding the interests of both the foreign investor and the host government. Among the contractual modalities evolved, the joint venture has emerged as one of the most important and acceptable instruments of foreign investment and technology transfer from transnational corporations, as also from medium-sized and small enterprises, both in the industrialized countries and the newly industrialized countries, to private and public sector enterprises in many developing countries.

Joint ventures can be defined as collaboration or new investments involving shared ownership between local and foreign partners. The parties to a joint venture may be individuals, corporate bodies, government or governmental undertakings and the agreement may be bipartite or multipartite. There are two fundamental forms in which the joint venture arrangements are used : *contractual joint venture* and *equity joint venture*.

Contractual Joint Venture

The contractual joint venture is a special combination of two or more parties where in some specific venture a profit is jointly sought without any corporate designation. It is, in fact, a risk-sharing venture in which no joint enterprise with separate legal personality is formed. The parties are bound only by the terms of their contractual agreement. The contractual joint venture scores over the equity joint venture in that the parties to the former need not comply with corporate formalities relating to profit sharing. They benefit immediately from the results of productive and commercial relations. The most significant advantage of the contractual joint venture is that the parties can adopt any rule in the contract without being fettered by the constraints imposed by the legal system of the host State.[1]

The contractual joint venture, however, suffers from the following drawbacks :

(i) In the absence of an autonomous corporate entity and a formal managerial organization, the parties are at times handicapped in taking swift decisions in cases of exigency;

(ii) As it does not have a board of directors as in the case of an equity joint venture, the parties are unable to impose a decision by executing voting power;

(iii) A complex system of contracting or sub-contracting may cause serious difficulties in the execution of contractual obligations and raise potential problems of contractual responsibility, particularly in regard to third parties; and

(iv) Foreign experts and technicians are sometimes tempted, especially in construction and engineering assignments, to hasten their work unduly in order to start a new task elsewhere as quickly as possible. These difficulties, however, can easily be overcome by formulating specific and precise provisions devoted to these matters in the basic agreement. As a matter of fact, the flexibility inherent in a contractual joint venture is far from being an obstacle to the cooperation between the parties and to its efficient management.

Contractual joint ventures are basically contracted for relatively limited duration and purposes and have been used for the supply of capital, equipment, industrial property, technical assistance and transfer of knowhow by the foreign party in return for fees or royalties. For developing countries contractual joint ventures would be more appropriate for projects where quick results are contemplated. They can be profitably employed by governmental undertakings in developing countries in short-term projects, exploration and exploitation of minerals, development of fishery industry etc.

Until recently, contractual joint ventures were traditionally employed by the socialist countries due to their nationalistic disinclination against foreign ownership of national enterprises.[2] Of late, these countries have issued regulations concerning the establishment and operation, in their respective territories, of joint ventures in limited liability company form in which the foreign equity participation is generally limited to 49% of the equity capital of the joint venture company.[3] The legislations in these countries, however, do not cover all questions relating to establishment and operation of joint ventures in their territories. For example, they do not as yet have corporate laws which would form the basic legal framework for

1. In China, contractual joint ventures can operate only under existing laws and regulations. Contracts relating to such joint ventures acquire legal force only upon their approval by the concerned authorities.

2. In China, despite a Joint Venture Law permitting establishment of Chinese-Foreign equity joint ventures, there appears to be a preference for contractual joint ventures. Since 1979, Chinese enterprises have signed more than 10,000 joint venture contracts totalling US $ 25 billion in foreign investment, but a majority of them are contractual joint ventures.

3. In the recent history of socialist countries, Yugoslavia was the first one to introduce a Joint Venture Law in 1968. Other socialist countries followed suit : Hungary in 1970, Romania in 1972; Vietnam in 1977; China and Poland in 1979; Bulgaria in 1980; Cuba in 1982; DPR Korea in 1984; the Soviet Union in 1987 and recently Laos. Czechoslovakia now allows the establishment of joint ventures without any express regulation. Only Albania has remained without joint venture legislation.

a joint venture company. Such a framework must, therefore, be created through contractual arrangements between the parties.

Equity joint ventures

In an equity joint venture, both the foreign and local parties are required to subscribe to the capital to float a joint venture company which would then engage itself in the execution of the project. Although equity joint ventures may take several forms, in the context of the developing countries, they have been limited to three types; minority foreign ownership; majority foreign ownership; and shared ownership. In this type of joint venture, there is one basic agreement between the partners incorporating the terms and conditions of their association. The *memorandum* and/or *articles of association* of the company to be formed and the drafts of the agreements to be executed by the proposed company for technical assistance and marketing arrangements are normally annexed to the basic agreement and form a part of the same. Equity joint ventures are generally appropriate to a "*standard product with a continuous market*". They are particularly widespread in the manufacturing of '*such products*' as chemicals, drugs, engineering and machine tools, automobiles and electronics. Recently, their use has also been extended to new fields including exploitation of minerals and other raw materials as well as to the oil industry. A unique feature of the equity joint venture is its adaptability to almost an infinite number of combinations of possible terms and conditions.

For the developing countries, the equity joint venture serves the following purposes :

(i) Partnership with a foreign investor based on shared ownership, control and responsibility constitutes a symbol of equality;

(ii) It stimulates the engagement of responsible local capital in productive enterprises;

(iii) It helps to develop a nucleus of experienced managerial personnel in the public as well as private sectors, in proportion to the participation of public authorities and private capital in the joint ventures;

(iv) Investment from the foreign owner of technology implies acceptance of market risks and provides the insurance that the technology applied would be relevant to the purposes of the venture and appropriate to the market place;

(v) It helps to advance the training of local labour and technicians;

(vi) Collaboration with the foreign partner brings with it both management and access to markets over which he has trading influence or authority; and

(vii) The association provides assurances for the continuity and competitive viability of the enterprise by the access it obtains to the foreign investor's research and development.

For the foreign investor, it offers the following advantages :

(i) Association with the local partner generates goodwill not only with the local employees but also with the host government;

(ii) It reduces his capital risk-sharing;

(iii) It decreases the possibility of nationalization or discriminatory legislation by the host State;

(iv) It obtains access to expanded markets;

(iv) It provides a means to shift production sites from a high-cost environments to one of lower cost, or to reduce overall business risk through geographic dispersion of manufacturing operations; and

(v) It enables him to use the local partner to support the venture with national inputs such as labour, raw materials and working capital, to reduce risk capital outlay by using local partner's inputs, or have access to institutional funds available to developing country firms.

Equity joint venture arrangements have gained recognition and interest not only of private business parties but also of developing countries in general for economic and political reasons. Joint venture agreements offer governments of developing countries some reassurance on such issues as control by the host country of management decisions, future levels of profit remittances and the development of local skills. On the other hand, a foreign investor may want to seek local equity participation not only to reduce its own cash investment and political risk but also in order to avail itself of the benefits arising from the familiarity of the local executives with the personnel, resources, markets and practices of the host country. The equity joint venture is, therefore, perceived as a means of reconciling the interests of the host government and the foreign investor on the one hand, and between the foreign investor and the local partner, on the other.

B. Scope for Joint Ventures in Asia and Africa

Despite the fact that developing countries contributed only 2 per cent to foreign direct investment outflows in 1985[4] the number of transnational corporations based in developing countries is growing. The bulk of foreign direct investment from developing countries is carried out by a relatively small number of firms which are leaders, both in size and technology in their home markets. Some of these firms have already attained a certain degree of sophistication and their manufacturing range now includes ships, automobiles, locomotives, machine tools, electrical power machinery and switch gears; heavy steel structurals; iron and steel plants; plant and machinery for petrochemical industry; agricultural machinery and implements; construction equipment; and sophisticated precision castings and forgings. In point of fact, industrial undertakings in these countries are already contributing to the development of other countries of the region either through joint ventures on a bilateral basis or a multipartite basis when collaboration with an undertaking of the industrialized country is involved. Undertakings, whether governmental or non-governmental, in these countries, have also developed considerable skills in the field of consultancy services. The range of these services include, *inter alia*, integrated consultancy services covering the entire spectrum of services from feasibility studies to engineering of the project, commissioning and initial operations, management, man-power development and training services. In the field of civil engineering works, the expertise available in these countries is such that their enterprises are now competing successfuly with the enterprises of the industrially advanced nations.

Thus, one of the striking phenomena in the international business during the last decade or so has been the foreign direct investment in manufacturing by hundreds of corporations from developing countries and territories, such as India, Republic of Korea, Hong Kong and Taiwan, in other developing countries. Approximately 90 per cent of the manufacturing affiliates established by these corporations have involved joint ventures with local partners engaging in scaled-down manufacturing using *labour-intensive technology* to produce and market standardized products at cheaper rates. They have found joint ventures with local partners advantageous to obtain capital, some management, knowledge of the political situation and other aspects of national environments. These corporations have used a number of parent-firm managers to manage their joint venture affiliates and have granted considerable autonomy to them. However, the substantial local ownership involved and the degree of autonomy granted to the affiliates have tended to lead to decisions that have been consistent with the interests of national partners and the host countries.[5]

It is, however, not possible for the newly industrialized countries of our region to cover the entire spectrum of developmental activity in other parts of the Third World as the totality of the resources at their disposal are too meagre considering the massive effort involved in the economic reconstruction of the Third World. This task can be accomplished only with the combined resources, capacities and skills of both the developed and developing nations with requisite tie-ups with such an industrially advanced nation in our region as Japan. The most active foreign investors in recent years have been the Japanese corporations. Over the last several decades, these corporations have increasingly adopted global strategies, selling simultaneously in domestic and export markets and achieving economies of scale in the process. The export successes of these corporatioans can be attributed largely to greater production efficiencies stemming from innovations in the organization of production and the introductions of information-based production technologies. These have helped the Japanese corporations to become low-cost producers in a number of key industries. They have already registered their presence in the industrialized West and South East Asia and are in search of newer markets. If foreign investment from these corporations could be diverted to other parts of Asia and Africa through joint ventures, it is bound to quicken the pace of development in those regions. Already, these corporations have shown marked preference for developing Asian and African nations where labour and resources are in abundance. In mid-1970s, about 80 per cent of the affiliates of Japanese corporations in developing countries were co-owned or minority-owned joint ventures. Small and medium-sized Japanese firms accounted for about half of the joint ventures in manufacturing upto the mid-1970s, but the large

4. UNCTC. *Joint Ventures as a form of International Economic Cooperation*, United Nations, 1988. (ST/CTC/93). p. 4

5. Louis T. Wellis, Jr. *Third World Multinationals* (Cambridge, MIT Press, 1983); and Sanjaya Lall, *The New Multinationals : The Spread of Third World Enterprises* (New York, 1983).

Japanese corporations have increased their involvements since then. The ownership pattern of the Japanese corporations is partially explained by the fact that their joint ventures in developing countries have been primarily for producing fairly standardized products, such as textiles, wearing apparel, footwear, consumer electronics and intermediates. Japanese trading companies have also been involved in many of the joint ventures in manufacturing operations with small and medium-sized firms by providing capital and financing and handling exports to and from the affiliates. By engaging in these joint ventures, the Japanese corporations shared the start-up risks, obtained management, particularly in marketing, and knowledge of local customs and political situations in the developing countries. In a number of cases, the Japanese corporations had ventures with more than one local partner. Although the Japanese corporations have used local managers, particularly in sales and to maintain contacts with Governments of host countries, they have generally controlled key strategic and operational decisions of affiliates. They have also tended to establish wholly-owned or majority-owned subsidiaries in offshore manufacturing in developing countries to export products to the United States and Western Europe.[6]

Since a joint venture, particularly an equity joint venture, is required to carry out its operations in the legal regime of the host country, it would be immaterial whether the investor is from a developing or developed country. The option vests with the host country whether it approves foreign investment from a source in a developing country or an industrialized country.

Amongst the newly industrialized countries of our region, capability already exists to offer technological assistance in the following fields :

Metallurgical Industries

A. Ferrous

Iron and steel based on electric arc furnace; Ferro Alloy;

Iron and steel structurals;

Iron and steel castings and forgings;

Iron and steel pipes.

6. UNCTC. *Joint Ventures as a Form of International Economic Cooperation* (United Nations, New York, 1988).

B. Non-ferrous

Semi-manufactures

Sodium metal and cadmium metal

Boilers and Steam Generating Plants

Boilers and steam generating plants upto 50 tons/per day capacity.

Prime Movers (other than Electrical Generators)

Diesel engines upto 50 H.P.

Electric Equipment

Equipment for transmission and distribution of electricity such as switchgears and capacitors, transformers;

Electric motors upto 50 H.P.

Electric fans;

Electric lamps;

Electric arc melting furnaces;

Electric cables and wires such as PILC and PVC

Telephone cables

Household appliances such as electric irons, heaters and radio receivers.

Transportation

Railway locomotives;

Buses, trucks, motor cycles, scooters, mopeds, bicycles;

Others, such as forklift trucks, cranes; Auto ancilliaries.

Industrial Machinery

Mixers and reactors, kneading mills, turbo mixers, power driven pump reciprocating, centrifugal referigeration plants for industrial use, speed reduction units.

Machine Tools

Machine tools.

Agricultural Machinery

Tractors, Agricultural implements.

Miscellaneous Mechanical & Engineering Industries

Plastic moulded goods;

Hand tools, small tools and the like, Pressure cookers;

Cutlery;

Steel furniture;

Commercial office and Household Equipment

Typewriters, both manual and electronic.

Airconditioners and refrigerators;

Sewing machines;

Hurricane lanterns.

Industrial Instruments

Water meters, steam meters, electricity meters,

Weighing machines—mechanical.

Mathematical, surveying and Drawing instruments.

Fertilizers

Single and triple super phosphate.

Chemicals (Other than Fertilizers)

Caustic soda, sulphuric acid, HCL, alum; Alcohol and alcohol based chemicals; Fine chemicals including photographic chemicals; synthetic resins; paints, varnishes and enamels; man-made fibres including regenerated cellulose, rayon, nylon etc.

Coke oven by-products;

Insecticides, fungicides, weedicides;

Textile auxiliaries;

Sizing materials including starch;

Oxygen;

Essential oils.

Dye-stuffs

Drugs and pharmaceuticals;

Textiles (including those dyed, printed or otherwise processed);

Paper and pulp including paper products;

Sugar; Food processing industries;

Vegetable oils and vanaspati;

Soaps, cosmetics and, toilet preparations;

Leather and leather goods;

Glue and gelatine;

Glass and glassware;

Cement and gypsum products;

Timber products.

Miscellaneous industries

Cigarettes;

Linoleum, whether felt-based or jute based, Zip fasteners–metallic;

Oil stoves;

Safety matches.

Services

Consultancy;

Construction;

Infrastructure, such as power generation; transportation water supply, industrial estates;

Hotel;

Tourism.

According to the laws and regulations collected and studied by the Secretariat in respect of the States in the Afro-Asian region governing foreign investment, the potential areas for establishing joint ventures in those countries appear to be as follows :

ASIA

Afghanistan

Under the Domestic and Foreign Investment Law of 1987, foreign investment appears to be welcome in almost all economic sectors. However, the law encourages two types of mixed investment—mixed investment consisting of foreign and domestic capital in which the foreign capital shall not exceed 49% of the total capital; and mixed investment consisting of private and State capital and foreign capital in which the share of the State does not exceed 33% of the total capital and the foreign share does not exceed 49% of the remaining capital. In exceptional cases, the share of foreign investor can be increased on the basis of a joint proposal by the national and foreign partners with the agreement of the Government, but the joint enterprise is obliged to balance the level of public and foreign shares in accordance with the law within five years.

Bahrain

Order No. 6 of 1984 and Decree No. 1 of 1986 apply to all industrial establishments which are defined as every establishment the principal object of which is to convert raw materials into fully or semi-manufactured products and to transform semi-manufactured products into fully manufactured products or to mix, assemble, pack or wrap products using mechanical power.

Under the Regulations for Industry, the capital participation of Bahrainis or citizens of other Gulf countries must not be less than 51 per cent of the share capital of the industrial establishment. In addition, industrial establishments are required to comply with the following conditions : the share of local production included in manufacture must not be less than 20 per cent in the first three years from the date of commencement of production and must rise to more than 40 per cent five years after this date; products should be of high quality; the production must meet a reasonable proportion of local consumption as determined by the appropriate authorities; the establishment must properly exploit the local raw materials, manpower etc.

Under Decree No. 11 of 1987, new industrial projects are required to comply with the following further conditions : submission of a feasibility study to the satisfaction of the Ministry of Development and Industry; provision for employment of local manpower and training opportunities for them; and it must contribute to industrial development by replacing imports, promoting exports and using locally available means of production.

Bangladesh

The Foreign Private Investment (Protection and Promotion) Act, 1980 encourages foreign investment generally on a joint venture basis. The proportion of equity between Bangladesh and foreign investors is determined on merits in each case of foreign investment. However, in the Export Processing Zone, foreign investment to the extent of 100 per cent ownership is allowed.

Under the Industrial Policy 1986, foreign investment is encouraged specially in : export-oriented industries; industries in Export Processing Zones; high technology products that will be either efficient import-substitute or export-oriented; undertakings in which more diversified use of natural resources is made; and existing public or private sector enterprises for increasing productivity and/or improving quality of products.

The Department of Industries identifies sectors/subsectors for foreign investment. This indicative priority list for foreign investment during the Third Five Year Plan (1985-90) includes : chemicals; engineering; textiles; food and allied products; and other industries requiring transfer of technology or for export only.

Brunei Darussalam

There are virtually no restrictions on foreign investment, except in areas concerning the public sector. The Government encourages foreign investment in particular in export-oriented industries. In joint ventures, equity participation of at least 30 per cent by local nationals is encouraged.