Joint Ventures and Other Growth Alternatives

David Healy
Growth Alternatives

- Internal Development
- Acquiring Technology
- Joint Venture (JV) Entities
- “Contractual” JV Agreements
  - Joint Marketing
  - Joint Development
  - Outsourcing
  - Hybrids
- Acquisitions
Internal Development: Pros

- Control of Design, Timing and Quality
- Design for Integration
- Known Team and Technology
- 100% IP Ownership and Control
- Can Control Third Party Access
- No Dependence on Third Party ("3P")
Internal Development: Cons

- Often Slowest Time to Market
  - Delays in Building a New Team
  - Conflicts in Resource Allocation
- May Be Highest Cost Approach
- Distracts from Core Competencies?
- Excess Baggage After Development Completion?
Acquiring Technology
License: Pros

- Often Fastest Time to Market
- Less Expensive, Easier Process
- Can Couple With Equity Investment, With
  - Upside Potential to Share Value Creation
  - Control Rights
  - Merger Veto, Refusal Right
Acquiring Technology
License: Cons

- Dependence on Third Party
- Risk of Termination or Nonrenewal
  - Licensor Acquisition or Bankruptcy
- Costly and Difficult to Get Exclusive Rights
- Third Party May Want Grant Back or Equity
- Above Unacceptable Risks for “Core IP”
Entity Joint Ventures: Pros

- Improved Ability to Address New Markets and Technologies
  > Pooling of Resources
  > Time to Market Advantages
- Sharing of Profits and Risks
  > IP Royalties Also Possible
- Unlike Acquisition, Can “Unscramble”
Entity Joint Ventures: Cons

- Not Truly Independent
- Upside / Liquidity Path Unclear
- Joint Control Unworkable
- ISOs May Be Unavailable
- Risks of Disputes or “Divorce”
- Risks of Giving JV Exclusive Rights
Entity JVs—Key Issues

- JV Structure; Choice of Entity
- Tax Planning
- Technology (IP) Contributions
- Employee Incentive Strategies
- Control; “Divorce” Planning
Entity JV Structure:
Choice of Entity

- If Tax Considerations Dominate--LLC
- If Equity Compensation or IPO Exit is Key--Corporation
Tax Planning

- **Choice of Entity**
  - Contract Arrangement May Be Tax Partnership

- **Structuring of Technology Contributions**
  - Grant of “All Substantial Rights”

- **Cross Border Technology Transfers**
  - Royalty Advisable If Contribute IP to Foreign JV

- **Special Allocation Provisions**

- **Exit Planning Issues**
IP Complexity

- JV vs. Member IP Rights
- Rights Pre, Post and During JV
- Royalty Structure
- JV Field of Use and Sublicensing Rights
- Assignability; Terminability
- Noncompetes
- Assign Parent Opportunities?
Control: Member Veto As To:

- Business Plan and Scope
- Budgets, Financings, Capital Calls
- Officers, Compensation
- Member Assignments or Admissions
- Exit Scenarios--IPO, M&A, Wind Up
- Key IP Issues
“Divorce” Planning

- Clear Initial Agreement On Goals, Tactics, Timing & Respective Contributions Is Key
- Escalation & Deadlock Resolution
- Clear rights to dissolve JV or terminate its exclusive rights in certain situations
- Have mechanism to achieve Exit Strategy by JV sale or IPO or JV partner buyout
- Consider Effect of Termination On:
  - IP, Employees, Facilities,
  - Other Assets, Rights & Liabilities
Employee Incentive Strategies

- Inducement Incentives
- Downside Protection—Severance; Vesting Acceleration, Right to Return to Members
- Phantom Stock Plans—”JVARs”; SAR Accounting
- Option Plans—Effect of Roll Up; Put/Call Rights; LLC Complexities
“Contractual” JVs-Types

- Joint Marketing, Co-branding and Linking Agreements
- Outsourcing; Joint Development
- Internet Hybrids of the above:
  - e-business Infrastructure Development
  - Sales and Customer Management
  - Web Hosting; Fulfillment; MIS
  - Content/Delivery JVs
- Above Often Coupled With Equity Investment
Contractual JVs: Pros

- Avoids Need for Entity Formation for Shorter Term and Project Specific Cooperation
- Retains Focus on Core Competencies
- Avoids Need to Build Infrastructure
- Fast, Low-resource Way to Add Needed Solutions and Services
- Leverages 3P’s Superior IP and Resources
- Shifts Risk to 3P
Contractual JVs: Cons

- Dependence on 3P and Contract Continuance
- Loss of Control & Flexibility
- Risk of Disputes; Termination Planning
- Impact on Expenses and Margins?
- Dilution If Give up Equity
M&A Risks May Favor JVs or Other Growth Alternatives

- EPS Dilution if Synergies Don’t Materialize
- Integration Risks: Employee/Culture, Customer and Market Channel Confusion
- Management Distraction
- Inheriting Unforeseen Risks (IP, Litigation)
### Decision Drivers

- **Core Technology, Control/Exclusivity Critical**
  - Buy or Grow

- **Can’t Depend on Others--Buy or Grow**

- **Internal R&D Impossible**
  - Buy, License, or Have 3P or JV Develop

- **Inability to Ramp Infrastructure Quickly**
  - Time to Market Critical: Buy or License; Market or Have 3P Provide Solution Via Contract or Entity JV
  - Inability to Afford Rapid Market Segment Penetration—partner With Party With Funds, Market Position or 1st Mover Advantage