



# "QUO VADIS EAST-WEST JOINT VENTURE?" Reflections on Selected Aspects of the Development of East-West Joint Ventures

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# ***WORKING PAPER***

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of the Development of East-West  
Joint Ventures**

*O. Bečvář*

Editor: E. Razvigorova

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## FOREWORD

This working paper is one of a series\* produced by TES-MTC project discussing the problems of East-West Joint Ventures located in the CMEA countries on a country basis.

The paper gives an overview on the main features of the process of East-West joint ventures' establishment and operation. The author concentrates his efforts on analyzing the state-of-the-art, the recent problems and their possible solutions in the fields of joint ventures' establishment, management, technology related to joint ventures, joint ventures' effectiveness, bookkeeping and supply in a joint venture, consultancy for joint ventures. The paper also stresses other possible forms of East-West joint ventures in order to overcome some of the operational problems with respect to East-West payment options, supply, market opportunities, etc.

At present discussions are going on in Czechoslovakia in connection with the latest legislation on enterprises with foreign property participation, as well as on the state-of-the-art of the joint venture practice in this country.

The Management of Technological Change (MTC) project, part of the Technology, Economy & Society (TES) Program, has developed an international network which is performing an empirical study on practical problems of joint ventures located in various CMEA countries. This working paper is an intermediate report of the Czechoslovakian national group headed by the Research Institute of Economy in Electrotechnical Industries in Prague. The author is member of the international MTC network and works closely together with the project.

F. Schmidt-Bleek  
Leader  
Technology, Economy and Society Program

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\*To date, the following papers have been published:

Djarova, Julia Joint Ventures: A New Reality of East-West Cooperation (State-of-the-Art), June 1988, WP-88-054.

Benedek, Tamas Some Experiences of Joint Venture Establishment and Operation in Hungary, September 1988, WP-88-88.

Ranenko, V., Soloviev, I. Joint Ventures with Foreign Capital Participation in the Soviet Union: Experiences and Future Outlook, January 1989, WP-89-03

Soloviev, I. Guidelines of Foreign Partner Selection in the USSR, January 1989, WP-89-02

Razvigorova, E. Joint Ventures: A New Practice in Bulgarian Foreign Economic Legislation, March 1989, WP-89-026

Razvigorova, E., Djarova, J., Leitner, W. A New Step Forward for Joint Ventures, June 1989, WP-89-00

# "QUO VADIS EAST-WEST JOINT VENTURE?"

## Reflections on Selected Aspects of the Development of East-West Joint Ventures

Otakar  
Bečvář<sup>1</sup>

### 1. Introduction

The world has been witnessing an information boom on East-West joint ventures. It is an outward sign of the euphoria which started in the CMEA countries at different points in time and which has now logically progressed to a stage in which it is gradually replaced by critical realism based on a scientific analysis of relations and being freed from unrealistic fiction.

Experienced economists are well aware of the fact that the establishment of joint ventures will not be motivated by altruistic reflections, but by social and entrepreneurial interests. The strategy is straight forward: to save costs and to achieve various benefits, particularly profit.

Notwithstanding their great popularity, joint ventures do not imply dramatic changes in East-West relations; they influence the overall economic relations only in a slight degree.

On the analogy of other CMEA countries, the proportion of the turnover achieved by joint ventures in the total output of Czechoslovakian economy is not decisive and will continue to be low in the near future. Up to now no heavy industry or power engineering plants, no motor car factories, etc., appeared among the existing and the discussed joint ventures. The interest concentrates on smaller, exceptionally on medium-sized projects.

In Europe, a special joint venture market has developed. The prove that it is right to talk about a market can be found in the offers for establishment of joint ventures which are getting an organized shape in form of lists of specified proposals. A pamphlet is being distributed in business circles issued by the Hungarian Chamber of Commerce; the Soviet Union has a similar approach, and different projects are under preparation in other countries, too. An inquiry is more likely to be presented by Western countries, i.e., interest in the establishment of a joint ventures has been shown during cooperation, negotiations and discussions of larger projects. Thus, the main features of a market do exist. According to incomplete information it would seem that supply and demand are not balanced. Other market features such as competition, price negotiations and participation of bank capital are also being encountered. The idea of a joint venture is based on the complementary character of the contribution made by the individual participants.

The final effect depends on the

1. differences in the structure of available technology and manufacturing conditions; diversity of natural conditions expressed by the capacity of natural fuel and raw material resources

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2. different level of economic development
3. specific features of industry structure in a given country

Let us consider a few simple examples: Bulgaria has an advanced production of hoisting devices, Hungary the production of buses, Poland production of road construction machinery, Czechoslovakia the production of heavy trucks, Rumania equipment for crude oil extraction.

Having analyzed these aspects one can say that for instance a) a correlation between the establishment of joint ventures and the existence of natural conditions does exist b) no relation between the level of development of a CMEA country and the number of joint venturers could be traced, as to c) it has not become usual yet to establish joint ventures for products which are considered to be a national specialty.

The objective conditions for the stipulation of the product structure to which the attention of manufacturing joint ventures should be drawn include, in addition to natural resources, qualified manpower, historical trends and transport facilities of a country, particularly the possibility of minimization of costs. Let us take for granted that it is possible nowadays to start any production practically anywhere, but the successful location of a manufacturing joint venture, or of other forms of cooperation, will be the one with the lowest production costs, the site where the reproduction process can be intensified.

Leading West European firms may prefer joint ventures to unilateral enterprise for a number of reasons:

- Easier winning of contracts based on calls for tender
- Sharing of efforts, responsibilities and risks
- Gaining of access to markets in new territories
- Overcoming of various import barriers
- Easier obtaining of permissions for the exploitation of raw material resources
- Development and manufacture of new products
- Utilization of qualified manpower

while always bearing in mind a lowering of production costs.

These firms show preference for joint ventures in the partner's country with a view to the

- possibility to exert greater influence on decision making in the managerial process
- possibility to effect rigid checks on product quality
- more profitable manufacturing conditions
- sometimes more favorable tax rates or possibly "tax vacations"

In the forms and activities of joint ventures gradual, but obvious changes have taken place already. Banks and Trading Corporations are being invited to participate. The shortness of time and the small number of existing joint ventures do not allow the Czechoslovakian research to reach conclusions on the basis of own experience. In the elaboration of the proposed economic concept of further continuity of the process in this field we have to rely on experience gained in other countries which we are studying and trying to analyze.

Encouraging news came from Hungary, the country with the greatest number of joint ventures, reporting that the economic results of these corporations are much better than the average level of all Hungarian enterprises.

The Institute of Economic Research in the Electrotechnical Industry has studied the findings ascertained in joint venture corporations in Czechoslovakia (TESSEK, AVEX, LUWEX, ROBOT, HALDEX, HOTELINVEST), as well as in other CMEA countries and studied also specialized literature; and having effected a classification and an analysis of

the material they elaborated a model of optimum orientation of joint ventures under the Czechoslovakian conditions of.

The working paper states some ascertained facts of CSSR and CMEA experience and attempts at hypotheses, prognostic conclusions and recommendations for possible further development in the studied field.

We start with the assumption that the process of joint ventures development is governed by certain economic principles of an objective nature that cannot be changed. Their identification, however, can be used to adjust the environment, economic tools and legal provisions respecting these principles and, in this way, contribute to the desirable growth and smooth process of the establishment of joint ventures.

It was found unavoidable to examine the main obstacles encountered and the methods for their removal. The discovered facts and suggestions of possible solutions are subject of the reflections made in this paper.

## 2. Concept of East-West Joint Ventures

There are dozens of joint venture definitions; one comes across in every specialized handbook. Taking the most recent period, i.e. 1988, it seems worthwhile to mention the excellent definition expressed in the book "East-West Joint Ventures" published by the Economic Commission for Europe, Geneva 1988. The written account of the speech pronounced by the President of the International Chamber of Commerce at the Meeting on Joint Ventures in Budapest, 31 October 1988, also includes the following concise sophisticated definition:

"An East-West joint venture is a juridical person under the law of the country where it has been established. Having its own property, the participants of which are juridical persons of different nationalities each having a share in the joint venture."

In order to improve the definition mentioned above, we consider it reasonable to add the goals of establishing the joint venture, e.g., the field of joint ventures' economic activity.

Not aspiring at a fully original version, instead utilizing a compilation of known interpretations, we submit the following text:

"A joint venture is a long-term agreement on partnership which creates a new profit-motivated entity having the following features:

- productive economic activity
- pooling of assets
- sharing of economic results and risks."

Besides those in literature, the issues of East-West joint ventures are being discussed in numerous symposiums, seminars and other international meetings. These undertakings are based on stipulations concerning the cooperation in the spheres of economy, technical and other sciences and environmental issues in the Final Act of the Conference on Security and Collaboration in Europe, Helsinki, 1975, according to which the participating countries "will support all forms of exchange of information and handing over of experience concerning industrial cooperation also by means of contacts between possible partners and, wherever it appears suitable, by means of mixed commissions for economic, industrial, technical and scientific collaboration of national and mixed commercial chambers and other suitable institutions".

In another part of the Final Act the expression "mixed enterprises" is mentioned. It is logical to assume that the exchange of information applies to the joint venture part of industrial cooperation as well.



The final document of the follow-up session of the CSCE held in Vienna, 1989, provides improved conditions for a broad range of joint economic activities, helping the future East-West industrial cooperation.

The issues of East-West joint ventures were also discussed at the Meeting in Budapest, October 1988.<sup>2</sup> One of the final proposals formulated at the meeting was the recommendation to search for deeper knowledge and to shape ideas on the whole complicated range of problems implied by joint ventures. The discussion showed that it is not sufficient to limit the specialized education to institutions of higher learning, i.e., to university students where the return effect can be expected some 6 – 10 years later and to specialized consultants who in principle interpret the legislation and help the interested parties to find their way in the intricate maze of regulations. The decision-makers from different countries should be those to whom the interpretation of principles, laws of development and possible hazards are addressed; the persons who prepare and approve the decisions regarding joint ventures should obtain information that had been discussed and consequently formulated with at least partial objectivity at a forum of professional economic researchers, other theoreticians and top professional experts from various countries.

For the stated purpose rational training of lecturers should be provided in special educational seminars. In addition a proper project should be elaborated, and a syllabus and teaching aids such as textbooks and audiovisual devices should be made available.

We all concur with the opinion that the development of joint ventures should receive our support. Allow me to add: Yes, on three levels:

- Support to the decision-making institutions particularly in the field of legal and financial tools
- Support in the field of economic research through analysis of relationships and issuing recommendations
- Support throughout activities extending help in the entrepreneurial territory, particularly to small and medium sized enterprises.

The three mentioned levels are reflected in the international coordination:

- The decision-making process on a governmental level has its central place in the ECE
- We expect the economic research to be expressed in the multilaterally elaborated joint venture development project at IIASA
- The consultancy activity coordination which we consider to be extremely important might perhaps be carried out under the sponsorship of the International Chamber of Commerce or others.

Somewhat apart, without known international coordination, stand the universities with their specialized economic faculties.

In the research and the preparation of documents on joint ventures full use is being made of computers. They are in operation in research institutes in the USSR, Bulgaria and other countries. They also serve in consultancy agencies for automated preliminary preparation of documents (also in different languages).

The scope of problems arising from the operation of joint ventures is very extensive. Most pressing is an issue which should be given top priority in the search for solution: Choosing of a joint venture product that is easily tradable on the international market – a convertible product, capable of competing by its technical performance, as well as by its price.

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<sup>2</sup>The Meeting was jointly organized by IIASA and the Hungarian Chamber of Commerce and Industry.

### **3. East-West Joint Ventures' Establishment**

The guidelines regulating the establishment and operation of enterprises with foreign capital participation were laid down in the CMEA countries in form of a number of legal norms. Laws which are being passed in many Socialist countries are to be considered as the highest form. The last law that came into force, as of 1 January 1989, is the one passed in Czechoslovakia.

The laws on enterprises with foreign capital participation link the protection of important national interests with the legitimate need of the foreign entrepreneurs for legal and economic security. The laws confirm the principle of economic independence of the enterprises, they limit the possibility for obligatory assignments of the state plan to be imposed on them. They guarantee transfer of foreign currency out of the country and do not limit the foreign participant's share.

As an additional form of security for the foreign investment intergovernmental agreements are being signed between the Western and the CMEA countries.

Conditions for the establishment of joint ventures in each of the Socialist countries have been developing, with a visible effort being made to satisfy the requirements of Western contractors. In the course of time, the differences in regulations in socialist countries have been decreasing, therefore, a high degree of unification may soon be expected. This will make it significantly easier for interested parties to orient themselves when choosing joint venture partners. They will be able to concentrate more on the technical aspects of cooperation.

When the authorization process for East-West joint ventures is compared with other forms of international economic cooperation, some differences become apparent.

Cases of industrial cooperation are being realized in varying dimensions. The authorization process to receive approval for the establishment in cases of smaller scale cooperation has been considerably simplified. For the establishment of joint ventures a unified regulation is in force which has no regard for project size. When the establishment of joint ventures becomes more frequent, it is expected that in the case of smaller projects, where the risks are rather limited, the required administration will be further simplified.

We can already say today that within the last three years the CMEA countries adopted or modified regulations for the establishment of joint ventures to such a level that in their entirety they meet the greatest part of expectations on the Western side and are comparable with the conditions in Western countries.

The obstacles for a dynamic development of joint ventures seem now to focalize in the necessity to tackle the technical and economic problems mainly connected with the properties of the common product and with the territorial universality of its sales.

### **4. Supplying of Joint Ventures**

The supply problem of joint ventures located in countries with planned economy counts, without doubt, among the most momentous ones. The uncertainty in this regard is apparently one of the negative aspects resulting from the exclusion of the jv companies from the national economic planning system. As the Soviet experts had informed, state orders are regulated by special provisions. On the other hand, the fact that in general no delivery obligations are imposed by the plan, is unanimously evaluated as a positive feature by all participants.

In this situation the proposal to include the joint ventures temporarily (until a balanced situation on the inner market can be achieved) to a certain extent into the state plans is being taken into consideration. It is presently under study in some countries.

Another possible variant of how to ensure material inputs for East-West joint ventures is the transfer of the supplying duty to the national participant that is directly interested in the economic result of the joint venture. As he possesses a system of established supply channels, he can carry out this service at the joint venture's expense; alternatively he could provide his assistance in this activity.

It has also been recommended to solve the problem of supplying in the CMEA countries (when the production is not top priority state commissions) by using supplies from the cooperative and private sectors. However, this could be taken into consideration in individual cases only, where the manufacture is based on supplies which are obtained from this sector. The selection of such items is limited, mostly to the sphere of foodstuff; considering the second proposal to establish other joint ventures for the supply, we have to face the fact that the manufacturers usually have dozens or hundreds of specialized sub-suppliers.<sup>3</sup>

The solution that appears obvious is to import the lacking items. This way usually collides with the second main problem of East-West joint ventures, namely the lack of foreign currencies, to which attention will be given later.

Let us make a digression here and examine some cases of handling of primary material substrates.

In many cases the Socialist countries' exports to the West consist of a number of raw materials, such as kaolin for technical and consumer porcelain production, brown coal for chemical fabrication and wood logs for industrial manufacture. A thorough economic analysis shows that it is useful to fabricate, or partly process, raw materials up to final or semi-final products, and then to distribute them from a joint venture located at the place of their origin, thus, eliminating the costs of raw material transportation. It was exactly this principle on which the joint venture that specialized in the manufacture of polyethylene from Soviet earth gas was based.

## **5. Managing of East-West Joint Venture Foreign Currency Assets**

One of the basic tasks of a newly established joint venture is to achieve a really balanced foreign currency position. The problem would naturally be non-existent if the currencies of the participants in the East-West joint venture were convertible. For the time being, the problem of the relation between a national currency and the freely convertible currencies is an obstacle for most joint ventures. Relatively simple is the situation in the most favorable instances when the yield from goods exports for hard currencies covers all expense for necessary imports from the West. In other instances no satisfactory solution can be found within industry and it is necessary to involve banks and to negotiate each case separately.

A possible way which is quite often used is to invite Trading Companies or other agencies to participate in the deal, trying to cover the expenses by means of other exportable commodities.

The solution for East-West joint ventures' currency problems in the smaller Socialist countries is being sought in the markets of other CMEA countries, hoping to find a larger basis. In this way foreign currencies and/or sub-supplies might be obtained.

The market of the smaller Socialist countries is practically never big enough for the manufacture of optimum series and, therefore, the possibility to supply other socialist countries with these products would be welcome. It is somewhat impeded by the non-convertibility of the currencies of the individual countries and the lack of balance in the

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<sup>3</sup>The proposal was made by Dr. von Herten UN ECE at the Meeting on Joint Ventures held in Budapest in 1988.

foreign trade between socialist countries. On the other hand, e.g., Czechoslovakia has recently signed agreements on the use of national currencies in the settlement of accounts within the scope of the so-called "direct relations" with the USSR and Bulgaria. We are taking into consideration the possibility to extend these facilities to the joint venture production. Another variant, which is not very simple either, is to link several countries by cooperation in the manufacture of a final product in the joint venture. We have been exploring this path as well.

Recommendations how to introduce "currency vacations" in addition to the "tax vacations", selling of the products on the domestic market only and starting to pay back the invested national or foreign hard currency capital in the second stage have been made. This concept is non-conform with the Eastern partners' wish to sell joint venture products for hard currencies as fast as possible.

## **6. East-West Joint Ventures Management**

The establishment of joint ventures does not only go along with a transfer of technical and technological information, but also with the transfer of management know-how, i.e., ways for rational company control oriented toward the reduction of administrative staff, of stock, and the use of logistic practices in marketing. These methods are described in technical literature and are lectured on in institutions of higher learning. However, their practical use through joint ventures is most effective.

The managers of joint ventures who are local citizens quickly understood the new economic pattern: increase in entrepreneurial independence, as well as in economic responsibility. They were also reminded of the fact that the main intensification resources as represented by the development of technical sciences and international cooperation must be accompanied by rational management. Thus, they create a model of joint venture activity and its external relations which is advantageous for all participants.

Some other issues of top executives' authorizations and protection of minority interests can be solved fairly easily with mutual satisfaction of both parties in the basic documents of the agreement, so we do not deal with them here.

The indispensable contacts and mutual acquainting of employees of a joint venture in the course of its operation enables them to form more objective opinions about people belonging to the other economic system.

In the operational practice impulses appear which force the joint venture management to adopt operative measures. As a consequence it is necessary to elaborate modifications of existing documents, which cannot be considered unchangeable.

The following documents have to be updated:

- Feasibility study
- Business plans
- Cash flow presumption

We mention this to underline the need for high flexibility in the whole complex of management.

## **7. Technology in East-West Joint Ventures**

The necessity to provide capital means for investment purposes in joint ventures forces organizations which furnish the necessary technology to change their behavior – compared to the moment when they applied for the license. In the latter case, in principle, a basis is created for future competitive production, therefore, a know-how owner is reluctant to hand over the best technology he has. Suppliers of know-how in joint

ventures, however, are interested in fast transfer of the latest technology to accelerate the implementation of a profitable production.

In order not to lose competitiveness in a given field, the big Western firms see themselves obliged to take a number of measures among which the acquiring of a great technical potential including qualified research workers in development and research institutions plays an important role; this exceeds their own potentials. Therefore, they tend to use in an increasing degree the capacities of universities and of state financed research institutions.

On the other hand, in contrast to many other regions, the CMEA countries have a high basic research potential, which is an important factor also in the joint venture area. Here the "grey brain matter" of highly qualified technical and scientific experts is available. These capacities for "invisible" deliveries are from the professional point of view, and particularly from the point of view of prices, highly competitive compared with the offers of the same highly qualified services by Western institutions.

Considering the above said we can draw the conclusion that R & D represent an area which is full of perspectives for joint ventures.

Two more remarks should be added on technology within the East-West joint ventures.

In the deliveries of technology for East-West joint ventures system licenses must be used guaranteeing the full compatibility of the delivered machinery. In that way many operational problems can be avoided.

The form of "venture companies" existing in Western countries does not yet have a counterpart in the East-West joint ventures. This type of companies need a great deal of inventive work and represents another unexploited area.

## **8. Efficiency of East-West Joint Ventures**

A joint venture is expected to be effective by itself. In East-West relations this is fairly difficult to achieve, because financing, credits, payments and yielding of profit must be accounted in both currency domains, in that of the national, as well as in that of convertible currency. Practice has shown that the former kind of turnover is predominant and is of vital importance when ensuring the running of joint ventures. But neither can the convertible currency domain be neglected over a longer period of time than allowance has been given for by own and otherwise acquired foreign currency means. Any surpassed returns in the hard currency domain can easily be converted for the benefit of national currency domain financing; the opposite process implies considerable problems.

Lower production costs and labor wages (which constitute only a fraction of wage costs in Western countries) are the main factors responsible for the establishing of joint ventures in developing countries.

In East-West relations these factors are also present when selecting a joint-venture partner, but, due to the smaller difference in wage levels, with lesser intensity.

On the other hand, compared to developing countries a number of circumstances play a positive role:

- A higher intellectual and technical level of industrial infrastructure;
- Geographical proximity;
- Higher economic and political stability;
- A market with a high degree of absorption (a common case).

In the decision-making process the importance of these factors has a tendency to increase even further.

In East-West joint ventures production factors from the Eastern and Western partner's resources may be used in combination as shown in the following table.

**Manufacturing East-West Joint Ventures**

Mixture of production factors assessed from the point of view of competitive ability (quality and price combination)

	Western partner	Eastern partner	JV	Note
Basic research for a new product	-	+	+	Cheaper in CMEA countries
Effectuated research for an existing product	+	-	+	
Technology	+	-	+	On higher level in the West
Raw materials inland	-	+	+	
Raw materials imported	+	-	+	
Energy	0	0	0	No marked differences
Wages	-	+	+	Lower wage level in CMEA countries

- + higher competitive ability
- lower competitive ability

The location of a joint venture in a CMEA country will prove effective, provided that the number and weight of production factors from local resources predominant.

As far as the labor wages as a cost item are concerned, it is evident that their importance is decreasing due to advancing automation and computerization, which however call for costly investments. Their utilization in East-West joint ventures is a matter for optimization calculations.

The profit tax is another important budget item. Though, there is a trend toward unification of the income tax rates, as well as of a number of other conditions in the CMEA countries, we must bear in mind that beside the published basic income tax rate the foundation from which it is calculated, i.e., whether it is calculated before or after the funds allocation to enterprise accounts had been made, is just as important for the entrepreneurs. The latter find it also important to know if the establishment of a risk fund is obligatory and in the affirmative, for what amount? One should well pay attention to whether paid out dividends are subjected to any additional taxation. Employees of foreign nationality are interested to know what portion of their salary they may transfer out of the country and whether there is any additional taxation on it.

The profitability of the joint venture production is decisively influenced by fixed prices. In some of the CMEA countries regulations exist, according to which a joint venture that manufactures and delivers products on the domestic market for which a wholesale price has been determined by the state is obliged to respect that price. If new products are brought on the market by the joint venture corporation, new prices will be based on the the joint venture's proposal. It is assumed that the prices tally with those on the world markets.

## 9. Activities of East-West Joint Ventures

According to the Hungarian sample<sup>4</sup> which is most representative, two thirds of joint ventures deal with manufacturing activities, one third with services.

East-West joint ventures producing consumer goods prevail by far. This is apparently due to lower claims on investments and faster returns of invested capital.

Production programs require compatibility with already manufactured equipment. The compatibility is reflected in two technical axioms: meeting of technical standards and keeping pace with the innovation rate of the basic production program. The latter requirement calls for creation in the joint venture of conditions for technical, technological and innovation capability correlated with the partners' level. Good will alone is not sufficient in sophisticated areas of cooperation. Implantation of imported technology in a joint venture factory will have far greater expectations of healthy development in cases when the differences in the technical level of the participants do not go too deep.

To date, we have seen transfers of production processes being verified before imitations (production re-run). It can be expected that the merger of partners of approximately equal abilities in joint ventures may create some technical improvements or even inventions (production first-run).

It can be presumed that the joint ventures will not only reproduce the introduced program of product manufacture or services, but will generate own activities as well. In positive instances an own culture derived from a mixture of intellectual and managerial inputs from both sides will come into existence, creating conditions for the origination of a synergetic effect.

The basis of joint ventures operations may easily originate, and sometimes must, from a host country. It is often a case of tradable services, by the use of travel, tourism, and the spa business, that still have the potential for development. In the case of joint ventures specialized in writing software for computer systems, Hungary succeeded with a whole line of rather elegant mathematical solutions.

In production, joint ventures have registered patents by socialist partners.

Art design constitutes an aesthetic basis for many utility goods (furniture, pottery, costume, jewelry, etc.) as well as cultural business. These values, too, often have their origin in CMEA countries.

One of the potential areas for East-West joint ventures in CMEA countries is the generation of system programs which at present make up approximately 70 % of all software deliveries. Each new computer type or model is accompanied by the delivery of a large package of system programs whose pain-staking production exceeds the possibilities of the hardware manufacturers. Therefore, the large computer manufacturing firms conclude hundreds of contracts with independent program "producers". Here is a great opportunity for the establishment of a joint venture between a renowned specialized Western software firm and software establishments in the socialist countries. Even though they would have to face competition from software exporters from France, England, the FRG and also Hungary on the market, the commodity is in short supply and there are good prospects for more participants. At present, the shortage proves to be a drag on the world-wide application of computer-aided techniques which is the reason for the boom.

An example of a well selected object of joint venture enterprise can be found in the Haldex joint venture which has been thoroughly economically tested by several years of operation in Czechoslovakia. The foreign partner contributed the know-how for the treatment of coal residues on waste tips in the proximity of collieries. The extraction of the

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<sup>4</sup>see MTC data base

rests of coal proved to be not only economical, but also beneficial from the environmental point of view.

#### 10. East West J.V. Book-Keeping and Consultancy Servicing

Regulations regarding joint venture companies' record keeping and ways of financing differ. Except in free trade areas, all accounting is done in local currency. Observing local regulations is unavoidable when seeking to satisfy financial institutions and banks. Disclosure of records on capital assets and operating results (always available to shareholders in the West) should not be refused.

Until a solution for the unification of regulations in both systems is reached, top business executives in joint ventures must do double accounting in order to satisfy both parties.

Difficulties in book-keeping arise above all with a view to the different accounting bases used in the socialist and the Western countries. The main differences are to be found in the record-keeping on business profits and losses abroad, on the value of good will, on stocks and work in progress, on loans, research and development expenses and on depreciation.

While in socialist countries the information system has to follow in the first line the fulfillment of the plan, Western book-keeping serves as an exact description of the commercial standing of a corporation to the date of the books closing.

These facts are directly linked with auditing. The authorized auditor states whether the record-keeping corresponds to the complex of methods and whether consolidated accounts were found true and fair.

Cooperation of auditors of both parties is useful particularly with the purpose of materialization of opinions on the correctness of the reported amount of achieved profit and the expectations as to the return of invested capital.

Let us recapitulate the basic information diagram common in Western countries. The data are expressed in mil. of US\$ usually for each trimester, for the period from the beginning of the year and compared to the same period of the previous year:

Net Sales
Financial Income and Expenses
-----
Income before Taxes
Income Tax
-----
Net Income

In addition we indicate the most important calculation coefficients of prosperity in %:

- Income in % of net sales
- Income before taxation in % of net sales
- Income after taxation in % of net sales
- Net income in % of stockholders equity

Assistance of consultancy agencies is recommendable especially during the establishment stage of an East-West joint venture. However, specialists from large international firms are able to analyze and solve almost all aspects and obstacles mentioned. For mid-sized and small enterprises a consultancy service should be available. This service must not be considered as consolidated on either side, but rather as a mutual interconnection between both sides of the joint venture's consultants which is highly beneficial for potential partners.



## 11. Special Ways to arrange East-West Joint Ventures

The object of enterprise, the territorial orientation of joint venture production inputs and outputs, customs and financial regulations and specific interests of the participants have given the impulse for some unconventional ways of organization.

The parallel establishment of structural joint ventures units in both partner countries constitutes an interesting way to deepen the actual cooperation and eliminate potential risks.

Information regarding an agreement between a Soviet company manufacturing machine tools and a producer in the Federal Republic of Germany has been published. In the Soviet Union, as well as in the engineering subsidiary in the FRG, special production control systems have been organized.

Applying the practice used in China and other Asian and South-American developing countries, experiments are being made in European socialist countries to create joint ventures in free trade areas and not only in harbor towns and cities.

For some commodities this form appears to be very useful. It proves to be good, especially in cases where the larger part of materials, components and equipment for free trade areas comes from abroad. Material, components and energy deliveries to a producer in a free trade area from a host country are considered as exports. And the host country regards deliveries of final products out of free trade areas as imports. This is a complication that will probably prevent the mass spreading of this system.

Through concentration of joint ventures in one locality isolated instances of joint venture parks such as we can find in China or Singapore come into existence; none, however, exist in CMEA countries. Hungary makes some efforts in this respect and so does Bulgaria for the so-called free trade areas.

For ambitious projects a simple organization of a joint venture is not sufficient. Often it will be necessary to propose a hybrid arrangement, i.e., cooperative linking of joint ventures to other subjects in the founders' countries or in a third country. Such a combination belongs to the most complicated ones and, thus, is subject to applied research which, in Czechoslovakia, has been carried out by the Institute of Economic Research in the Electrotechnical Industry. This Institute will publish a report on the results. In case those are positive, a concept for the elaboration of a trilateral joint venture will be drawn up. Such an arrangement would facilitate a rational deployment of manufacture of individual components (parts) constituting the final product and would imply a shortening of the preparatory time for the launching of production while allowing the manufacture of larger production series. A problem arises at the moment when accounting is to be done. One of the possible variants would be the settlement of mutual deliveries of components in convertible currencies.

Besides the possibility of founding a trilateral joint venture the extension of an existing joint venture by adding one more partner could be taken into consideration. In Czechoslovakia, several practical instances to extend an existing joint venture are being negotiated. The projects in question will be analyzed and an attempt toward generalization and application of the obtained findings will be made.

## 12. The State-of-the-Art in Czechoslovakia

At the beginning of 1989 sixteen joint ventures have been in operation in Czechoslovakia, five of them being East-East joint ventures. 80% of all joint ventures are companies limited by shares. The remaining 20% are associations (see attached list).<sup>5</sup>

<sup>5</sup>By the time when this working paper will have been published the MTC data base will have information about 20 registered joint ventures in Czechoslovakia. (Another five have been reported through the media.)

A listing of joint ventures in the CSSR by sectors shows that

25%	are engaged in machinery and machine-tools
13%	" " " chemistry and timber industry
6%	" " " transport
6%	" " " electronics and software
6%	" " " civil engineering
18%	" " " service and trade
13%	" " " health care
13%	" " " others

No joint ventures have been established in the sectors of consulting and banking in Czechoslovakia.

Before the end of 1988 Act No 173/88 on Enterprises with Foreign Property Participation in the CSSR has been passed and is in force as from 1 January 1989. This law provides conditions for the creation of companies with foreign legal or natural persons' participation. Compared to the old status many conditions have been simplified and facilitated, e.g., in general only one central authority of the State administration gives the permission to set up a joint venture.

- An authorization can be granted in any branch of the national economy (except those sectors related to national defense and security).
- In the State Plan for Economic and Social Development no tasks can be imposed on the corporation.
- The corporation shall have the right to dispose freely of the funds for the purposes for which the same have been created.
- Upon paying the taxes due and allocating the necessary sums into the funds, the earnings available may be distributed among the shareholders.
- The corporations are not obliged to offer their own exchange for sale to a bank.
- There are no limitations regarding the share of foreign capital participation.
- No special nationality is required for the corporation's chairman.

Rules governing particular areas of activity shall be enacted by the Central Authorities in the near future.

Further necessary steps have been undertaken to clarify and facilitate significant problems like the material supply of joint venture companies or the system of price stipulation.

On the other hand self-financing of joint venture companies is a categorical requirement.

Closing this short deliberation on the feasibility of joint ventures in Czechoslovakia, it seems that the necessary conditions have been established, as well as further moderated factors which support a positive development of joint ventures.

### **13. The Practice of Czechoslovakian East-West Joint Ventures**

In the first quarter of 1989, all 12 East-West joint ventures which have been in operation on Czechoslovakian territory were approached by the IEVEP and asked to communicate their experience, viewpoints and recommendations according to the uniform IIASA questionnaire. In several cases the firms were given assistance in filling in the answers. By the closing day, 66% of the questionnaires had been sent back.

While evaluating the answers to the questions one has to bear in mind that most joint ventures in Czechoslovakia had only recently been established (and registered), i.e., in 1988. Only two joint ventures have been operating form more than one year. Most of them are in the stage establishment, of shaping their own entrepreneurial policy and in preparation of investments and other initial undertakings.

The distribution of joint ventures among the different branches of activity is as follows:

in %

Manufacture	Tourism Hotels	Medical care	Projects and Engineering	Total
42	25	16.5	16.5	100

The distribution of foreign partners is as follows:

Austria	Holland	Denmark	FRG	France	UK	Total
52	8	16	8	8	8	100

As far as the legal form is concerned, joint ventures established as joint-stock companies are predominant. Only one joint venture has been established as a consortium and one is an Ltd. Company.

In all cases the capital share of the Czechoslovakian partners is larger, which is partially due to previous legal stipulations; the law concerning joint ventures with foreign ownership participation permitting foreign capital majority has been valid since the beginning of 1989 only. The overall amount of basic capital lies within the limits of 2 to 140 mil. of Czechoslovakian crowns (Cčs). According to this we can say that the enterprises are mostly of medium size. The ownership participation of Czechoslovakian partners in the joint ventures consists in all cases of the investment of financial capital and long-term leasing of buildings or land, to a smaller extent they provide machinery and licenses.

All joint ventures are being established for an unlimited duration which is to be put down to the considerable investments in buildings or technology and subsequent possibilities of production program innovation, factors contributing to long-term tendencies of entrepreneurial objectives. Within the joint ventures the activities include marketing and technical pre-production stages (development and partially also research). In non-manufacturing activities no financial or consultancy services are represented.

It should be noted that the Czechoslovakian and the foreign participants were known to each other from previous business activities, mostly foreign trade activities; as a newly established relation one can consider those joint ventures involved in construction of hotels and facilities for spas.

In the joint venture turnover which has been borne to date, home market deliveries are predominant. The size of the share achieved by exports reflects the fact that the joint ventures are "newcomers" on the world markets, though they receive the assistance of the foreign partner company.

The introduced products and the used technology in the new joint ventures have in general a progressive character.

In joint ventures which have been operating for more than one year positive results have been achieved in local currency. From the achieved profit reserves remained which joint ventures intend to carry over to next period for better use.

The joint ventures employ local manpower, in full agreement with the foreign partner's viewpoint. The percentage of staff working in administration in the overall number of employees is lower than in comparable national enterprises. In joint ventures which are in the stage of project elaboration for the construction of premises the comparison would not be relevant.

The research of motives for the establishment of joint ventures has focused:

- a. for the national partners of the host country on the interest in
  - ensuring of new product manufacture with foreign assistance
  - obtaining freely exchangeable currencies, often to be used to purchase components and technology
  - providing capital for the building of premises (particularly in the sphere of hotel and spa facility construction)
- b. for the foreign partners on the interest in
  - the extension of the field of activities to new markets
  - in some cases in obtaining products on the basis of economically more advantageous basic materials
  - utilization of suitable local conditions for the development of tourism and health resorts.

The initiative in the negotiations leading to the establishment of a joint venture cannot be exactly pointed out, usually it resulted from previous trade relations.

The establishment of the joint venture was negotiated with the highest authority in the given branch, the foreign trade activity license with the Federal Ministry of Foreign Trade. In addition to the registration at the competent local court, the new joint ventures opened accounts with a bank and in most cases obtained authorization to raise credits in foreign currency.

A positive tendency is that in the actual process of preparation a certain number of persons was usually involved who now continue as executive members of the newly established joint venture management.

Consulting agencies were usually not involved in the establishment until the stage of preparation of foundation documents.

The responding companies found the elaboration of a technical-economical analysis, executed in the way which is custom in Czechoslovakia, to exert an important influence on the success of the dealings leading to the establishment of a joint venture.

The foreign partners devoted the same attention to the elaboration of a feasibility study. Market studies, realized by both sides in their respective regions served a decisive basis for both analyses. Other segments of the approving process were considered as less important.

If the importance of criteria for the choice of a partner is to be determined, the first place belongs to the standing of the firm which in itself is the result of a number of factors such as the production program or the qualification of the staff. Concerning the order of priority of the means by which the joint venture is to be provided, in manufacturing organizations priority is given to modern technology based on licenses and know-how and naturally oriented to universally (if possible globally) tradable

products.

It can be stated that specific factors exist in Czechoslovakia which are favourable for the establishment of joint ventures. First, this is the high qualification of manpower in manufacturing research and development, and designing and in engineering services. Second, the planning system and the material supply structure can sometimes affect the material and parts delivery of the newly established enterprise, and it often forces the participants to adopt individual solution. As temporarily complicated are to be considered the functionally important issues of currency convertability. These call for special solutions when import requirements are not covered by adequate exports.

The duration of the partial stages of joint venture establishment preparation has been gradually shortened. The administrative procedures were considerably simplified after the law for enterprises with foreign ownership participation had been passed. The actual approval of the application is issued within a period of three months.

In the setting of prices the joint ventures see no important obstacles to their development. The method of price setting is not obligatorily regulated for foreign trade prices; they are always agreed upon in the contract. For the prices on the domestic market a gradual rationalization of their setting is envisaged. The foreign trade monopoly does not appear as a problem either. It can be avoided by issuing authorizations for foreign trade activities. The prescription of planned delivery tasks has been abolished by law. The responding companies expressed certain apprehensions in the sphere of provisionment during the transitional period while there is a tendency to limit the budgeting system prior to the application of a full free supply mechanism on the basis of real demand.

The joint ventures viewpoint is that a technically and economically competitive product can only be produced through the application of modern technology. This appears to be a decisive element for the success of joint ventures.

The joint venture has the same aim which all entrepreneurs have, i.e., to increase the profit. This can only be achieved through the application of modern technology and a good position on the market.

In the identification and classification of problems one underlines the economic issues of the realization of the entrepreneurial objective in particular. Problems of administrative character are being designated as less important. From the technical point of view, the problem to ensure first class quality permanently ranks first. On the other hand, personnel issues such as remuneration, style and culture of management are regarded as less problematic.

Among environmental uncertainties the responding companies stress the increasingly changeable consumer preferences and their accuracy. In manufacturing joint ventures the influence of competition is also important, however, in Czechoslovakia this aspect does not apply to joint ventures operating in the field of tourism and spas.

The management structure of the joint ventures has in most cases a standard form, typical for joint-stock companies.

The joint ventures mention no particular problems in the relations between the managers – different nationalities. The executive managing jobs are held by local specialists with the agreement of the foreign partners.

The decisions on strategic issues have to be taken unanimously. In some instances, special consulting groups are being used (policy committees).

The responding companies mentioned only isolated factors as risky, e.g., to achieve and keep high quality, including adaptation to changing foreign technical standards and to provide supplies, both national and imported ones.

In the analysis of advantages of joint ventures in comparison with traditional foreign economic relations the foreign capital investment in whatever form it is realized is dominant. The main feature of the integration formalized by the establishment of an independent organization (joint venture), is the rational management system of the enterprise, which could never be provided to such a degree by other forms of industrial cooperation.

The short period of practice has shown that the joint venture brings an improvement of management procedures, including application of new methods. This is considered to be a secondary important benefit resulting from the development of joint ventures.

## EAST-WEST JOINT VENTURES IN THE CSSR

Name	Partner	Share %	Field of Activity	Capitalisation Fund in mil	Founded
1. TESSEK Praha	SENETEK PLC, Aarhus, DK	49	Chemical production, transfer of technology	Kcs 30	30.12.1986
	TESLA BRNO	51			
2. AVEX Bratislava	N.V. Philips, Eindhoven, NL	20	production of consumer electronics, video recorders	Kcs 140	12.08.1987
	Transakta FTO, Praha	80			
3. HOTELINVEST Praha	Warimpex, Wien, A	49	tourism, building of hotels	Kcs 50	14.01.1988
	Cedok Praha	51			
4. LUWEX Praha	Warimpex, Grassi, Waema, Wien, A	49	projecting and engineering activities, export and import import of blast air equipment	Kcs 10	11.03.1988
	ZVS Milevsko	51			
	Warimpex, Wien, A	49			
5. BALNEX Praha	Cedok Praha	51	treatment, building of medical institution	Kcs 15.7	16.03.1988
	Warimpex, Wien, A	49			
6. BALNEX I. Praha	Warimpex, Wien, A	31	treatment, building of medical institutions	n.a.	16.03.1988
	Balnea, Praha	69			
7. RECOOP TOUR Praha	Grassi GmbH, Wien, A	49	tourism, building of hotels	Kcs 15	16.03.1988
	RECREA				
	FTC TRADEX				
8. MSZ Dolni Nemci	MSZ Seligenstadt, FRG	45	breeding of fur animals	Kcs 13	30.03.1988
	JZD Javorina, Dolni Nemci	55			
9. TOURINVEST Praha	CBC, Paris, F	49	tourism, building of hotels	Kcs 50	26.04.1988
	Cedok, Praha	51			
10. DANCO Praha	Naturgas Syd, Vejen, DK	49	production of pipes, pipe fittings and couplers for gas pipings, building of gas pipings	Kcs 135.3	01.07.1988
	CPP Konzern, Praha	51			
11. AGROTOP Straznice	G. Topham & Co. GmbH Wien, A	40	processing of wood and lumber	Kcs 20	26.01.1989
	Agropodnik, Hodonin				
	Transakta FTO, Praha	60			
12. HALDEX Ostrava	Tatabanya Srenbanyak Tatabanya, H	50	processing of waste rocks from mining of black coal	Kcs 65	03.01.1983
13. ROBOT Presov	2 Soviet organizations	50	research and production in the area of robotics	Rbl 10	19.04.1985
	7 Czechoslovakian organizations	50			
14. CHINA-CZECHO- SLOVAK CO. FOR OCEAN SHIPPING	China Ocean Shipping Co., China	50	ocean shipping	US \$ 10	26.04.1987
	Czechoslovak Ocean Shipping Co.	50			
15. INTER- KOMPRESOR Praha	Kompresormas Kazan, SSSR	50	cooperation in production of superchargers, coordination of scientific and technical activities	Rbl 1	09.06.1988
	CKD Praha, Kombinat	50			
	Uralmas, Sverdlovsk, SSSR	50			
16. SKODA URALMAS Plzen	SKODA Konzern, Plzen	50	direction of scientific research and developing activities, projection and deliveries of rolling mills	Rbl 0.5 + US \$ 0.3 Kcs 5.0 + US \$ 0.3	01.12.1988