

TO PARTNER OR ACQUIRE

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Cross-border alliances between companies are a fact of modern business. Such alliances are particularly relevant today because the ability to create and sustain global collaborations is vital for companies to compete and be profitable.

Two commonly recognised forms of collaborations are joint ventures and acquisitions.

In India, a joint venture is generally understood as a technical and financial collaboration between two existing companies. Typically, in a joint venture, one foreign company comes together with an Indian company to form a third company, either a private or public limited company, and hold agreed portions of its share capital. On the other hand, an acquisition is a complete takeover of a company, either through a purchase of shares, assets or the entire business.

As joint ventures and acquisitions differ greatly in their utility, one of the most important decisions for any company is whether or not a joint venture will be best suited to achieve its corporate goals, as opposed to an acquisition or simple organic growth. A company that needs international technology which has not been implemented in India can consider creating a joint venture with a foreign company that has such technology. On the other hand, an acquisition may be better for a company that seeks to gain market share or an exclusive distribution channel.

Structurally, a joint venture offers significant contractual support in respect of coordination and co-operation with a partner and, at the same time, alleviates the integration challenges presented by an acquisition. Instances when a joint venture is preferred to an acquisition are:

1. When the assets are difficult to separate. Assuming that a company manufactures two different products from one factory. If an acquirer were to buy out such a company, it will be saddled with assets that it does not need. Therefore, if a joint venture is arranged, the required assets can be structured to flow into the joint venture company without the other undesired assets.

2. When a full acquisition will increase management costs. In a corporate acquisition, the acquirer acquires an existing corps of employees having their own routine and culture. Integrating such employees can prove difficult.
3. When valuation is difficult. A joint venture is an effective and easy solution when the valuation of a target company is difficult.
4. When legal or regulatory constraints make an acquisition difficult. Generally, joint ventures have lesser regulatory constraints easier to put in place.

Assuming that a joint venture is the preferred mode of alliance, one issue that must be dealt with at the contracting stage is control and management of the joint venture company. The shareholders' agreement can prescribe the number of directors on the board, the quorum for board meetings and general meetings, the mode of day-to-day management of the company, the procedure to be followed on the bankruptcy of a joint venture partner, etc. To prevent a deadlock, the chairman of the board of directors can be given a casting vote.

Protecting confidential information is very important in joint ventures. To protect sensitive business information from being divulged to others, confidentiality and non-disclosure agreements must be entered into prior to commencing negotiations. Relevant clauses should also be incorporated in the shareholders' agreement. Indian courts enforce such agreements and grant injunctions on adequate proof of breach or proposed breach.

In many instances, companies route their investments into an Indian joint venture company through an offshore tax jurisdiction. India has double taxation avoidance agreements ("DTAA") with many countries. Many foreign companies route their investments through Mauritius because under the India-Mauritius DTAA, a Mauritius resident does not pay any capital gains tax on a transfer of shares of an Indian company. Cyprus is another offshore destination gaining popularity.

On the flip side, a joint venture is also susceptible to various other hazards such as misappropriation of knowledge, hold-up by the joint venture partner, etc., which may make an acquisition more attractive.

Structuring an acquisition so as to optimise tax and operational benefits is extremely important. For example, amalgamating two companies by following the procedure under the Companies Act, 1956, can save capital gains tax that may otherwise be applicable on an asset or share acquisition deal. However, the court procedure can be long drawn and requires compliance of a number of procedural formalities.

Likewise, although a share purchase transaction can be completed fairly quickly, it requires a much higher level of due diligence on the company because, effectively, the buyer of the shares becomes the owner of the company and inherits all its liabilities also. As such, no compromise should be made on due diligence, and it is imperative to require the seller to resolve all company compliance matters before closing. An asset purchase transaction attracts capital gains tax and VAT on the assets, and is usually the easiest to close.

An acquisition of a listed company can trigger the Securities Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (the “Takeover Regulations”), as amended from time to time. If this occurs, the Takeover Regulations have to be followed and an open offer has to be made to at least 20% of a target company’s existing shareholders. In a buoyant stock market, it can, sometimes, be difficult to successfully close an open offer.

Further, in cross-border acquisitions, it is important to comply with the government’s foreign investment regulations. Various industry sectors in India such as telecommunication, banking, insurance, aviation, defence, etc. are restricted to foreign investment, and compliance of sectoral caps and sector-specific guidelines is imperative. The Vodafone-Hutchison deal is a classic example of the importance of complying with foreign investment regulations and obtaining the requisite government approvals at the very beginning. Otherwise, the foreign investor runs a high risk of post-closing scrutiny.

On the anvil is a competition law, similar to the Hart-Scott-Rodino Act in the US and EU competition legislation. Once notified, most mega mergers that have an adverse effect on competition or cross a certain turnover threshold in India or abroad will have to be reported to the Competition Commission (“CC”). The CC will have to assess the impact of the merger on competition and public interest in India, and will have the authority to either approve or disapprove it.

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Therefore, the decision between a joint venture and an acquisition should be an informed one based on objective business criteria.