CHAPTER 10

Business Collaborations

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Regulatory Framework Coverage
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The Limited Liability Partnership Act, 2008
FDI Policy of the Government of India

10.1 Joint Ventures (JVs)	
Definition	◆ Joint ventures can be defined as "an enterprise in which two or more investors share ownership and control over property rights and operation". ◆ Joint Venture commonly referred to as a "JV", are typically formed either by individuals, business entities, corporations or partnerships.
Example of JV Companies	◆ Indian Oil Skytanking Ltd. (between Holders -Ruchi Soya and Indian Oil), ◆ Ratnagiri Gas & Power Private Ltd. (between NTPC Ltd. and GAIL India Ltd.), ◆ Mahanagar Gas Ltd. (BG Group of U.K. and GAIL India Ltd.) and ◆ Petronet LNG Ltd. (between PSU's, namely, BPCL, GAIL India Ltd., ONGC and IOCL).
Advantages of Forming Joint Venture	◆ **Risk Sharing:** Risk sharing is one of the biggest advantages of forming a Joint Venture in those industries where the cost of product development and likelihood of failure of any particular product is very high. ◆ **Economies of Scale:** JV with a larger company can provide the economies of scale necessary to compete locally or globally and can be an effective way by which two companies can pool resources and achieve critical mass. ◆ **Market Access:** Forming a JV with the right partner can provide instant access to established, efficient and effective distribution channels and receptive customer bases. ◆ **Exploring the Global Market:** Formation of JV can be advantageous to those companies, which are foreseeing an attractive business opportunity in a foreign market. ◆ **Easy acquisition of other entity or business:** When a company wants to acquire another company but unable due to cost involvement, size, or geographical restrictions or legal barriers, teaming up with a JV Partner can be an attractive option.

	◆ **Cost Efficiency:** For a small-scale company/ entity, it is difficult to set up the infrastructure and the machinery required product development. In the moment of need joint venture is the perfect solution. For example, if a company has a plan for the perfect product, however due to financial shortage there is not enough machinery or resources available. ◆ **Flexible nature:** The joint venture enterprises provide flexibility to each participant to continue with their individual businesses. The joint venture participants can only interfere within the participated project.
Disadvantages of Joint Venture	◆ **Restricted flexibility where full concentration is required for JV Project:** Flexibility is important however, some projects require full concentration and thus the simultaneous work may become impossible. ◆ **Lack of equal involvement:** An equal involvement from all the Joint Venture partners may not be possible. ◆ **Cultural Differences:** Different cultures and management styles may result in poor co-operation and integration. People with different beliefs, tastes, and preferences can create hurdles. ◆ **Extensive Research and planning required:** Joint venture can result in a frustrating experience and ultimately a failure if it lacks adequate planning and research. ◆ **Lack of clear communication:** A joint venture involves different companies from different horizons with different goals there is often a severe lack of communication between partners. ◆ **Unreliable partners:** It is possible that the partners do not devote 100% of their attention to the project and become unreliable. ◆ **Creation of competitor:** Disadvantage of JV is possibility of the creation of a competitor or a potential competitor in the form of one's own joint venture partner.
Strategies of Entering into Joint Venture	◆ **Identification of Prospective JV Partners.** ◆ **Reliable Partners:** JV with strong and trustworthy partner would generate enormous benefits for both the partners and the Joint Venture entity. ◆ **Strong JV Relationship:** Partners must strive to develop joint venture relationships that are easy to maintain, financially profitable, intellectually rewarding, and long-lasting. ◆ **Equal Contribution:** Joint Venture Partners must make sure that all the partners have equal contribution in the Joint Venture entity in terms of skills, intellectual resources, marketing resources, capital, and so on. Unbalanced or unequal contributions are never healthy for the success of a Joint Venture entity. ◆ **Written Agreement:** Agreement between two or more parties always be written and must clearly define all the terms, relates to rights and responsibilities of each partner. The language of the agreement must be simple and there should be no ambiguity. Also there should be no clashing of interest. ◆ **Limiting Scope of JV:** It is essential that limits and scope of the venture should be defined in the beginning itself. At a later stage, once the trust amongst the partners is developed the scope of Joint Venture can be increased with the mutual consent of all the partners. ◆ **Defined Business Model:** A well-defined business model provides a base for the legal and financial frameworks. ◆ **Flexibility:** The partners in JV should try to be flexible and favour partners who demonstrate the same level of flexibility.

	◆ **Exit Routes:** JV Partners much establish clear protocols in the beginning itself for amending or unwinding the relation if it fails to meet the expectations or in case there arises any dispute.
Equity Joint Venture	The equity joint venture is an arrangement whereby a separate legal entity is created in accordance with the agreement of two or more parties. **Key characteristics of equity-based joint ventures are as following:** ◆ There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity. ◆ Shared Ownership by the parties involved. ◆ Shared management of the jointly owned entity. ◆ Shared responsibilities regarding capital investment and other financing arrangements. ◆ Shared profits and losses according to the JV Agreement.
Contractual Joint Venture	The creation of such a separate legal entity is not feasible in view of one or the other reasons. The two parties do not share ownership of the business entity but each of the two parties exercises some elements of control in the joint venture. **Key characteristics of such a relationship are:** ◆ Two or more parties have a common intention – of running a business venture. ◆ Each party will bring some inputs in the form of money or materials. ◆ Both parties exercise some a certain degree of control on the venture. ◆ The relationship is not a transaction to transaction relationship but has a character of relatively longer time duration.

QUESTIONS

Ques 1: 'Every Equity based joint venture gives birth to a new entity'. Discuss in brief the different types of entities which are permitted by Government of India to form a joint venture entity.

Hint: Refer Topic Equity Joint Venture and Contractual Joint Venture.

Ques 2: 'Joint Ventures can be extremely valuable and chances of their failure can be reduced to a great extent, if strategically formed' — Comment on important strategies of joint venture.

Hint: Refer Topic Strategies of Entering into Joint Venture.

Questions For Practice

Ques 1: Discuss advantages of Joint Venture?

Hint: Refer Topic Advantages of Joint Venture.

Ques 2: Discuss disadvantges of Joint Venture?

Hint: Refer disadvantges of Joint Venture.

10.2 Restrictions under FDI Policy of the Government of India

- A Citizen or entity from Pakistan can invest only after the approval of the Government of India. They cannot invest in defence, space, atomic energy and sectors prohibited for foreign investment.
- A Citizen or entity from Bangladesh can invest only after the approval of the Government of India. However, there are specific sectors that are barred from investment as is in the case of entities from Pakistan.
- NRI residents in Nepal and Bhutan as well as citizens of Nepal and Bhutan can invest on repatriation basis subject to investment coming in free foreign exchange through normal banking channels.

- Foreign Venture Capital Investor (FVCI) duly registered in India may contribute up to 100% of the capital of an Indian Company under the automatic route and may also set up a domestic asset management company to manage the fund.
- Foreign Institutional Investor (FII) can invest only under the Portfolio Investment Scheme which limits the individual holding of an FII to 10% of the capital of the company and the aggregate limit for FII investment to 24% of the capital of the company.

Question For Practice

Ques 1: Discuss Restrictions under FDI Policy of the Government of India.

Hint: Refer Topic 10.2 Restrictions under FDI Policy of the Government of India.

10.3 Key advantages of using an LLP firm as an SPV as compared to a company

- Low cost of incorporation of an LLP.
- Flexibility of rules of management and governance based on Agreement between the contracting Partners.
- Partners can be companies while management is by Designated Partners who are individuals.
- Low annual maintenance cost.
- There may not be any necessity of getting the accounts audited before the project takes off.
- An LLP firm does not have to pay Dividend Distribution Tax (DDT) on share of profits transferred to the Partners, which makes it tax efficient.
- Voluntary winding of an LLP firm which has no creditors is very easy and can be done without intervention of any court or tribunal.
- Investment in LLP Firms is permitted only in sectors in which 100% FDI is permitted through automatic route without any performance linked conditions.

Question For Practice

Ques 1: Discuss Key advantages of using an LLP firm as an SPV as compared to a company?

Hint: Refer Topic 10.3 Key advantages of using an LLP firm as an SPV as compared to a company.

10.4 Key issues which must be kept in mind while drafting Shareholders' Agreement (SHA)/ Partnership Agreement (PA)

- The business of the new company/LLP.
- Manner and extent to which resources (financial, manpower, technology, etc.) will be brought in.
- Provisions relating to allotment and transfer of shares.
- Constitution of the Board of Directors/Designated Partners.
- Manner in which decision making will take place.
- Decision regarding the Chairman and Managing Director of the entity; their rights, duties and responsibilities.
- Persons responsible for managing finances, marketing, production, etc.
- Dividend distribution policy.
- Term of office of the nominated directors, the manner of their appointment and changes among them.
- Valuation of the company at the time of separation.
- Dispute Resolution Mechanism.

Note: This list is inclusive not exhaustive.

Question For Practice

Ques 1: Discuss Key issues which must be kept in mind while drafting Shareholders' Agreement (SHA)/ Partnership Agreement (PA)?

Hint: Refer Topic 10.4 Key issues which must be kept in mind while drafting Shareholders' Agreement (SHA)/ Partnership Agreement (PA)

10.5 Essential components of a Joint Venture Agreement

(This list is inclusive not exhaustive)

JV Agreement contains the following components :

- Description (Nature of the Agreement).
- Parties (full description of the parties to the Agreement).
- Recitals (states the situation as it existed prior to the execution of this Agreement, also used to convey the intention of the parties).
- Operative Part (defines the rules for the future; typically consists of name and constitution of the new entity being set up, equity investments, rules relating to loans by either party, activities to be undertaken, role of each party, constitution of the Board, names of the Chairman and Managing Director and their powers, duties, etc., matters to be decided by consensus, managerial remuneration, milestones to be reached and plan of action).
- Legal aspects:
  - Amendments of the JV Agreement.
  - Duration of the JV.
  - Termination.
  - Dispute resolution by amicable consultation and/or Arbitration mechanism/Alternate form of Dispute Resolution.
  - Confidentiality and Non-Disclosure Agreement.
  - Non- compete clause.
  - Indemnification
  - Procedure for execution.

QUESTION

Ques 1: Global Infra Ltd., an Indian Entity, is in the process of drafting a joint venture agreement for forming Joint Venture (JV) with a foreign company based out of Singapore to expand its business outside India. Advise on the key issues which parties to the agreement should consider while drafting the JV Agreement.

Hint: Refer Topic 10.5 Essential components of a Joint Venture Agreement.

10.6 Special Purpose Vehicle (SPV)

Meaning of SPV	Special Purpose Vehicle (SPV) /Special Purpose Entity (SPE) are generally formed for a special purpose. Scope of these kind of companies or entities are limited only to those activities which are required to be performed to attain that specific purpose.
Benefits of SPV	◆ **Ownership of Assets** – An SPV allows the ownership of a single asset often by multiple parties and allows for ease of transfer between parties. ◆ **Minimum Statutory Requirement** – Depending on the choice of jurisdiction, it is relatively cheap and easy to set up an SPV. ◆ **Clarity of documentation** – It is easy to limit certain activities or to prohibit unauthorised transactions within the SPV documentation. ◆ **Tax benefits** – SPVs are often used to make a transaction tax efficient by choosing the most favourable tax residence for the vehicle. ◆ **Legal protection** – By structuring the SPV appropriately, the sponsor may limit legal liability in the event that the underlying project fails. ◆ **Accounting Reasons** – Debts raised through SPV are not reflected in the balance sheet of the sponsor. It reflects a pleasant picture and enhances the debt raising ability of the sponsor.

	◆ Separating the risk and freeing up the capital as a result SPV and the sponsoring company are protected against risks like insolvency which may arise during the course of operation. ◆ SPV also allows securitization of assets without disturbing the managerial relationship. Under the arrangement, any predictable income stream generated by secured assets can be securitized.
Purpose of SPV	The main purpose of a Special Purpose Vehicle is to allow the parent company to make highly leveraged or speculative investments without endangering the entire company. If the SPV goes bankrupt, it will not affect the parent company. SPVs are mostly formed to raise funds from the market or when Government Regulations specify creation of a separate vehicle for carrying out any specified activity. SPVs are created by a parent company to implement large-scale projects and operations of an SPV are legally limited to specific assets.
Difference between SPV and Company	The company as distinguished from an SPV may be called a general purpose vehicle. A company may do many things which are mentioned in the memorandum of association (MoA) or permitted by the Companies Act but scope of operation of SPV is limited and focused. MoA is quite narrow in the case of an SPV. This is primarily to provide comfort to lenders who are concerned about their investment.
Establishment of SPV	◆ A sponsoring corporation hives off assets or activities from the rest of the company into an SPV. ◆ This isolation of assets is important for providing comfort to investors. ◆ The assets or activities are distanced from the parent company hence the performance of the new entity will not be affected by the ups and downs of the originating entity. ◆ SPV will be subject to fewer risks and thus provide greater comfort to the lenders. In the absence of adequate distance between the sponsor and the new entity, the later will not be an SPV but only a subsidiary company. ◆ Good SPV should be able to stand on its feet, independent of the sponsoring company.
SPV preferred vehicle for funds raising by Infrastructure Sector	◆ The proposed SPV which is likely to be a government company will add to the availability of long-term funds for infrastructure sector projects. ◆ The implementation of the Smart Cities Mission at the City level done by a Special Purpose Vehicle (SPV) created for the purpose. The SPV plan, appraise, approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects. ◆ The execution of projects may be done through joint ventures, subsidiaries, Public Private Partnership (PPP), turnkey contracts, etc. suitably dovetailed with revenue streams. ◆ Funds requirement for Infrastructure sector are huge. There are different organisations, like the Infrastructure Development Finance Company (IDFC), Power Finance Corporation (PFC) and Indian Rail Finance Corporation (IRFC) etc. which are engaged in raising funds for development of infrastructure sector projects for the sectors they are involved in.

Questions For Practice

Ques 1: Discuss benefits of SPV?

Hint: Refer Topic Benefits of SPV.

Ques 2: SPV preferred vehicle for funds raising by Infrastructure Sector. Comment.

Hint: Refer Topic SPV preferred vehicle for funds raising by Infrastructure Sector.

Ques 3: Write Short Note On: "Establishment of SPV".

Hint: Refer Topic "Establishment of SPV".

10.7 Business Collaboration

Collaboration is when two or more entities work together through idea sharing and thinking to accomplish a common goal is known as Collaboration. Collaboration provides solutions, give a strong sense of purpose and also reinforce the objectives of coming together.

Types of Business Collaboration

- **Horizontal Collaboration:** When the businesses in the same set of functional area agree to collaborate in a way to improve their competencies is known as Horizontal Collaboration.

  Example: conducting research toward new or improved products and services requires monetary investment, time, and worker capacity.

- **Vertical Collaboration**: Vertical Collaboration is a collaboration wherein the business collaborates with companies in its supply chain either upward and/or downwards (its suppliers and/or distributors). Vertical collaboration often allows businesses to minimize risk in the supply chain and obtain lower prices in exchange for long-term commitment.

  Example: Computers shipping with pre-installed third-party software, discounted airport transfers offered by airlines etc.

- **Intersectional Collaboration**: When the Businesses from different functional areas agree to share their special knowledge for the advancement of all partners in collaboration is known as Intersectional Collaboration.

  Example: Manufacturing and Marketing collaborations, Referral rewards, tie-ups.

- **Joint Venture**: Two or more businesses form a new company. The new company is its own legal entity, and its profits are split according to terms spelled out in a formal contract is a Joint Venture.

  Example: One party in the joint venture provides technical support and another party provides manufacturing and marketing arrangements in joint venture.

- **Equity**: A company acquires a minor equity stake in another business in exchange for a monetary investment. Such exchanges can accompany other types of collaboration and, to a certain extent, agreed-upon access to decision making.

  Example: Funding to start-ups on equity basis, equity partnership in technical know-how.

Question For Practice

Ques 1: What do you mean by Business Collaboration? Discuss various types of Business Collaboration?

Hint: Refer Topic 10.7 Business Collaboration.