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Joint Ventures - What Is Your Exit Strategy?

Introduction

Knowing and understanding your exit strategy is vital before investing or acquiring a stake in an entity. This is particularly true in the context of a joint venture.

Often, joint ventures are established by parties to combine resources and technology or expertise to develop a business. Each party would have its own considerations and partners would likely seek to restrict other partners from transferring their shares and exiting the joint venture due to the business's reliance on their contributions. Such restrictions also serve to prevent the transfer of shares to third parties who may be competitors or parties deemed undesirable to work with.

The restrictions on the transfer of shares in a joint venture commonly take the shape and form of either a right of first offer mechanism (**ROFO**) or a right of first refusal mechanism (**ROFR**) within the shareholders agreement entered into between the shareholders.

What is a ROFO?

A generic ROFO clause grants a non-selling shareholder the right to make an offer for shares that a selling shareholder intends to sell (**Sale Shares**), before the selling shareholder may solicit third party buyers for the Sale Shares.

What is a ROFR?

A generic ROFR clause grants a non-selling shareholder the right to either, within a stipulated time, refuse or accept an offer from a selling shareholder for the Sale Shares after the selling shareholder has received a bona fide offer for the Sale Shares from third party buyers.

Does the ROFO or ROFR Suit Your Exit Strategy?

If your exit strategy is to sell your stake in the joint venture within a short to medium timeframe, the ROFO mechanism would be more favourable to you.

The ROFO clause places an obligation on the non-selling shareholder to make an offer to the selling shareholder. The selling shareholder may choose to accept or reject such offer and elect to shop for a better offer from third party buyers. Having received an offer from the non-selling shareholder, the selling shareholder may under the terms of the ROFO go to market with such offer and could possibly obtain a higher realisation of the value of the Sale Shares if it is able to find third party buyers willing to acquire such shares at a premium above that of the non-selling shareholder's offer. The selling shareholder is then free to sell the Sale Shares to the third party buyer at the higher price.

On the other hand, the ROFR mechanism tends to favour the shareholders who intend to invest long-term in the joint venture.

The ROFR clause places an obligation on the selling shareholder to first obtain a third party offer for the Sale Shares. This is often difficult due to the cost that a potential third party buyer will need to incur conducting legal and financial due diligence prior to making an offer, while knowing that such offer is still subject to the non-selling shareholder's right of refusal. Such considerations could potentially drive down the offer from third party buyers. As the ROFR mechanism allows the non-selling shareholder to match a low offer from third party buyers, it may actually hamper a selling shareholder intending to exit from realising the full value of its shares.

Conclusion

The issues considered above in relation to the ROFO or ROFR are not exhaustive and parties should strive to adapt and structure such restrictions that will be favourable to their interests, financial projections, and investment strategies. There are different ways in which ROFO or ROFR can be creatively structured and tailored to suit a particular shareholder's interests, in particular its exit strategy.

Shareholders should give careful thought on the exit terms and restrictions in their shareholders agreement and seek guidance from legal counsels before agreeing to and signing off on such agreements.

For more information, or should you have any queries or require assistance, please feel free to contact **Aaron Kok** at **akok@bihlilee.com.sg** or **Jesher Ho** at **jho@bihlilee.com.sg**.

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