

### KEY CONCEPTS

■ Foreign Collaboration ■ Business Collaboration ■ Joint Venture ■ Special Purpose Vehicle ■ Share-holder Agreement ■ Joint Venture Agreement

### Learning Objectives

#### To understand:

- The meaning and features of Foreign Collaboration
- Joint Venture and its types
- Meaning of Special Purpose Vehicle

### Lesson Outline

- Business Collaboration
- Foreign Collaboration
- Joint Venture
- Advantages of Joint Venture
- Disadvantages of Joint Venture
- Strategies of Joint Venture
- Modes of formation of Joint Ventures
- Restrictions under FDI Policy
- Essential Features of a Shareholders' Agreement (SHA)/ Joint Venture Agreement/ LLP Partnership Agreement (PA)
- Special Purpose Vehicle (SPV)
- Benefits and Purpose of Special Purpose Vehicles
- LLP as a Special Purpose Vehicle
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

## REGULATORY FRAMEWORK

- The Companies Act, 2013
- The Foreign Exchange Management Act, 1999
- The Limited Liability Partnership Act, 2008
- FDI Policy

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

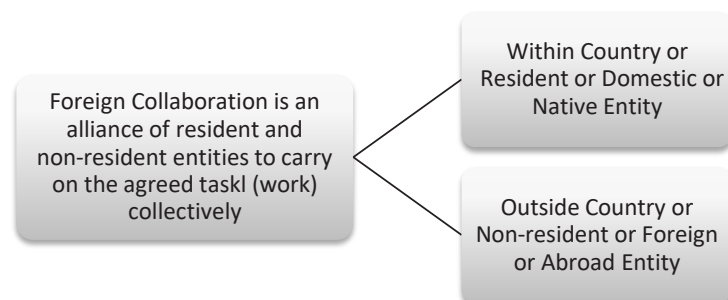
**Intersectional Collaboration:** When the Businesses from different functional areas agree to share their special knowledge for the advancement of all partners in collaboration is known as Intersectional Collaboration. For example: Manufacturing and Marketing collaborations, Referral rewards, tie-ups.

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

## FOREIGN COLLABORATION

### Meaning of Foreign collaboration



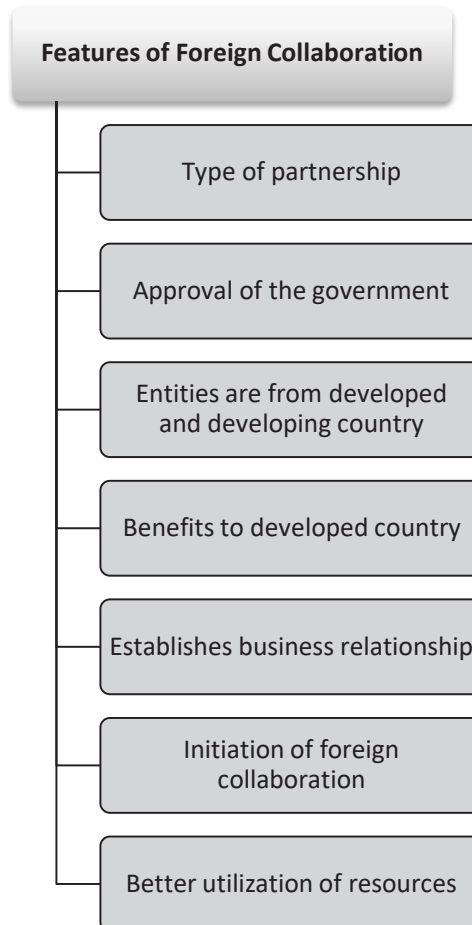
- Foreign collaboration is an alliance incorporated to carry on the agreed task collectively with the participation (role) of resident and non-resident entities. Foreign collaboration is an alliance of domestic (native) and foreign (non-native) entities like individuals, firms, companies, organizations, governments, etc., that come together with an intention to finalize a contract on some tasks or jobs or projects.
- Foreign collaboration is an alliance (a union or an association) formed for mutual benefit of collaborating parties.
- Foreign collaboration is a mutual co-operation between one or more resident and non-resident entities. In other words, for example, an alliance (a union or an association) between a foreign based company and a domestic company forms a foreign collaboration. It is a strategic alliance between one or more resident and non-resident entities. Only two or more resident (native) entities cannot make a foreign collaboration possible. For its formation and as per above definitions, it is mandatory that one or more non-resident (foreign) entities must always collaborate with one or more resident (domestic) entities.
- Before starting a foreign collaboration, both entities, for example, a resident and non-resident company must always seek approval (permission) from the Governmental Authority of the domestic country.
- During an ongoing process of seeking permission, the collaborating entities prepare a preliminary agreement.
- According to this preliminary agreement, for example, the non-resident company agrees to provide finance, technology, machinery, know-how, management consultancy, technical experts, and so on. On the other hand, resident company promises to supply cheap labour, low-cost and quality raw-materials, sufficient land for setting factories, etc.
- After obtaining the necessary permission, individual representative of a resident and non-resident entity signs this preliminary agreement. Signing the agreement acts as a written acceptance to each other's expectations, terms and conditions. After acceptance, a contract is executed, and foreign collaboration gets established. Contract is a legally enforceable agreement.
- After establishing foreign collaboration, resident and non-resident entity start business together in the domestic country.
- Collaborating entities share their profits as per the profit-sharing ratio mentioned in their executed contract.
- The tenure (term) of the foreign collaboration is specified in the written contract.

### Examples of Foreign Collaboration

Some prominent examples of foreign collaboration between an Indian and Foreign entity are depicted below.

- ICICI Lombard GIC (General Insurance Company) Limited is a financial foreign collaboration between ICICI Bank Ltd., India and Fairfax Financial Holdings Ltd., Canada.
- ING Vysya Bank Ltd. is a financial foreign collaboration formed between ING Group from Netherlands and Vysya Bank from India.
- Tata DOCOMO is a technical foreign collaboration between Tata Teleservices from India and NTT Docomo, Inc. from Japan.
- Sikkim Manipal University (SMU) from India runs some academic programs through an educational foreign collaboration with abroad universities like Liverpool School of Tropical Medicine from UK, Loma Linda and Louisiana State Universities from USA, Kuopio University from Finland, and University of Adelaide from Australia.

## Features of Foreign Collaboration



1. **Type of partnership:** Foreign collaboration is a type of partnership between a domestic entity and foreign based entity. In such an alliance, each partner plays some crucial role. Foreign entity generally provides support for finance, technology, engineering, management, etc. On the other hand, a domestic based entity provides cheap labour, high-quality raw materials, land and so on. Here, domestic and foreign entity share their profits as per profit-sharing ratio mentioned in their contract.
2. **Requires an Approval of the government:** Before initiating foreign collaboration, collaborating entities (domestic and foreign) must seek permission from the government of the domestic country. The government gives approval only when the contract of foreign collaboration is prepared in accordance with the industrial or foreign policy of its country.
3. **Entities are from developed and developing country:** In foreign collaboration, one or more abroad entities are generally from developed countries like U.S.A., Germany, Japan, etc. Whereas, a domestic entity is from a developing country or less-developed country (LDC). Some examples of developing countries are India, Sri-Lanka, Indonesia, and so on.
4. **Benefits to developed country:** The benefits of foreign collaboration to a developed country are as follows:
  - Foreign collaboration helps a developed country earn good returns on its overall investments made in a domestic country.

- It also aids a developed country earn a good reputation for providing financial and technical assistance (support) to the developing country.
- 5. Benefits to developing country:** The benefits of foreign collaboration to a developing country are as follows:
- Foreign collaboration helps a developing country to get finance, technology, machinery, know-how, management and technical expertise, etc. from a developed country.
  - It also assists a developing country to achieve a faster economic growth.
- 6. Establishes business relationships:** Foreign collaboration establishes business (trade) relationships among different countries. It removes their economic gaps (hurdles) and brings them closer to each other.
- 7. Initiation of foreign collaboration:** A foreign collaboration is initiated at the government and/or corporate level. At governmental level foreign collaboration, a government of some foreign country collaborates with the government of a domestic country. Similarly, at corporate level foreign collaboration, a company from some foreign country collaborates with the company from a domestic country. These companies may be either private or public in nature.
- 8. Better utilization of resources:** Though developed countries are good with finance, technology, management and technical expertise, generally, they face difficulties to meet a continuous supply of low-cost labour and quality raw materials. On the other hand, generally, a developing country has more availability of low-cost labour and plenty of quality raw materials. Foreign collaboration brings developed and developing country together and helps them to satisfy each other's needs by exchanging their excess resources. Finally, this leads to a better utilization of available resources.
- 9. Scope of foreign collaboration:** The scope of foreign collaboration is very wide. It covers core business activities such as: Finance, Production, Management and Technical consultancy, Advertising and Marketing, etc.
- 10. Miscellaneous features:** Miscellaneous features of foreign collaboration are listed as follows:
- Foreign collaboration reduces unemployment in a developing country.
  - It improves infrastructure in a developing country.
  - It helps to increase revenue of the governments in the form of taxes and duties.
  - It also aids to achieve economic growth in developed and developing country

### Objectives of Foreign Collaboration

The main intention/ prime goal or objective of foreign collaboration is to:

- Improve the financial growth of the collaborating entities.
- Occupy a major market share for the collaborating entities.
- Reduce the higher operating cost of a non-resident entity.
- Make an optimum and effective use of resources available in the resident entity's country.
- Generate employment in the resident entity's country.

### Types of Foreign Collaboration

- 1. Financial collaboration:** In case of financial collaboration, the inflow of foreign investment takes place in the domestic (host) country. In this method, the foreign company lends finance by:
  - **Purchasing ownership shares:** Here, foreign company purchases ownership shares of the domestic company and in return gets the dividend for these shares.
  - **Giving long-term loans:** Here, foreign company gives long-term loans to the domestic company and in return gets interest from these loans.
  - **Giving credit facility:** Here, foreign company gives credit facility to the domestic (native) company. The native company uses this credit facility to purchase raw-materials, plant and machinery.

Thus, in financial collaboration, there is an inflow of finance from developed countries to developing countries.

- 2. Technical collaboration:** In case of technical collaboration, the inflow of foreign technology takes place in the domestic (host) country. Technical collaboration includes integration of foreign technology with domestic (indigenous) technology. In technical collaboration, the foreign company provides technological know-how, professional services and expertise, installs automated machineries, etc., in the domestic country. Here, an inflow of modern technology takes place from the developed country to the developing country. Technical collaboration helps to remove an existing technological gap. Therefore, the governments of developing countries encourage such collaborations. In developing countries, most of the foreign collaborations are technical in nature.
- 3. Marketing collaboration:** In case of marketing collaboration, the inflow of foreign goods and services take place in the domestic (host) country. In marketing collaboration integration of domestic and foreign market takes place. In marketing collaboration, foreign company agrees to sell goods produced by the domestic company. The foreign company sells these goods in its own country and/or in the international market. It uses its distribution network to sell the goods. From the viewpoint of a developing country, marketing collaboration is very beneficial for increasing its exports of goods and services.
- 4. Management consultancy collaboration:** In case of management consultancy collaboration, the inflow of foreign management consultancy takes place in the domestic (host) country. In management consultancy collaboration integration of domestic and foreign consultancy takes place. In management consultancy collaboration, foreign company provides management skills to the domestic company and teaches it everything about management. In other words, it gives advice and solves management problems of the domestic company. It teaches management skills for the following:
  - Production management.
  - Marketing management.
  - Personnel management.
  - Financial management.

The foreign company also helps the domestic company to modernize and diversify its business process. So, in management consultancy collaboration, the foreign company increases the management efficiency of the domestic company. This type of collaboration is found in both private and public sector.

### Foreign Collaboration in India

In India there are basically two forms of foreign collaboration. The collaboration may be either financial collaboration or it may be technical. In case of financial collaboration the approving authority is the Reserve Bank of India and in the case of technical collaboration the approving authority is Department for Promotion of Industry and Internal Trade (DPIIT) in the Ministry of Commerce and Industry, Government of India.

The approach of the Government has been roughly the same since the year 1949 that is to allow foreign direct investment on preferential basis in sectors that will be beneficial for the country. The foreign or Indian undertakings will have to conform to the Industrial policy of the country. Foreign investors are in all cases considered equal to their Indian partners. The Government has enforced The Foreign Exchange Management Act 1999 (FEMA) with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

For setting up a foreign collaboration, approval from the government under the relevant foreign exchange laws in force and the requisite Government policy is required.

Under the Act now a foreign collaboration may be formed by a foreign company without the necessity of forming a company with an Indian counterpart. Any foreign collaboration which exceeds the minimum limited set out in the automatic route requires approval from the government.

The Government has set up a Foreign Investment Promotion board to encourage foreign investment in India. Some of the functions of the Board include:

- speed up clearance of proposals
- to review the collaborations cleared
- ear-marking and ascertaining of contacts to invest in India

## JOINT VENTURE

A simple dictionary meaning of the word ‘Joint Venture’ is a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities.

It is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint Ventures are generally created for a single activity or project, and may have a limited time span. The use of a separate entity allows the parties to limit the liabilities associated with the relationship.

In India till recently, almost all equity-based ventures were structured in the form of a company. However, with the government permitting foreign investment in Limited Liability Partnership (LLP) Firms, there is significant interest in LLP firms.

### Definition

Alternatively, we can define a joint venture is an association of two or more individuals or business entities who combine and pool their respective expertise, financial resources, skills, experience, and knowledge in the furtherance of a particular project or undertaking. As per the Indian Accounting Standard (Ind AS), a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

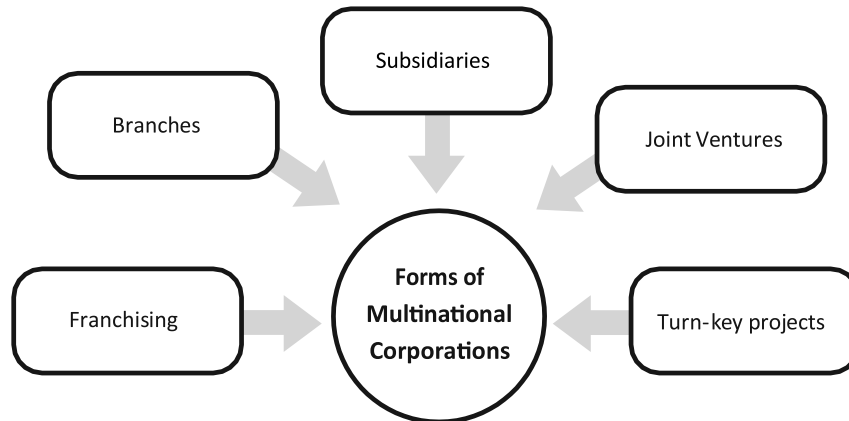
*A **Joint-ventures** can be defined as “an enterprise in which two or more investors share ownership and control over property rights and operation”. The venture can be for one specific project only, or a continuing business relationship. Entering into a joint venture is a major decision. Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects.*

Joint Venture commonly referred to as a “JV”, are typically formed either by individuals, business entities, corporations or partnerships. The contributions to the joint ventures are either in the form of money [capital], services, or physical asset(s), i.e. equipment or intellectual property [software, patents], etc., or a combination of all. Business entities, who do not individually have the capacity, in terms of resources finances and technical know-how etc. can benefit by forming Joint Venture for pooling of resources, sharing technical know-how and exploring larger markets for their goods and services.

JVs are also common in the manufacturing, mining, and service industries. A JV may be formed to conduct research and development work on a new product or technical application, to manufacture or produce various products, to market and distribute products and services in a specified geographic area, or to perform a combination of these functions.

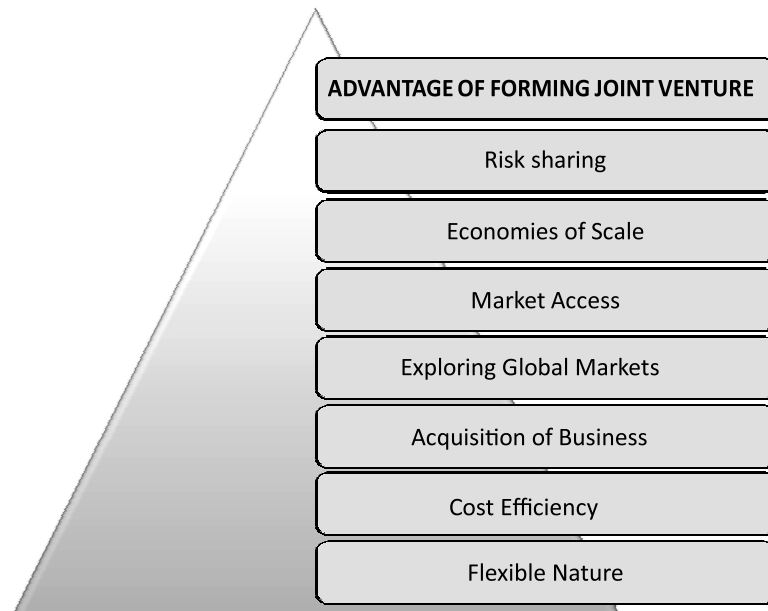
*Examples of Joint Venture Companies in India are Indian Oil Skytanking Ltd. (between Holders -Ruchi Soya and Indian Oil), Ratnagiri Gas & Power Private Ltd. (between NTPC Ltd. and GAIL India Ltd.), Mahanagar GasLtd. (BG Group of U.K. and GAIL India Ltd.) and Petronet LNG Ltd. (between PSU's, namely, BPCL, GAIL India Ltd., ONGC and IOCL).*

**MNC's in different forms including Joint Ventures**



**Advantages of Forming Joint Venture**

Various advantages of forming Joint Venture are as follows:



- (i) **Risk Sharing:** Risk sharing is one of the biggest advantages of forming a Joint Venture, particularly, in those industries where the cost of product development and likelihood of failure of any particular product is very high.

- (ii) **Economies of Scale:** Another advantage of forming a JV is for the industries which have high fixed costs, a 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.
- (iii) **Market Access:** For companies that lack a basic understanding of customers and the relationship and infrastructure to distribute their products to customers, forming a JV with the right partner can provide instant access to established, efficient and effective distribution channels and receptive customer bases. This is important to a company because creating new distribution channels and identifying new customer bases can be extremely difficult, time consuming and expensive activities.
- (iv) **Exploring the Global Market:** Formation of JV can be advantageous to those companies, which are foreseeing an attractive business opportunity in a foreign market. Partnering with foreign company would provide an ease to that Company for penetrating a foreign market, which can otherwise be difficult both because of a lack of experience in such market and local barriers to foreign-owned or foreign-controlled companies.
- (v) **Easy acquisition of other entity or business:** When a company wants to acquire another, but cannot due to cost, size, or geographical restrictions or legal barriers, teaming up with a JV Partner can be an attractive option. The JV is substantially less costly and thus less risky than complete acquisitions, and is sometimes used as a first step to a complete acquisition with the JV Partner. Such an arrangement allows the purchaser the flexibility to cut its losses if the investment proves less fruitful than anticipated.
- (vi) **Cost Efficiency:** For a small-scale company/ entity, sometimes 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. At such a time, if another company, which is equipped, lends a hand in the form of joint venture, by way of resource sharing and cost sharing it becomes easier to produce.
- (vii) **Flexible nature:** The joint venture enterprises provide flexibility, each participant has the freedom to continue with their individual businesses. The joint venture participants can only interfere within the participated project. Thus, during the term of the contract participants can freely resume their business as long as they fulfil the needs mentioned in the agreement.

### Disadvantages of Joint Venture

Disadvantages of forming Joint Venture are as follows:

- (i) **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. In times like such the participants need to focus on the product of the joint venture and the individual businesses suffer in the process. For example, company A requires technological assets thus in joint venture company B avails the facility. In the same time, if the company B requires those technical assets then he has to postpone the individual project for the time being.
- (ii) **Lack of equal involvement:** An equal involvement from all the Joint Venture partners may not be possible. It is extremely unlikely for all the companies working together to share the same involvement and responsibilities.
- (iii) **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.

- (iv) **Extensive Research and planning required:** Joint venture can result in a frustrating experience and ultimately a failure if it lacks adequate planning and research.
- (v) **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.
- (vi) **Unreliable partners:** Because of the separate nature of a joint venture, it is possible that the partner do not devote 100% of their attention to the project and become unreliable.
- (vii) **Creation of competitor:** Another potential disadvantage of a JV is the 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 a Joint Venture

Strategies of Joint Venture
● Identification of Prospective JV Partners
● Reliable Partners
● Strong JV Relationship
● Equal Contribution
● Written Agreement
● Limiting Scope of JV
● Defined Business Model
● Flexibility
● Exit Routes

Joint ventures can be very effective for growth and success of a business. If formed strategically Joint Ventures can be extremely valuable and chances of their failure can be reduced to a greater extent.

#### Following are the strategies for forming a successful Jointing Venture:

**Identification of prospective Joint Venture Partner(s):** The prospective partner should be strong in terms of business, technology and resources. One partner must be able to compliment the other partner especially in those areas where it lacks. For example, one entity's strength is economies of scale and another entity's strength is strong marketing and their brand value. Both the entities, if formed into JV can complement each other and they can have a larger market for their products.

**Trustworthy:** Joint Venture Partner should never be weak or untrustworthy partner, as it would definitely lead to failure of the joint venture. On the other hand, a JV with strong and trustworthy partner would generate enormous benefits for both the partners and the Joint Venture entity.

**Development of Strong Joint Venture Relationship:** Partners must strive to develop joint venture relationships that are easy to maintain, financially profitable, intellectually rewarding, and long-lasting. After a necessary period of negotiation and implementation, the Joint Venture relationship should grow well quickly and painlessly.

**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:** The 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 the scope of Joint Venture:** 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.

**Well defined Business Model:** The firms in a JV must clearly define the nature of the new venture including the proposition to the customer, the channels and relationship management, the value chain, the structure and roles, investments, income, costs and payments, success factors and the timetable for delivery. A well-defined business model provides a base for the legal and financial framework.

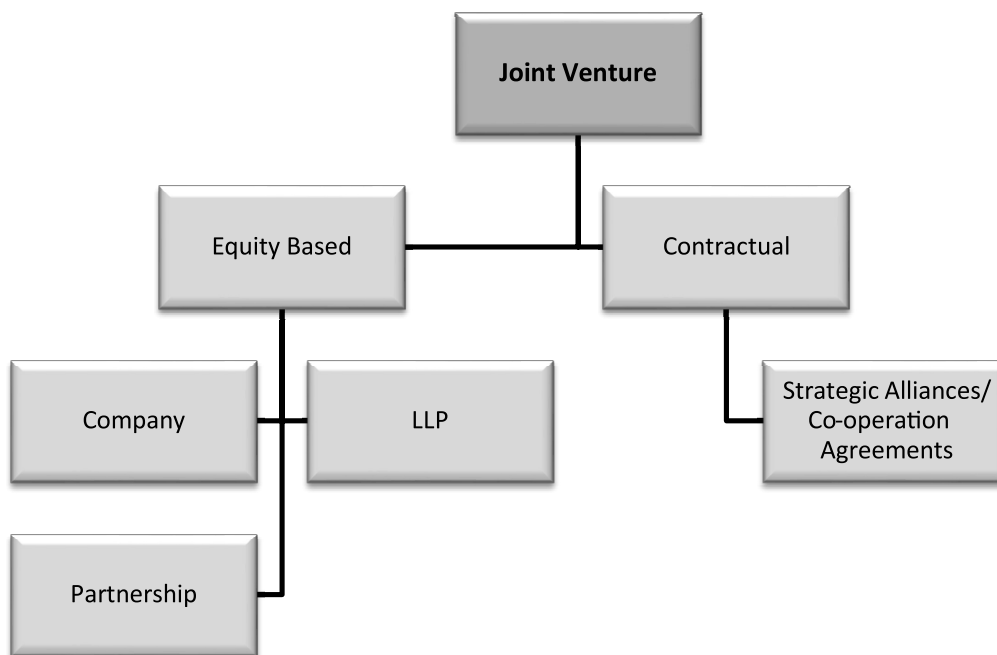
**Flexibility:** The partners in JV should try to be flexible and favour partners who demonstrate the same level of flexibility.

**Establishment of 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.

### Formation of Joint Ventures

A Joint Venture can be of the following types :

1. An Equity based Joint Venture
2. Contractual Joint Venture



#### (1) Equity based 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.

The parties undertake to provide money or other resources as their contribution to the assets or other capital of that legal entity. The entity is generally established as a limited liability company and is distinct from either of the parties which participate in its creation.

The newly created company, thus, becomes the owner of the resources contributed by the parties to the joint venture arrangement. Each of the parties in turn becomes the owner of the company having equity in the company.

The parties to a joint venture agreement agree on purposes and functions of the newly created entity, the proportion of capital contribution by each party and the share of each party in the profits of the company and on other matters such as its management, operation, duration and termination.

Generally speaking, in an equity based joint venture, the profits and losses of the jointly owned entity are distributed among the parties according to the ratio of the capital contributions made by them. However, the division of profits and losses is not the only characteristic of an equity-based joint venture. The key characteristics of equity-based joint ventures are as following:

- (a) There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity
- (b) Shared Ownership by the parties involved.
- (c) Shared management of the jointly owned entity.
- (d) Shared responsibilities regarding capital investment and other financing arrangements.
- (e) Shared profits and losses according to the JV Agreement.

***Circumstances indicating SPV:***

All the above five characteristics need not be fulfilled in every equity based joint venture. For example, one of the parties to the agreement may be providing investment but might not have any say in the management of the Joint Venture.

Again, a foreign company may want to exercise management control even though it is not investing in the JV company. Typically, if a foreign company is providing technology and other knowledge-based inputs, it may want to ensure that the JV company is managed as per its directions. In such cases, the foreign company may retain an option to invest in the JV Company on a later date. This may be done by a foreign company to create a foothold for itself in a sector where Foreign Direct Investment (FDI) is not allowed.

**(2) Contractual Joint Venture**

The contractual joint venture might be used where the establishment of a separate legal entity is not needed or 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.

The contractual joint venture agreement can be entered into in situations where the project involves a narrow task or a limited activity or is for a limited term or where the laws of the host country do not permit the ownership of property by foreign citizens.

For the purposes of contractual joint venture, the relationship between parties is set forth in the contract or agreement concluded between them.

The way joint venture company would carry out its operations is always based on the negotiations between the parties, the results of which reflect in the joint venture agreement entered into between the parties.

The licensing agreement, know-how agreement, technical services or technical assistance agreement, franchise agreement and agreement covering all other commercial matters might even form annexes to the main joint venture agreement. These can be signed once the joint venture company is established.

An example of a contractual joint venture is a franchisee relationship. The key characteristics of such a relationship are:

- (i) Two or more parties have a common intention – of running a business venture.
- (ii) Each party will bring some inputs in the form of money, technology or materials.
- (iii) Each party exercises certain degree of control on the venture.
- (iv) The relationship is not a transaction-to-transaction relationship but has a character of relatively longer time duration.

The above four characteristics are the distinguishing features of a Contractual Joint Venture as opposed to an Equity based relationship.

It is important to note that a joint venture agreement, be it for the establishment of a limited liability company or not, and the different contracts must be concluded in accordance with laws and regulations applicable to such companies including tax laws concerning these companies or the laws relating to agency or partnership as well as other economic laws, in addition to laws relating to labour, sales of goods, insurance and foreign economic and trade contract.

Every equity based joint venture gives birth to a new entity. Government of India permits certain type of entities. Different types of entities are summed up below:

- (1) **Company** – A limited liability company is the most preferred structure for joint venture entities in India.

Government also encourages investment being in the form of equity capital of a company incorporated in India. Companies in India are mainly of two types – private limited and public limited. There is no minimum share capital prescribed either for private limited company or public limited company.

A private limited company must have at least two shareholders, while a public limited company must have seven shareholders. The only exception to this is a one-person company. The shareholders may be foreign citizens or foreign companies. Companies Act 2013 makes it mandatory that at least one director of every company is resident of India.

- (2) **Limited Liability Partnership (LLP) Firm** – LLP Firm structure is regulated in India by The Limited Liability Partnership Act, 2008. Government of India has now allowed foreign investments in LLP firms subject to certain restrictions.

LLP Firms are partnership firms with limited liability of partners. An LLP Firm combines the convenience of a partnership firm with the limited liability feature earlier found only in a company. An LLP Firm needs minimum two partners. It also requires minimum two Designated Partners out of which at least one should be resident of India. The two partners can also be appointed as Designated Partners. There is no requirement of minimum capital contribution to incorporate an LLP Firm.

- (3) **Venture Capital Fund** – A duly registered Foreign Venture Capital Investor is allowed to contribute up to 100% in Indian Venture Capital Undertakings / Venture Capital Funds / other companies.
- (4) **Trusts** – A foreign company is not allowed to use Trust as a form of a joint venture entity in India. SEBI has introduced regulations for some funds like Real Estate Investments Trusts, Infrastructure Investment Funds, Alternative Investment Funds. Such funds are now permitted to receive foreign investment from a person resident outside India.
- (5) **Other Entities** – Foreign companies are not allowed to use any structures other than those mentioned above for the purpose of equity based joint venture entities.

### Restrictions under FDI Policy of the Government of India

Typically, any non-resident entity can set up an equity based joint venture in India. However, some entities face restrictions under FDI Policy of Government of India. The restrictions are as follows:

1. A Citizen or entity land border from India as per FDI Policy 2020 can invest only after the approval of the Government of India. Entity invest in defense, space, atomic energy and sectors prohibited for foreign investment.
2. 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 (USD or EURO) through normal banking channels.
3. A Foreign Institutional Investor (FII) can invest only under the Portfolio Investment Scheme with certain limits.
4. A 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. Such investments are subject to the relevant RBI Rules and Regulations and FDI policy including sectoral caps, etc. SEBI registered FVCIs are also allowed to invest under the FDI Scheme, as non-resident entities, in other companies.

### Examples of Joint Venture (JV) Companies in India

- **Tata Starbucks**

Tata Starbucks Private Limited, formerly known as Tata Starbucks Limited, is a 50:50 joint venture company, owned by Tata Consumer Products and Starbucks Corporation, that owns and manages Starbucks outlets in India. The outlets are branded Starbucks “A Tata Alliance”. India.

- **Bharti-AXA General Insurance Co Ltd.**

Bharti AXA General Insurance Co Ltd is a JV between India’s leading business group Bharti Enterprises and an insurance major from France, AXA. This leading insurer in India’s initial operations. The company is licensed by (IRDAI) the Insurance Regulatory and Development Authority of India.

- **Fratelli Wines**

Fratelli Wines is an Indo-Italian joint venture between Italy’s Secci brothers, Alessio and Andrea, the New Delhi-based Sekhri brothers, Kapil and Gaurav, and Mohite-Patil Ranjitsinh and Arjunsinh from Solapur Maharashtra.

- **Mahindra-Renault Ltd.**

A Joint venture between Mahindra-Renault, brings together India’s largest automobile manufacturer Mahindra & Mahindra and world-renowned vehicle maker, Renault SA of France. This joint venture has launched several cars together.

- **ICICI Bank (Insurance & Investments)**

ICICI Bank has two successful joint ventures to offer a variety of insurance and investment products to customers in India and Indian citizens residing in various parts of the world.

1. ICICI Prudential Life Insurance Company Ltd is a joint venture between ICICI Bank and UK-based Prudential Corporation Holdings Limited.
2. ICICI Lombard is a joint venture between ICICI Bank and Fairfax Financial Holdings Ltd of Canada.

- **AirAsia India**

AirAsia India is a joint venture between Malaysia-based AirAsia Berhad and Tata Sons. The airline ranks as the fourth largest Low-Cost Carrier (LCC) in India. AirAsia India is also the second JV in the airline industry of Tata Sons.

*Source: <https://www.thethrive.in/business-article/five-successful-joint-venture-companies-jvc-in-india/>*

### Documents for Joint Ventures

Finalization of a joint venture goes through many stages. The first may be called the familiarisation stage when the two partners generally attempt to know each other.

The second may be called the engagement phase when there is a level of commitment but still it is not very firm or long-term. The final stage is when broad understanding has been reached on the terms of the Joint Venture.

At each stage, the documentation is different. The Indian companies preferred to have a Memorandum of Understanding (MOU) to define the relationship at the initial stage. The MOU is a brief document without much legal jargon. The MOU states the duties of both parties and lays down a road map for the future. During the engagement phase, a contractual Joint Venture may be envisaged. The parties are putting in relatively higher amount of resources at this stage. Hence, it is customary to have well-drafted legally binding contracts.

The contracts are generally of a fixed duration or are related to specific events like getting an order or achieving certain sales volumes. At the concluding stage, the parties have developed higher confidence in each other. So, an equity-based joint venture is considered. The documentation for an equity Joint Venture must take into account all possibilities that may arise over a fairly long period of time.

Hence, the Joint Venture Agreement or Shareholders' Agreement or LLP Agreement must be prepared carefully to avoid any confusion even many years down the line. Generally speaking, most equity Joint Ventures in India are structured in the form of private or public limited liability companies. In a company, Articles of Association is a very important document. Companies Act, 2013 gives the promoters freedom to draft the articles as per their requirements. It is hence, advisable to devote time and attention to the Articles and not depend on a standard off-the-shelf draft, especially in case of a joint venture company where one of the partners is a foreign national / company.

### Essential Features of a Shareholders' Agreement (SHA) / Joint Venture Agreement / Partnership Agreement (PA)

The SHA / PA is not a document for the government or the courts. SHA / PA is a working document and should be drafted with business essentials in focus. The key questions that an SHA / PA must address are common-sense ones that any entrepreneur is bound to ask when he / she joins hands with another entrepreneur.

Some of the key issues which must be kept in mind while drafting the SHA/PA are summarised below:

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

*The above examples are indicative and are not exhaustive.*

### **Essential components of a Joint Venture Agreement**

In India, there is no legally prescribed format of a Joint Venture Agreement. However, in actual practice, the Agreement contains the following components (illustrative and not exhaustive):

- (a) Description (Nature of the Agreement)
- (b) Parties (full description of the parties to the Agreement)
- (c) Recitals (states the situation as it existed prior to the execution of this Agreement; It is also used to convey the intention of the parties)
- (d) 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)
- (e) Legal aspects:
  - (i) Amendments of the JV Agreement
  - (ii) Duration of the JV
  - (iii) Termination
  - (iv) Dispute resolution by amicable consultation and/or Arbitration mechanism/Alternate form of Dispute Resolution
  - (v) Courts of particular State (in India) or Country (where the JV partner is foreign entity) that will have the jurisdiction in the event of dispute
  - (vi) Confidentiality and Non-Disclosure Agreement
  - (vii) Non-compete clause
  - (viii) Indemnification
  - (ix) Procedure for execution.

## SPECIAL PURPOSE VEHICLE (SPV)

### Meaning of Special Purpose Vehicle (SPV)

A Special Purpose Vehicle (SPV) or 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. These companies/entities close their operations once the purpose is attained. The operations of these entities are limited to the acquisition and financing of specific assets. SPVs are generally a subsidiary company whose obligations are secured even if the parent company goes bankrupt.

An SPV can be formed for any lawful purpose. No SPV can be formed for an unlawful purpose, or for undertaking activities which are contrary to the provisions of law or public policy. An SPV is, primarily, a business association of persons or entities eligible to participate in the association.

A SPVs/SPEs may be formed through limited partnerships, trusts, corporations, limited liability corporations or other entities. An SPV/SPE may be designed for independent ownership, management and funding of a company or as protection of a project from operational or insolvency issues. SPVs help companies securitize assets, create joint ventures, isolate corporate assets or perform other financial transactions.

Thus, based on above meaning, we can conclude that a SPV is an entity which has distinct identity from its promoters or sponsors or constituents or shareholders.

To give an example, the implementation of the Mission (under the Smart Cities Mission Project of the Ministry of Housing & Urban Affairs, Government of India) at the City level will be done by a Special Purpose Vehicle (SPV) created for the purpose. The SPV will plan, appraise, approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects. Each smart city will have a SPV which will be headed by a full time CEO and have nominees of Central Government, State Government and ULB on its Board. The SPV will be a limited company incorporated under the Companies Act, 2013 at the city-level.

### Benefits of Special Purpose Vehicle (SPV)

The biggest advantage of SPV is that it helps in separating the risk and freeing up the capital. As a result, the SPV and the sponsoring company are protected against risks like insolvency, which may arise during the course of operation. The SPV also allows securitisation of assets without disturbing the managerial relationship. Under the arrangement, any predictable income stream generated by secure assets can be securitised.

#### Model SPV:

- (a) **Ownership of Assets** – An SPV allows the ownership of a single asset often by multiple parties and allows for ease of transfer between parties.
- (b) **Minimum Statutory Requirement** – Depending on the choice of jurisdiction, it is relatively cheap and easy to set up an SPV.
- (c) **Clarity of documentation** – It is easy to limit certain activities or to prohibit unauthorised transactions within the SPV documentation.
- (d) **Tax benefits** – SPVs are often used to make a transaction tax efficient by choosing the most favourable tax residence for the vehicle. SPVs are method of financial engineering schemes which have as their main goal, the avoidance of tax. Some countries have different tax rates for capital gains and gains from property sales.
- (e) **Legal protection** – By structuring the SPV appropriately, the sponsor may limit legal liability in the event that the underlying project fails.

- (f) **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. Losses incurred by SPV are not shown in the balance sheet of the sponsor, so it helps to maintain the healthy picture of the sponsor in the eyes of its stakeholders.
- (g) The key advantage is that it helps in separating the risk and freeing up the capital. As a result, the SPV and the sponsoring company are protected against risks like insolvency, which may arise during the course of operation.
- (h) The 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 Special Purpose Vehicle

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.

SPVs are also formed by banks and financial institution for Securitisation. The total assets of banks or financial institution mainly comprise of loans and receivables along with their future cash flow to a separate entity, which may be formed for a specific purpose. The SPV is allowed to raise debt which will be backed by these receivables and their future cash flows. The difference between the incomes received from these receivables and cost of servicing that debt will be profit/earning of the SPV. By securitization through SPV the risk involved in this activity is separated from the general business of the bank.

Indirect acquisition of assets - SPVs can be used for acquiring assets indirectly for the purpose of tax saving. In this method, the sponsor takes the assets on lease from its SPV. Expenses incurred as rent, is allowed as a deduction to sponsor for income tax purpose. On the other hand, the SPV acquires the asset through raising debt, the interest on which is a deductible expense for tax purpose. This way the same asset can be used to claim deduction by both, which results in saving of tax.

Government also forms SPVs for special projects. Purpose behind formation of SPV is to get easy finance and various approvals from State and Central Government at many levels and on completion of projects, it provides easy exit route for Government.

### Difference between a Special Purpose Vehicle (SPV) and a Company

SPVs are mostly formed to raise funds from the market. Technically, an SPV is a company. It has to follow the rules of formation of a company laid down in the Companies Act. Like a company, the SPV is an artificial person. It has all the attributes of a legal person. It is independent of members subscribing to the shares of the SPV. The SPV has an existence of its own in the eyes of law. It can sue and be sued in its name. The SPV has to adhere to all the regulations laid down in the Companies Act. Members of an SPV are mostly the companies and individuals sponsoring the entity. An SPV can also be a partnership firm.

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. An SPV may also do the same, but its scope of operation is limited and focused. If it is not so, the SPV had better be called a company. The MoA is quite narrow in the case of an SPV. This is primarily to provide comfort to lenders who are concerned about their investment.

### How is an SPV established?

Like a company, an SPV must have promoter(s) or sponsor(s). Usually, 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. The SPV will be subject to fewer risks and thus provide greater comfort to the lenders. What is important here is the distance between the sponsoring company and the SPV. 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.

A good SPV should be able to stand on its feet, independent of the sponsoring company. Unfortunately, this does not happen in practice. One of the reasons for the collapse of the Enron SPV was that it became a vehicle for furthering the ends of the parent company in violation of the prudential norms of corporate financing and accounting.

### SPV as preferred vehicle for funds raising by Infrastructure Sector

The funds requirement for Infrastructure sector are huge. There are different organisations, like the Infrastructure Development Finance Company (IDFC), Power Finance Corporation (PFC), 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. The proposed SPV, which is likely to be a government company, will add to the availability of long-term funds for infrastructure sector projects.

Further. 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 detailed with revenue streams.

### LLP FIRM AS A SPECIAL PURPOSE VEHICLE

A Limited Liability Partnership (LLP) Firm combines the simplicity of a partnership firm with the advantage of limited liability as available in the case of a company.

Before the passing of The Limited Liability Partnership Act in 2008, a foreign company intending to participate in tender or some other project in consortium with an Indian company had only the option of setting up a company (whether private or public) as a Special Purpose Vehicle (SPV). The disadvantage was that winding up such a company is difficult.

Foreign companies are not permitted to invest in partnership firms.

Moreover, consortium members do not want to be saddled with unlimited liability as is the case in a partnership firm under The Indian Partnership Act, 1932. Foreign Investment in some LLP firms has been allowed now.

LLP firm as an SPV between a foreign company and an Indian company has the advantage of being easy to wind up after the purpose is over and the liability of the two partner companies is limited.

Key advantages of using an LLP firm as an SPV as compared to a company are as follows:

- (a) Low cost of incorporation of an LLP;
- (b) Flexibility of rules of management and governance based on Agreement between the contracting Partners;

- (c) Partners can be companies while management is by Designated Partners who are individuals. By this, there is divorce between ownership and management;
- (d) Low annual maintenance cost;
- (e) There may not be any necessity of getting the accounts audited before the project takes off;
- (f) 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;
- (g) Voluntary winding of an LLP firm which has no creditors is very easy and can be done without intervention of any court or tribunal;
- (h) Investment in LLP Firms is permitted only in sectors in which 100% FDI is permitted through automatic route without any performance linked conditions.

#### LESSON ROUND-UP

- Collaboration is when two or more entities work together through idea sharing and thinking to accomplish a common goal is known as Collaboration.
- Foreign collaboration is an alliance incorporated to carry on the agreed task collectively with the participation (role) of resident and non-resident entities.
- In India there are basically two forms of foreign collaboration. The collaboration may be either financial collaboration or it may be technical. In case of financial collaboration, the inflow of foreign investment takes place in the domestic (host) country. In case of technical collaboration, the inflow of foreign technology takes place in the domestic (host) country.
- A simply dictionary meaning of the word 'Joint Venture' is a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities.
- There are various advantages of forming Joint Venture such as Risk Sharing, Economies of Scale, Market Access, Exploring the Global Market, Easy acquisition of other entity or business, Cost Efficiency, Flexible nature.
- There are two modes of formation of Joint Ventures: Equity Joint Venture and Contractual Joint Venture.
- Some entities face restrictions under FDI Policy of Government of India.
- Government of India permits certain type of entities. Different types of entities are: Company, Limited Liability Partnership, Venture Capital Fund, Trusts and other entities.
- Some of the key issues which must be kept in mind while drafting the shareholders' Agreement (SHA)/ Joint Venture Agreement/LLP Partnership Agreement (PA) are specified in the chapter.
- A special Purpose Vehicle (SPV) or Special Purpose Entities (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.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Explain the meaning and features of foreign collaboration.
2. Define a Joint Venture Company. What are its characteristics?
3. Distinguish between a Joint Venture Company and a Special Purpose Vehicle (SPV)
4. Explain, with reasons, why the concept of Special Purpose Vehicle (SPV) has gained prominence in India in recent times. Quote Examples.

**LIST OF FURTHER READINGS**

- ICSI Premier on Company Law
- Bare Act- The Companies Act, 2013
- Bare Act- The LLP Act, 2008
- Bare Act-The Foreign Exchange Management Act, 1999
- FDI Policy of the Government of India

**OTHER REFERENCES (Including Websites and Video Links)**

- <https://www.mca.gov.in/content/mca/global/en/home.html>
- <https://www.rbi.org.in/>
- <https://dpiit.gov.in/>

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