

BACK TO THE BASICS

HSA's fortnightly bite-sized analysis of topics of relevance and interest in the world of transactions

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New investor and heterogenous existing shareholders: Importance of clarity

An early-stage investor (**Investor**) often encounters situations where its prospective target (**Company**) has a mixed bag of shareholders. At this stage, the Company may have financial and other investors (these may be a corporate entity or high net worth individuals who have collectively or singularly invested in the Company) in addition to promoter shareholders.

In such situations, instead of drafting a standard form Investment Agreement for the Investor, we recommend an initial consideration of the following facts:

- **Who controls the Company?** - A check on who controls the Company, which is a factor of legal control as well as influence in decision making, is vital. It may not always be just the promoter who exercises control and may include one or more financial investors.
- **Is there a need for consolidation amongst existing shareholders?** - If there are too many disparate shareholders, a consolidation inter se the existing shareholders may be prudent to ensure a lower number of shareholders by the time the Investor enters the Company. While this aids risk mitigation and operational efficiency, it also has implications on commercials, tax burden, timelines, etc.
- **Whether any of the existing shareholders are seeking secondary exit?** - There may be situations wherein an existing shareholder(s) is keen to exit through a secondary route as part of the Investor's investment. This would have an impact on the deal structure and necessitate an evaluation of potential business and the operational impact such exit may have on the Company.
- **Whether an authorized representative has been identified?** - Identifying an authorized representative that fronts all discussions on behalf of the existing shareholders of the Company can help streamline the entire process. This is important from a negotiation standpoint but even more important during the tenure of the Investor in the Company. In case there is a need for two authorized representatives, it needs to be ensured that they do not have the contractual leeway to act disparately, as that would create difficulties for the Investor in complying with the shareholders' arrangement.
- **Will a uniform non-compete be applicable to all shareholders?** - It is important to ascertain whether the same standard of non-compete could be applied to all the existing shareholders, or would differentiation be required in case a uniform non-compete is not applicable, it can impact negotiations, commercials, timelines, etc.

AUTHORS



Saurya Bhattacharya
Partner

saurya.bhattacharya@hsalegal.com



Issues like these, when addressed correctly in documentation, add value to the smooth progress of not just the investment transaction, but also the Company's operations and shareholders' relationships subsequent thereto.

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mail@hsalegal.com