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India's IPO Boom

As a listing frenzy sweeps the country, law firms try to keep up

How the PE exit has evolved
Leaders talk scaling strategies
CCI targets e-commerce sector

Evolution of the exit

Exit strategies in Indian private equity deals have transformed, with investors now prioritising enforceable exit mechanisms, dispute resolution clauses and realistic timelines to navigate the challenges of protracted legal battles. **By Nimitt Dixit**

- **Exit disputes significantly impact foreign investment in Indian markets.**
- **Investors now prioritise enforceable, strategic exit clauses in agreements.**
- **Prolonged legal battles prompt preference for settlement over litigation.**

In the fast-paced world of private equity and venture capital investments in India, exit strategies have long been a thorny issue. Over the past decade, foreign investors have grown increasingly cautious, their enthusiasm tempered by the harsh realities of protracted exit disputes that can leave them entangled in India's labyrinthine legal system.

This stems from a perfect storm of challenges unique to the Indian market: Promoters skilled at stalling exits through strategic use of court mechanisms, vague exit clauses in hastily drafted agreements, and a lack of jurisdictional clarity on dispute resolution that allows parties to take advantage when it comes to contested exits.

The scale of this problem is significant. According to a 2023 report by the Indian Private Equity and Venture Capital Association (IVCA), approximately 15 percent of all private equity exits in India between 2018 and 2022 involved some form of dispute. This translates to roughly 75 disputed exits out of 500 total exits during this period. More alarmingly, the average duration of these disputes was 4.7 years, with some cases dragging on for over a decade.

The case of Shaadi.com and Westbridge Capital serves as a stark reminder of the perils that await unsuspecting investors. What began as a promising partnership in 2006 devolved into a bitter legal battle that dragged on for years, significantly eroding the value of Westbridge's investment. This cautionary tale is far from unique, with exit disputes in India taking an average of five to six years to resolve – a timeframe that aligns ominously with the typical lifespan of investment funds.

But with India's growing global reputation as a high-return market, both in private equity and public capital, investors have continued to grow their Indian bets, albeit with a more cautious approach to contract negotiation, creating pragmatic and enforceable exit strategies and dispute clauses to ensure smoother departures for their portfolio companies.

The exit evolves

A decade ago, it was common practice for investors to include a veritable smorgasbord of exit mechanisms in their agreements. From initial public offerings (IPOs) to buy-backs, third-party sales, drag-along rights, put options, and call options – contracts were often stuffed with every conceivable exit strategy.

However, as Harshita Srivastava, co-head of Nishith Desai Associates'

private equity and M&A practice, points out, "in the last decade, many of these exit clauses went into dispute." Investors realised that some of these clauses were theoretical, and not really enforceable against the company. "This realisation has led to a more nuanced and strategic approach to drafting exit clauses."

Today's investors have become far more pragmatic. Instead of throwing in the proverbial kitchen sink, they're making calculated decisions about which exit options to include based on their intention and ability to enforce them within a specified timeframe. "Parties are resorting to including only those exit clauses that they intend to enforce," Srivastava explains. "They want to identify two or three exit options that work for them strategically."

This shift has given rise to the popularity of "exit waterfalls" – a structured approach where investors stipulate a fixed order in which exit options are to be exercised. This method provides clarity on exit strategy and timelines and reduces the potential for disputes down the line.

Interestingly, this evolution isn't confined to the investor side of the table. Indian promoters, once happy to agree to any clause as long as the money was flowing in, have become more sophisticated and engaged in the negotiation process. Gone are the days when a "Byju's approach" of accepting all terms without scrutiny was the norm. Today's new-age promoters are actively participating in shareholder contract negotiations, demonstrating a keen understanding of the implications of each clause.

This increased engagement from both sides has led to more balanced and enforceable contracts. However, it has also highlighted the critical importance of careful drafting, particularly when it comes to dispute resolution and governing law clauses. Experts say that all too often, contracts inadvertently provide multiple options for dispute resolution due to drafting oversights, creating ambiguity that can be exploited in future conflicts.

Contracts also envisage exits more clearly when it comes to material breach of contracts by either party, including allowing stake sales to direct competitors – the key issue in the Shaadi.com exit dispute. Investors are being pushed back on their insistence to unilaterally adjudicate material breaches, and usually settle on third-party adjudication or event-based triggers such as filing of a First Information Report, or adjudication by a court of first instance.

Another significant change in the exit landscape is the timeframe in which exits are planned and executed. "Exits are no longer an overnight action," observes Dheeraj Nair, partner and co-chair of the disputes practice at JSA Advocates & Solicitors. "When people start talking about exits, the conversation and internal strategy often begins three or four years before the actual event." This extended runway allows for meticulous planning, including the preparation of internal communications and boardroom strategies.

Dispute challenges

Despite these improvements, the spectre of India's judicial system continues to loom large over investment decisions. The National Company Law Tribunal (NCLT) and Indian courts are often viewed as delay tactics by international investors, with Indian promoters leveraging the system's notorious slowness to their advantage.

This wariness has led to a preference for settlement over litigation. Experts say that roughly 90 percent of exit disputes get settled. People get tired and prefer to settle for a lesser value to stop the drain on energy and time. Many investors prefer to exit at a loss rather than face a prolonged court battle in India.

The situation has led to calls for reform. There's a growing consensus that India needs a separate authority to handle these disputes – one staffed by judges who understand the complexities of financial and commercial disputes. As one expert put it, "India needs a Singapore-like system to boost investor confidence."

The impact of these prolonged disputes on investment flows is significant. A 2023 survey by Preqin, a global leader in alternative assets data, revealed that 62 percent of foreign investors cited concerns about exit mechanisms and potential disputes as a major factor in their decision-making process for Indian investments. This hesitation is reflected in the numbers: While India saw a record $70 billion in foreign direct investment in the fiscal year 2023-24, venture capital inflows declined by 72 percent in the same period.

"While relief does come, it can even take up to seven or eight years, longer than the life of the fund and the envisaged investment itself, making investors wary of putting money into the country," Nair adds.

Despite these challenges, the Indian market remains attractive to foreign investors, thanks in part to the lessons learnt by investors and promoters from the exit disputes over the last two decades. Disputes in marquee deals like Hero Honda and Maruti Suzuki that took over six years to resolve have made investors realise that litigation is likely unavoidable. "Today's contracts are no longer merely drafted to be closed, but are crafted with potential litigation in mind," Nair explains.

Investors and promoters no longer treat dispute resolution clauses as boilerplate, instead emphasising tightly worded clauses that without ambiguity specify the choice of mode of resolution, forum, governing law, law of the arbitration agreement, seat and venue, Srivastava adds.

The new generation of Indian entrepreneurs, educated and globally minded, are bringing fresh perspectives to the table. Experts note that now clear, educated promoters are coming in – they don't simply want to sit on investments. They want to make money, exit, and start new businesses.

Promoter due diligence remains a cornerstone of the investment process. As Nair notes, "Investors evaluate the founder as much as the business itself. They are increasingly concerned about the values, ethics, and ideas of the promoter." ●