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NAVIGATING A SHAREHOLDERS AGREEMENT: ROFR OR ROFO?

In the first of our new series, HFW Insights: Navigating a shareholders agreement, in which we distil common corporate and transactional issues into bite-sized insight, we answer a commonly asked question: What is the difference between a right of first refusal (ROFR) and a right of first offer (ROFO)?

Acquiring another company is a common growth strategy, especially when businesses are looking to expand overseas.

Negotiating and agreeing on the sale and purchase agreement can be challenging. There may be complicating factors, such as local laws restricting foreign ownership that necessitate entering into Joint Ventures with the sellers. It may also be beneficial to have the sellers onboard, in helping you to navigate the local business landscape.

When are ROFRs and ROFOs used?

A key concern for shareholders when negotiating shareholders agreements is to restrict the transfer of shares to third parties, who (may be competitors or parties deemed undesirable to work with. ROFR or ROFO mechanisms address such concerns in different ways

What are ROFRs and ROFOs?

Simply put:

A **ROFR** provides the non-selling shareholders with a right to either accept or refuse an offer from a selling shareholder **after** the selling shareholder has received a third party offer for its shares.

A **ROFO** provides the non-selling shareholders with the right to make an offer for the selling shareholder's shares **before** the selling shareholder can solicit for third party offers for its shares.

Which ones should I use?

What is the investment strategy? Is there an investment horizon timeline? Are you a strategic investor or purely a financial investor? Do you have an exit strategy? Each of these factors, and more, should influence your decision in deciding between a ROFR or ROFO.

A ROFR is considered to favour those shareholders who intend to stay long-term (likely buyers); while a ROFO is seen to favour likely sellers.

In a ROFR mechanism, the selling shareholder has to solicit an offer from a third party before offering its shares to the non-selling shareholders.

From experience, third party buyers are reluctant to incur due diligence expenses or spend time negotiating a deal when the shares are subject to a ROFR.

This uncertainty can lead to lower offers from third party buyers and so the selling shareholder is unlikely to realise the full value of its shares.

In contrast, the ROFO places the onus on the non-selling shareholder to make an offer for the selling shareholder's shares, usually within a given timeframe.

The selling shareholder is then free to accept or refuse the offer. If they refuse, they are free to sell it to a third party at a higher price.

A ROFO mechanism therefore often favours the selling shareholders.

Non-selling shareholders should, therefore, be careful to ensure that their offer reflects the fair value of the shares, which could assist the selling shareholders in realising the value of their shares in an exit.

Key takeaways

The above considerations are not exhaustive. Whether a ROFR or a ROFO is preferred ultimately depends on the circumstances and motivations of each shareholder, in particular the investment or exit strategy of the shareholder.

A careful analysis of the advantages and disadvantages of a ROFR and a ROFO can go a long way in getting you a better deal, whether you are the buyer or the seller.

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