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VC and Thai corporations: Navigating local law

As the venture capital (VC) market continues to grow, Thai start-ups are a natural focus for VC firms interested in Southeast Asian investment. Start-ups making use of new technology have a need for initial capital, are interested in disrupting existing markets, and offer potentially large equity returns on investment – a perfect asset for the investment portfolio of many VCs, which have the available capital to seed new ventures and bet on the next new thing, rather than financing existing and well-seasoned companies.

This perfect asset is not always a perfect fit, however, due to several quirks of the Thai legal system. As you will see, Thai law does not recognize the full spectrum of equity and debt relationships that exist in other legal systems such as Singapore, Europe, or the US. The outlier status of Thailand in this regard necessitates an alternative approach, which fortunately includes positive knock-on effects.

The standard business model of a VC firm involves financing a number of new companies in the hopes of realizing significant gains from enough of them to be profitable. VCs are in the business of providing financing at an early stage, then letting their companies innovate, experiment and expand. And while VCs have to be great at spotting the companies that will become successful, they don't need to, or even particularly want to, take an active role in managing their companies. Venture capitalists want new companies that think differently and create new products or services; they don't want to squelch that creativity – they want to harness it.

Typical VC investments embody this philosophy in several ways, often by making the VC financer into a sort of silent investor that takes no active role in management but enjoys the rights to profit from the company's future growth, for instance at the time of the company's IPO.

Legal instruments like warrants and call options, future equity grants, employee stock option agreements, convertible notes, and hybrid debt instruments offer investors a possible future equity position in exchange for early-stage financing, while preserving the management structure of the existing start-up as much as possible. Companies in the VC firm's portfolio keep their existing team and management style, and their VC sponsors get the chance to participate in future profits, which can be huge.

These legal relationships are murky at times, occupying neither a pure "debt" nor "equity" position in the corporate books. Yet they have been recognized by US, Australian and European legal systems, and VC firms and other investors in those jurisdictions frequently make use of these instruments.

Technical legal factors create several obstacles to VC business in Thailand – but also offer a way forward for investors who can structure investments creatively. Specifically, Thai law can restrict the ability of local corporations to issue many of the hybrid or future equity positions VCs so often use. An ideal work-around is made possible by the Thai Board of Investment (BOI) and several imaginative business structures.

Foreign investors are permitted to own domestic companies with approval from the BOI, an agency tasked with encouraging foreign investment in Thai businesses. However, and crucially, the ability under the BOI for an overseas holding company to hold 100% of a Thai company permits a neat work-around for this situation.

Alternatively, this foreign ownership stake can be accomplished through a foreign business licence (FBL). With approval for a 100% foreign owner of a Thai company under the BOI or through an FBL, a holding company in (for example) Singapore can then own the domestic Thai company and issue equity interests of its own stock – including hybrid and future equity interests not permitted under Thai law – to the VC, employees and other shareholders. This corporate structure complies with Thai business law while preserving the nimble ownership model preferred by VC investors.

Several tax advantages are available to companies taking advantage of this structure. In addition to permitting a broader spectrum of investment types, other jurisdictions may have different tax rates on corporate or individual incomes. By creating an offshore investment vehicle for a Thai company, in a location which has double tax agreements with Thailand in place, the investor is able to reduce withholding tax on profits and dividends.

Investors can allocate the management functions of the enterprise between jurisdictions to realize income where the tax rates are the most advantageous, and otherwise structure the company to maximize profitability and shareholder returns.

International investment and cross-border transactions necessarily involve the combination of different legal regimes, and picking and choosing between different jurisdictions. Quirks in the law make the process of investing more interesting, but they need not make it more difficult. Thailand's system of foreign investment includes a host of challenges – but with a close understanding of relevant laws, it also allows a compelling way forward.

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