# Financing your entry into the EC

The following factors are important in determining how the alliance should be financed. These factors should not be considered in isolation, they are interconnected and the decision on the form and amount of financing should be made based on how each factor influences the overall deal.

## The structure of the alliance

The type of strategic alliance contemplated will influence the extent and nature of the financial commitment to the alliance. For instance, a joint venture based on equal shares for the partners will have different financing implications than would a licensing arrangement or a marketing agreement. Joint ventures involve more significant legal and financial obligations than do other forms of cooperation. In fact, co-marketing, cross-manufacturing, and cross-licensing alliances may not require much financial commitment at all since they involve the use of existing resources that can be financed out of existing operating budgets.

## Roles of parties

The amount that a company may be willing to invest in an alliance will depend on its role. It may assume the role of financier, in which case it takes on the responsibility for providing capital for the whole project. If it wants controlling interest in a project, it will have to make a corresponding financial contribution. Sometimes, an investment is required as evidence of serious interest in and commitment to a project. It may also be limited to an initial exploration of future possibilities for cooperation.

If the role of one of the parties is to contribute know-how to a project, it may offer rights to a patent in exchange for shares in the venture. This kind of a transaction may be especially advantageous when the country in which the transfer is made taxes dividends from shares at lower rates than it does royalties from patents.

## Capital Sources Available

Much also depends on the availability of local financing. Canadian companies may discover sources of reasonably priced capital in other countries and regions. Regional governments and their institutions can be particularly helpful in providing access to local sources of financing (see Chapter V).

Private institutions such as banks and suppliers may view the transaction as an attractive business opportunity representing reasonable risk for the returns involved. Guarantees also may be offered by one of the parties which may help the venture obtain financing at more reasonable rates without committing the internal funds of either partner. Given the strength and reputation of either party, a stock issue may be possible in the country targeted for investment.

International lending institutions, such as the European Investment Bank (EIB), may have an interest in participating financially in the venture because it may complement their mandate or their other interests. For example, through its New Community Instrument IV, the EC works with the EIB to raise capital for small- and medium-sized businesses.

## The tax and legal aspect

Canadian corporations are subject to tax on worldwide income, while foreign or foreign controlled corporations are taxed in Canada only on their income from Canadian sources. The tax laws of other countries vary on the issue of residency and control. Thus, who controls a company and where it resides has a bearing on the corporate taxes the alliance would pay and in which country.

The objective of tax treaties is to prevent double taxation, to establish fiscal cooperation between taxing authorities of the signatory countries, to ensure fairness to taxpayers, and provide for adequate enforcement of respective revenue laws. Such treaties tend to reduce the amount of tax that a corporation from one country must pay another country. Thus, in setting up the alliance, it is important to consider how one can best take advantage of the various tax treaties that exist between Canada and the countries of Europe. Proper planning can greatly reduce one's tax burden.

## Risks and reward

The financial return available for the risk involved in the investment may represent an opportunity that cannot be matched by other available investment opportunities such as the money markets or other business projects. In such a situation, if funds are available, it may be desirable for the company to assume financial responsibility for the largest part of the investment.

## Put together a statement of financial criteria

Your firm should formulate financial criteria that will enable you to define financial performance objectives, policies relating to investments, financing risk, new share issues, retained earnings, and earnings-per-share targets. This statement should also include your intentions in terms of funding requirements, sources of funds, key financial ratios and dividend objectives. Finally, it should describe the organization and structure you will use to manage the financial affairs of the proposed venture.