Switzerland – Growing Asian Prospects

Bär & Karrer AG

Swiss Business Environment

General

While the Swiss economy has been in an upswing in 2014 with an estimated GDP growth of 1.9 per cent , challenges such as the appreciation of the Swiss franc result in a relatively moderate GDP growth of 0.9 per cent in 2015 as predicted by the State Secretariat for Economic Affairs (SECO). Consequently, the economic development is expected to be stabilized with an anticipated GDP of 1.5 per cent in 2016. The Swiss Market Index (SMI), Switzerland's blue-chip stock market index, meanwhile rose by a respectable 9.5per cent in 2014. In the first nine months of 2015, the SMI has gained another 3.8 per cent.

This sound performance of the Swiss economy is to a large extent due to a steady increase of Swiss exports to Asian countries. In 2014 Swiss exports (excl. precious metals, precious and semi-precious stones, works of art and antiques) reached an all-time high of 208.4 billion Swiss francs. After a slight decline in 2013, exports to Asia picked up the continuing growth rate of previous years (+3 per cent in 2014) and meanwhile amount to 21.7 per cent of Switzerland's total exports (i.e. 45.3 billion Swiss francs).

Looking more closely at the Swiss exports to Asia, the biggest trade partners are China and Honkong with exports of 8.8 billion Swiss francs (+7.4 per cent in 2014) and 7.0 billion Swiss francs (+4.2 per cent in 2014) respecitvely. The enactment of the free trade agreement between China and Switzerland is expected to further boost the Sino-Swiss relationship. The agreement entered into force on 1 July 2014, however the stipulated periods of transition postpone its full effectiveness by 5 to 10 years in some major areas. This agreement can be seen as a major breakthrough, as Switzerland is both the first continental European country and the first country among the world's 20 largest economies to have such free trade agreement with China. It is expected to further expand the bilateral trade relations between Switzerland and China, mainly as a consequence of wideranging savings in customs duties.

Turning to Swiss imports, the significane of Asia is continuously increasing as well. In 2014 imports from Asia reached a record of 27.6 billion Swiss francs, which amounts to 15 per cent of total imports. A growing amount of goods originate from China (+6.6 per cent in 2014), Hongkong (+25 per cent) and Vietnam (+37 per cent), while imports from Japan have been slightly decreasing (-1 per cent).

Selected Swiss Industries

Watch industry

The Swiss watch industry has emerged from the crisis year 2008 in a vigorous condition, with exports hitting a record 19.3 billion Swiss francs (CHF) in 2011 and a monthly record of CHF 1.97 billion in July 2012. This represented a global market share of over 50 per cent in terms of value. In the high-end sector, the Swiss predominance is even more impressive. Indeed, around 95 per cent of the watches sold with a price tag of over CHF 1,000 are made in Switzerland. A more recent prespective shows that the Swiss watch industry remains strong, with a new record in exports of 22 billion Swiss francs in 2014. Ten years ago the turnover in the industry was half this size.

During the past years, one of the main success drivers was the growing Asian demand for Swiss luxury watches. While around the turn of the millennium exports to Europe and Asia were on an equal level, this has changed significantly. Since 2010 more than half of the total exports go to Asia (53 per cent in 2014) and only a third remains in Europe. To a great extent this development is facilitated by the large demand of Hongkong (exports of 4.1bn in 2014). Beyond that, China, Japan, Singapore and the United Arab Emirates are notable importers.

The "Swiss made" label is expected to be strenghened further as a new legislation defining the conditions for its use has been passed by the Swiss parliament and federal counsel. The new regulation will enter into force in January 2017 with a two-year period of transition. It provides that – in case of industrial products such as watches – 60 per cent of the production costs has to be incurred in Switzerland in order to use the "Swiss made" label. The appetite of Asian buyers is not limited to individual Swiss watches anymore but has lately expanded to several companies active in the watch sector. A stand-out example is the acquisition of Prothor Holdings SA and its subsidiaries La Joux-Perret SA, a leading manufacturer of mechanical movements, and high-end watch brand Arnold & Son, by the Japanese Citizen Holdings Co Ltd in March 2012. Further examples include the acquisition of Eterna and Corum, two Swiss luxury watch companies, by the Chinese company China Haidian in 2011 and 2013, respectively.

Mechanical and electrical engineering industry

The Swiss mechanical and electrical engineering industry experienced slightly more difficulties than the watch industry mainly as it is under considerable pressure due to the ongoing sovereign debt crisis and the strength of the Swiss franc. While in 2010, the respective exports rose by 8 per cent, 2011 already indicated the beginning of a downward trend with a moderate 1.2 per cent growth and 2012 saw a decline of 9.7 per cent. Exports to China (including Hong Kong) performed particularly badly with a decrease of 36 per cent. In 2013 (-0.0 per cent) and 2014 (+0.1 per cent) overall exports have not decreased further and flattened on the level of the previous year.

As opposed to the high margins in the watch industry, margins in the Swiss mechanical and electrical engineering industry were already quite low before the crisis and continued to decline during the last years. The appreciation of the Swiss franc therefore led to an increased pressure on firms active in this sector prompting some of these firms to divest parts not seen as key to their business in order to further concentrate on their main strengths. One example is the Swiss company OC Oerlikon, a world leader in machine and plant engineering, divesting its natural fibers and textile components business units to the Chinese Jinsheng Group in 2013.

Chemical and pharmaceutical industry

Switzerland's chemical and pharmaceutical industry has a global market share of around ten per cent, making the country one of the leading nations worldwide in this sector, which is remarkable given Switzerland's size and population of only about eight million inhabitants. In terms of turnover, the Swiss company Novartis is currently the largest pharmaceutical company in the world and Roche, it's domestic rival, thefourth largest.

Exports in the chemical and pharmaceutical industry increased in 2014 by 4.4bn Swiss francs (+ 5 per cent). With a total of 85.3bn Swiss francs the most exports derive from this industy (41 per cent of exports). Again, Asia is an increasingly important trade partner to Switzerland also in the chemical and pharmaceutical industry. Most significantly, the exports to China have risen by 40 per cent in 2013. With increasing global competition, companies active in the sector have continued to focus on their core competencies, leading to ongoing regrouping and restructuring in the industry. Highly specialised companies have emerged out of formerly diversified companies with broad product offerings.

Clariant, for example, a Swiss specialty chemicals company, recently sold its textile chemicals, paper, specialties and emulsions businesses to the United States-based private investment firm SK Capital Partners.

M&A-Outlook 2015–2016

The activity on the M&A market in Switzerland was quite significant in 2014. Particularly, it was characterized by a comeback of mega deals, most notably the 41 billion Swiss francs blockbuster merger between Lafarge and Holcim. Despite an only slight increase in numbers of deals in 2014 (+4.1 per cent), the total deal volume reached an outstanding 175.8bn Swiss francs, which is 8.5 times higher than in the previous year.

Although US or European counterparties were still involved in most deals with a Swiss buyer or seller, the relative importance of Asian-Pacific counterparties has continued to rise at a fast pace. In 2014 the volume of deals involving a Swiss party as well as a party from the Asia-Pacific region amounted to over 11bn USD.

After this extraordinary year of 2014, the Swiss M&A market faced – in line with the European market – a cooling down in 2015. The main reason for the declining number of transactions are the worsening geopolitical development, the ongoing monetary instability in the Eurozone and – in Switzerland – the strong Swiss franc, which puts pressure on the Swiss export industry and makes potential targets more expensive for foreign investors. Nevertheless it is quite possible, that the Swiss M&A Market will gain further momentum. The rising GDP, positive stock market trends, low interest rates and good quarterly results recently published by many major Swiss companies with strong balance sheets and large cash reserves are quite strong indicators of a stable environment and lay the foundation for a busy M&A market. Particularly, industries such as pharma and healthcare as well as IT/telecom, are expected to remain attractive sectors for transactions. Also, many privately held Swiss SMEs have to find a solution for the succession in their ownership and management which leads to interesting investment opportunities in various sectors (such as the industrial goods and services sector).

Swiss Legal Environment

In General

In Switzerland, there is no general set of rules and regulations dealing with foreign investments. Rather, the regulatory framework depends on the type of business the target company is active in. The Swiss Federal Constitution guarantees freedom of trade and industry throughout Switzerland. This allows anyone, including foreign nationals, to found or hold an interest in a company and to operate a business in Switzerland. For most commercial undertakings, neither an approval, registration or licence by the authorities, nor a membership of a professional association are required.

Sectors for which registration or the approval from a government authority is necessary are, for example, banking, insurance, investment funds, gambling houses, as well as the manufacturing and trading of certain arms. Other types of businesses or professions that may need some sort of either a federal or cantonal approval or licence are, for example, broadcasting companies, schools, hotels and restaurants (only in certain cantons), physicians, dentists, pharmacists and attorneys.

Because of the direct democracy in Switzerland, public opinion has a big influence on the legal and commercial landscape. Historically, the Swiss have been very liberal, both with respect to economic as well as social topics. However, in connection with the crisis after 2008, public opinion in Switzerland with respect to big companies – in particular the finance industry – had been fairly negative and certain regulations have been made which are untypical for Switzerland (such as the below discussed regulation against "fat-cat salaries"). However, it seems that public opinion is again shifting back to a more pro-business approach.

Corporate Structures

Swiss corporate law provides different forms of business organisations to set up a company and do business in Switzerland. The appropriate form of a business entity depends on many factors such as the size of the company and the nature of the business. Tax issues may play an important role in choosing the right business entity as well. Companies and private individuals from foreign countries are free to choose the legal form that best fits their business. Swiss law distinguishes between the partnership-type unincorporated companies (sole proprietorship) and capital based incorporated companies (company limited by shares and limited liability company).

Company limited by shares

The most popular and widespread type of business association under Swiss law is the company limited by shares (AG). An enterprise constituted in this form has its own name, its own legal personality separate from its members and a fixed nominal capital divided into shares.

This type is often chosen by foreign companies as the legal form for their Swiss subsidiaries. The legal form of a company limited by shares may be used for very big companies as well as medium- and small-sized companies. A company limited by shares may be found by one or more individuals who do not need to be Swiss citizens or residents in Switzerland. However, it must be represented by at least one person residing in Switzerland. The share capital must be at least 100,000 Swiss francs. In the case of registered shares, a contribution of at least 20 per cent of the par value of each share shall be made. In all cases the contribution of registered share capital shall be at least 50,000 Swiss Francs which have to be paid in upon incorporation (in cash or in kind). Bearer shares must be fully paid up before they can be issued. The supreme body is the board of directors that represents the company externally.

Limited liability company

The limited liability Company, GmbH, is a good alternative to the company limited by shares for smaller businesses. GmbH as well has its own legal personality separate from its members. The company's liability is limited to its assets only. The nominal capital that must be paid in is 20,000 Swiss francs. Unlike the company limited by shares, no board of directors is required and the management lies with the managing directors.

Setting up a company

Setting up a Swiss company is a very straightforward process that generally takes two to four weeks from the submission of the required documents to the date the company is considered legally established. The timeframe depends on the nature of the company and the location in Switzerland.

Purchasing a business or a company

When purchasing a business, an acquirer can choose between an asset deal or a share deal. While share deals are generally more common, the decision should be carefully assessed and will namely depend on whether or not:

1. The target is organised as a corporation;
2. The acquirer wants to purchase the entire business;
3. There is a risk of hidden liabilities;
4. The assets are easily transferable;
5. Tax and accounting considerations favour one approach over the other;
6. Assets must be pledged in order to finance the transaction.

M&A transactions relating to privately held Swiss businesses or companies are not governed by a specific statute. Instead, the general rules applying to the sale of goods basically apply, as specified by case law. Where deals are handled by professional parties, detailed contractual documentation concretises the relatively rudimentary legal basis.

Reorganisations

Apart from setting up a new company or purchasing an existing business or company, other options are available for investing and/or establishing a company in Switzerland, such as setting up a branch office, the formation of a joint venture or the undertaking of a cross-border merger. The most common choices for a foreign company located in Switzerland are subsidiaries (in the form of companies limited by shares or limited liability) and branch offices.

Mergers, de-mergers and transfers of assets between companies and transformations are regulated by the Swiss Code of Obligations and the Swiss Merger Act. In case of (cross-border) mergers, the provisions of Swiss Antitrust Law have to be observed.

Management and Leveraged Buyouts

A management buyout is a transaction by which the target's managers and additional equity and debt investors, such as banks or private equity funds, jointly acquire the shares of the target company. The main difference towards leveraged buyouts is that the initiative for the buyout is taken by debt and equity investors.

Formal purchaser in both cases will usually be a newly formed acquisition company which purchases the shares and is merged into the target after a certain period of time, subject to tax rulings (if relevant). The acquisition is normally financed through the company's assets and the future earnings which service the company's loans. Where a bank is involved in financing an acquisition, usually the share of the target (or the acquisition company) will be pledged as a security. While debt investors expect a regular interest payment and a (partial) repayment of the loans and sometimes an option to purchase shares (in the event of mezzanine facilities), equity investors hope to achieve an appropriate return in view of the company's expected development and the prospects of an exit in the form of a share sale.

In 2009, during the financial crisis, the buyout market came to a near standstill due to the lack of leverage possibilities but has slowly recovered since then.

Private Equity

The structure most commonly used for private equity in Switzerland is that of an offshore (regularly a Jersey or Guernsey) limited partnership with its investment advisor, and possibly also its key limited partners located in Switzerland. While new company forms for collective investment schemes have been introduced in Switzerland by the Swiss Collective Investment Schemes Act of 2006, in particular the limited partnership for collective investment intended to be the Swiss equivalent of the common law limited partnership, these legal vehicles have had very limited success as of today mainly due to the lack of the Swiss Financial Market Supervisory Authority (FINMA)'s respective approval practice and uncertainties with regard to the taxation of the carried interest.

Joint Ventures

Companies can be combined not only by an acquisition or merger but also by a joint venture, either formed as partnership or, more commonly, organised as corporation. It is noteworthy that a Swiss joint venture corporation (JVC) cannot legally bind itself by entering into a contractual agreement when it comes to subject matters falling within the competency of the shareholders' meeting (like a share capital increase) or the board of directors (eg with respect to board majority requirements, delegation of business to management or approval of share transfers). In consequence, a Swiss corporation should normally abstain from executing a joint venture agreement, except with regard to a specified list of rights and obligations involving non-corporate issues, such as the entering into of a licence, loan, lease or purchase agreement with one of the joint venture partners acting as a counter-party.

In instances related to corporate matters, only the (future) shareholders can assume contractual obligations in the joint venture agreement where they will usually agree that necessary steps must be taken to implement the contractual arrangements at the corporate level, eg by exercising shareholders' rights or to instruct the board members to draft internal rules of organisation containing the agreed arrangements or to appoint specific managers, and so on.

Where the contractual arrangements are not or cannot be translated into the corporate documents, each joint venture partner still has the possibility of suing the other party for specific performance. For instance, a party can be sued in its capacity as a shareholder of the JVC, to exercise its voting right in a manner consistent with its contractual obligations. The same is true for board resolutions provided a shareholder is in a position to instruct a board member how to vote, given that a director is subject to non-transferable and inalienable fiduciary duties. If specific performance is impossible, the party who breached the joint venture agreement will be liable for damages.

Selected Recent Legal Developments

Amendment to the Collective Investment Schemes Act

An amendment to the Collective Investment Schemes Act (CISA) has come into effect in March 2013. It aims at further adapting the Swiss regulation to international standards, especially to the European Union Alternative Investment Funds Managers Directive (AFIMD), and hence to guarantee a discrimination-free access of Swiss financial service providers to European financial markets.

The new EU directive (AFIMD) introduced a common regulation for alternative investment fund (AIF) managers at EU level in July 2011, which brings far reaching regulatory changes for asset managers of alternative investment funds such as hedge funds and private equity funds. AIF managers which are domiciled or managed in the EU or distribute their shares to professional investors in the EU are required to obtain an authorisation and are supervised under the new regime. Once the AIFMD has been implemented into the national laws of all EU Member states, it will be appliedon all EU investment advisors of collective investment schemes, who are not already subject to the Undertakings for Collective Investment in Transferable Securities (UCITS IV) Directive. The management of collective investment schemes can no longer be delegated to investment advisors domiciled in non-EU states which are not subject to an equivalent supervision.

The partial revision of the CISA allows the Swiss Financial Market Supervisory Authority (FINMA) to license Swiss AIFMs and to ensure that such AIFMs are fully compliant with the AIFM Directive. In line with the AIFMD, the revised CISA newly regulates any manager of Swiss and foreign funds. Furthermore, the CISA introduced a new regime governing the distribution of funds in Switzerland. The Swiss legislature is currently working on new legislation for financial services and prodcuts offered to investors in Switzerland, the Federal Financial Services Act (FFSA). It is expected that the FFSA will also have an impact on fundraising in Switzerland. The earliest possible date for the FFSA to enter into force is 1 January 2017.

Popular Initiative "Against Fat-Cat-Salaries"

In March 2013, a popular initiative "against fat-cat salaries" ("Abzockerinitiative") has been approved by the Swiss voters. The initiative resulted in an amendmend of the Swiss Federal Constitution. Until the implementation as part of the revision of Swiss company law, the relevant provisions are set out in an interim regulation enacted by the federal counsel. The initiative applies to companies incorporated in Switzerland and listed on a stock exchange either in Switzerland or abroad. In substance, it strengthens shareholders' rights and calls for extensive new mandatory rules on transparency and compensation of board members and senior management:

1. The aggregate compensation of the board of directors and the senior management will be subject to the approval of the general meeting of shareholders;
2. Severance payments (golden parachutes), advance payments and similar extraordinary payments to directors or senior managers, as well as multiple contracts between directors and senior managers and group companies will be prohibited;
3. The articles of association will have to include rules for directors and senior managers on loans, retirement benefits, incentive and participations plans, and the number of positions outside the group;
4. The Chairman of the board, the board members, the members of the board's compensation committee, as well as the independent proxy will have to be elected annually by the general meeting of shareholders; and
5. Companies will no longer be allowed to act as corporate proxies but will need to allow shareholders to cast their votes electronically from a remote location.

Until the definite implementation into Swiss law it is hard to assess the exact effects these regulations will have on the market. However, especially the harsh penal provisions of the initiative are expected to have a negative impact on the competitiveness of the Swiss economy, should they be strictly imposed. The initiative could also have adverse effects on private equity in particular, as private equity firms routinely grant compensations to the management of their portfolio companies if these companies can be sold with a benefit. As the initiative text prohibits sale and purchase incentives, this practice would most certainly no longer be possible, stripping private equity firms of an incentive tool to improve the performance of their portfolio companies.

Capital Contribution Principle Replacing the Nominal Value Principle

As from 1 January 2011, any repayment of capital contribution reserves contributions by a company to its shareholders (including share premium and capital contributions) after 31 December 1996 is treated in the same way as the repayment of nominal share capital. Such repayments are not subject to income tax in the hands of Swiss-resident private individuals and are exempt from federal dividend withholding tax according to Swiss law.

In order to qualify for tax-free repayment or distribution, the reserves must originate from contributions made by the shareholders. The tax-free distribution of such reserves requires that the reserve is reflected in a separate reserve account in the balance sheet, and further, that any fluctuations are regularly reported to the Swiss Federal Tax Administration (SFTA).

The capital contribution principle is currently being discussed in the Swiss parliament. It is currently rather uncertain whether new rules will be implemented to restrict repayments of capital contribution reserves or not.

Revision of the Federal Act on Stock Exchanges and Securities Dealers

A revisions of the federal act on stock exchanges and securities dealers entered into force on 1 May 2013, according to which, insider dealing and manipulation of exchange rates will henceforth qualify as possible basis for incriminated money laundering.

Revised Swiss Takeover Regime

On 1 May 2013, the revised Swiss takeover regime has come into force. The most relevant changes are the abolishment of the control premium and the obligation to offer an all-cash alternative in a number of situations where such obligation previously did not exist. With respect to the structuring of public tender offers, bidders need to consider the implications of the revised regime and explore novel approaches.

Pre-tender Offer Stake Building

Stake building prior to the launch of a public tender offer allows the bidder to increase the chances of success of its public tender offer because a significant stake at launch reduces the likelihood of a competing bid. If a competing bid is launched, the initial bidder is likely to make an attractive return on investment on the stake it tenders into the competing bid.

Under the revised Swiss takeover regime of 1 May 2013, pre-offer stake building has become more complex. According to the minimum price rule, the offer price in the public tender offer must be at least equal to:

1. The highest price that the bidder has paid for target shares in the 12 months preceding the publication of the public tender offer; and
2. The 60 trading days volume weighted average price (or based on a valuation if the target shares are deemed illiquid).

The minimum price rule applies to mandatory offers and change-of-control offers, ie offers which extend to shares whose acquisition would entail a mandatory offer obligation. The rule does not apply to purely voluntary offers, including partial tender offers and offers for any portion of shares of a target which has a valid opting out provision in its articles of association.

The abolishment of the control premium means that in down markets, or when a specific target's share price plummets due to a target specific negative event, a bidder's purchases of target shares in the 12 months preceding the launch of the offer and, in particular, the ones prior to the fall of the target's share price, will set the floor for the subsequent tender offer price.

Under the revised minimum price rule, a bidder will have to carefully weigh the advantages of pre-launch stake building against the risk of setting the minimum offer price at a level which may proof unnecessarily high.

Another new restriction on pre-launch stake building applies to exchange offers. An all-cash alternative must be offered to all recipients of a change-of-control offer if the bidder (or persons acting in concert with the bidder) has purchased 10 per cent or more of the target shares for cash during the 12-month period preceding the announcement of the exchange offer.

Opting Out to Ensure Flexibility?

The only way to avoid the applicability of the revised minimum price rule (and the obligation to offer a cash alternative in exchange offers where the bidder purchases 10 per cent or more target shares for cash prior to the offer) is to introduce a valid opting out provision in the articles of association of the potential target company.

According to the revised practice of the Takeover Board, the shareholders' resolution on the introduction of an opting out is presumed to be in the interest of the target company or its shareholders, if a majority of votes is reached both by counting the votes of all shareholders represented and by counting the votes of only such shareholders who have an interest in introducing the opting out provision.

Even if these requirements are fulfilled, the Takeover Board may in exceptional circumstances hold that the presumption proves wrong. If the shareholders' resolution does not fulfill the requirements of the double counting of the votes, the Takeover Board presumes that the opting out is to the disadvantage of the minority shareholders and, therefore, not validly introduced.

All-cash Alternative During Exchange Offers

The rules on cash alternatives in exchange offers have not only been tightened with respect to pre-offer stake building, the Takeover Board has also acknowledged that during the period following the settlement of the offer, there should no longer be any restrictions on the bidder with respect to purchases of target shares for cash. A bidder in an exchange offer may, therefore, acquire target shares for cash following the settlement of the offer for as long as the best price rule is respected (ie for six months after the end of the additional acceptance period, the price paid may not be higher than the value of the shares offered in exchange).

Another accentuation of the revised regime on exchange offers relates to the period from the publication of the offer until the settlement. It extends to all types of offers, including partial offers and offers where the target company disposes of a valid opting out provision in its articles of association. In the event that during this period the bidder (or any person acting in concert) purchases any amount of equity securities of the target for cash, the bidder must extend an all-cash alternative to all recipients of the exchange offer.

With respect to all situations where a cash alternative must be offered, the cash alternative and the shares offered in exchange may differ in their respective values. According to the Takeover Board, both types of considerations must comply with the minimum price rule.

The new rules are increasingly restrictive on the bidder and will increase his financing costs.

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