

The Buyer's Playbook

Legal Insights Into M&A

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Minority Investments and Joint Ventures: Key Legal Considerations

In this instalment of *The Buyer's Playbook*, we explore the recent trends and key legal considerations in minority investments and joint ventures.

The global investment market is seeing a continued rise in minority investments and joint ventures, as both strategic investors and private equity firms look to deploy capital while avoiding full control acquisitions. In the current geopolitical and economic environment, minority investments are increasingly used to access growth, partnerships or market exposure while limiting downside risk.

Minority investments, however, require careful structuring. Unlike 100% buyouts, they involve balancing three competing objectives: protecting the company's ability to operate efficiently, granting the minority investor rights proportionate to its economic stake and preserving the desired level of control for the majority shareholder.

As minority investments have become more common, market practice has evolved towards increasingly tiered and bespoke protections, with investor rights calibrated by reference to shareholding size. These protections are typically documented in a shareholders' agreement and, in some cases, the company's constitutional documents.

In this instalment, we discuss the key provisions commonly negotiated in minority investment and joint venture transactions.

Governance Framework

The governance framework is often the most sensitive aspect of a minority investment:

- **Board Representation:** Minority investors holding a significant stake (typically in the range of 20-40%) will commonly seek the right to appoint one or more directors to the board. Where the minority stake is smaller (around 10% or below), full board representation is less common, and investors may instead seek board observer rights.
- **Joint Ventures:** Where investors hold 50% shareholdings in a joint venture, governance rights are more heavily negotiated. It is common to see equal board representation, with mechanisms such as rotating chairmanships to manage control dynamics.
- **Information Rights:** Investors with smaller minority stakes typically receive more limited information rights than those with larger holdings, reflecting their reduced governance influence. Information rights typically include access to budgets, business plans, and financial forecasts and projections.

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Reserved Matters

Minority investors often seek protection through a list of reserved matters requiring investor consent.

The scope of reserved matters is typically linked to shareholding size. In our experience, investors holding more than 20% may have consent rights over a broader range of operational and strategic matters, such as approval of annual budgets, significant acquisitions or disposals, financing arrangements and senior management changes.

Investors holding around 10% or less will usually have consent rights limited to fundamental matters, including changes to the nature of the business, amendments to constitutional documents and changes to share rights — and often only where those changes adversely affect the minority investor.

Exit Strategy

Exit provisions are a core feature of minority investments. A minority investor will not have the right to determine the timing and form of exit and so will look to negotiate exit provisions, customarily at the time of the investment in the shareholders' agreement, to set out a clearly defined process for an exit.

Typically negotiated exit provisions include:

- **Drag Rights:** Shareholders' agreements typically include drag-along rights, enabling the majority shareholder to sell the company without minority consent and resulting in the minority getting dragged, subject to agreed conditions such as a minimum price threshold and shareholder approval levels.
- **Tag Rights:** Tag-along rights allowing minority investors to participate in a sale by the majority shareholder are increasingly standard, particularly where minority investors hold 20% or more. For smaller minority stakes, tag rights are often more heavily negotiated.
- **Forced Exits:** Investors with larger minority stakes may also negotiate rights to require the company to pursue an exit or IPO after a defined period (commonly five to eight years).
- **Right of First Refusal/Right of First Offer:** A right of first refusal gives an investor the right to buy shares from another shareholder on the same terms as agreed with a third party before the third party may buy them, while a right of first offer gives the investor the right to buy or bid on shares before the owner tries to sell them to a third party.

Restrictive Covenants

The treatment of restrictive covenants varies significantly depending on stake size and deal context.

Minority investors holding smaller stakes (around 10% or below) typically resist restrictions on their ability to invest in competing businesses. In contrast, for larger minority stakes, restrictive covenants are more common, particularly where the investor has access to sensitive information. In founder-led or early-stage businesses, minority investors will often require senior management to be subject to non-compete and non-solicit obligations.

Restrictions are typically tailored by reference to geography, business lines and revenue thresholds, with customary carve-outs for an investor's existing portfolio companies.

Deadlock Scenarios

Deadlock situations can arise where decisions require unanimous consent or no shareholder has control (particularly in the context of joint ventures).

Shareholders' agreements commonly include deadlock resolution mechanisms, such as escalation to senior executives, mediation or referral to an independent third party. In some cases, deadlock provisions include put and call options, allowing one party to exit or acquire the other's stake if the deadlock cannot be resolved.

Additional Minority Protections

Depending on stake size and deal dynamics, minority investors may also seek additional contractual protections, including:

- **Lock-In Periods:** Restrictions preventing existing shareholders from transferring shares for an initial period, providing comfort that key shareholders remain committed post-investment.
- **Pre-Emption Rights:** Rights requiring existing shareholders to be offered shares before any transfer to third parties and requiring newly issued shares to be offered to existing shareholders before allotment, subject to customary carve-outs such as employee incentive arrangements.
- **Put Options:** Rights enabling the minority investor to require the majority shareholder to acquire its shares at a pre-agreed price. These are less common but may feature in deadlock or downside protection scenarios.

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- **Quorum Requirements:** Where a minority investor appoints a director, quorum provisions may be negotiated to ensure that board meetings cannot proceed without that director being present.
- **Most Favoured Nation:** An investor will have the right to receive any more favourable terms that are given to future investors.
- **Preferred Equity:** Investors that are issued preference shares vs. ordinary shares will have preferred rights to income and capital on a return of capital or an exit.

Regulatory Considerations

The rights granted to minority investors can have regulatory implications. Board representation, veto rights and influence over operational matters may trigger regulatory approvals or filings, depending on the sector and jurisdiction in which the company operates. These considerations should be assessed early in the structuring process.

Balancing Minority Protection and Control

While minority investments can provide significant benefits to companies and majority shareholders, majority investors will typically seek to limit minority protections to preserve flexibility and control. The final allocation of rights reflects a negotiated balance between capital investment, governance influence and commercial objectives.

Key Takeaways

- Investor rights are typically tiered by shareholding size, with governance, consent and exit protections calibrated to the level of economic exposure and influence being taken.

- Governance and reserved matters are central to value protection, but overly expansive minority rights can impede day-to-day operations and strategic flexibility if not carefully scoped.
- Exit mechanics should be addressed early, with drag, tag and time-based exit rights tailored to the investment horizon and the parties' commercial objectives.
- Regulatory considerations should not be overlooked, as board representation and consent rights can trigger approval or notification requirements in certain sectors and jurisdictions.
- Approach to due diligence will differ for a minority investment in comparison to an acquisition or a disposal. The minority investment due diligence process will typically focus on understanding the business and the value of it, instead of having warranty and indemnity protection.

Conclusion

Minority investments are increasingly common, but they require more careful structuring than full buyouts, given the inherent tension between minority protection and majority control.

There is no one-size-fits-all approach: The key to effective minority investment structures is to strike a bespoke balance between protection, control and execution efficiency.

If you would like to discuss any of the matters discussed here, please reach out to us.