

## **Business Advice Series Part Eight: Ten typical mistakes investors make in Hungary**

### **After management conflict, stay the course**

**A business venture in Hungary can end up on the wrong track. Beyond purely commercial considerations - such as a faulty analysis of the market or of costs - what is being addressed here are those cases in which the Hungarian business partner intentionally tries to exploit his foreign business partner, or even tries to force him out of the company.**

We took a look at a typical case of this nature in the two preceding installments. If, in the course of a due diligence review, evidence comes to light that the managing partner has abused his position, then he should leave the company. Often, in an attempt to avoid paying compensation for damages or even criminal prosecution, he will offer to sell his stake in the company. Whoever takes part in the retirement of such a partner should be very vigilant.

#### **Negotiating an exit**

The negotiations to retire a partner who deceived his fellow partners are fraught with distrust. It is important to make sure that all the technical details are properly attended to. The goal is to facilitate a trouble-free transfer of the retiring partner's stake. You want to arrange matters so the retiring partner can have no possible subsequent adverse impact on the company, nor exert any influence on the company, either legally or practically. This means that the stake must be paid for through an escrow account with a "simultaneous transfer" (i.e. the sale has to be entered at the court of registry). If the retiring partner (who was the CEO) still has to take part in certain of the company's legal or operational transactions, then the pay out for his stake should be made incrementally.

Another important matter: under no circumstances should you agree to waive all claims against the retiring partner. Partners caught in this position often insist on such a waiver. If negotiations threaten to fall apart on this sticking point, then a partial waiver can be considered. One could, for instance, waive the right to any further damages, but still retain the right to press criminal charges if the partner's former or current behaviour call for it. All documents should be immediately executable. For this reason, it makes sense to have a notary certify certain key documents.

But the problems are still by no means over. Besides the fact that tranquillity has to be restored within the company, there is also the danger that the former CEO can still make trouble as regards the company's business contacts. In the past, it was always the former CEO who negotiated with the company's most important clients, not the new foreign majority owner. This person knows the business, and is perhaps still not financially secure despite the sale of his stake in the company. This, and the fact that he might still be relatively young means that he will remain active in the business world.

In brief: As the employee of another company, or the owner of a new company of his own, the former CEO will try to strategically poach clients from his former partners. The only way to foil his ambitions is by making him agree to the inclusion of a stiff non-competition clause in the sales contract. This clause should guarantee that the former CEO, either as the head of his own company or as an executive of a third company, is not permitted to approach the clients of his former clients, directly or through agents. This aspect of a partner's departure should be negotiated very

carefully.

Once the partner has left the company, the foreign stakeholder, who now has full control, will have to concentrate on restructuring it. Certain operational procedures that were put into practice under the former CEO have to be amended. There will have to be lots of meetings with clients. In these matters one still has to keep the former CEO in mind. It is essential that his former "co-conspirators" - some of whom might still work for the company - cannot continue to have a negative influence. One should also keep an eye on his activities on the market. Otherwise, the non-competition clause will not have much real meaning.

The current majority owner might, at this point, be considering a complete restructuring of the company. There are perhaps new possibilities or requirements regarding the tax aspects of the business. It is also often the case that the company's labour practices have to be brought into line with labour law.

The next installment in this series, entitled "Restructuring - if you do it, do it right," is dedicated to this stage in the life of a company.

*The 'Business Advice Series' points out the recurrent pitfalls of doing business in Hungary and gives advice aimed at making your business more successful.*