

PREPARING FOR INVESTMENT



ENTREPRENEURIAL
BUSINESS LAWYERS

mbmcommercial.co.uk

PREPARING FOR INVESTMENT



INTRODUCTION

Before seeking funding for your business and indeed, even if you're not currently seeking funding but may, at some point, be likely to do so, it is worth making an investment of your own in the meantime. A few simple steps, taken early, before the "pressure of the deal" is upon you, can make all the difference, not just to your success in gaining the money you seek but also to the quality of that money. As a start-up company you may be unfamiliar with the steps you should take to shine out in the beauty pageant that is the hunt for finance. There are some winning categories which will catch the judge's eye every time. However, there is no plastic surgery required and all the procedures can be simply surmised as follows:-

REVIEW YOUR BUSINESS PLAN

You will probably have written your business plan at the outset; that exciting phase where you saw your idea taking shape in front of you and becoming a life of its own. Alternatively, you may not have written one at all; your business may have come into being rather more organically. Either way, if you have ambitions to grow, you will need to address your lack of business plan, or revisit your original repeatedly. Your business and the market in which it performs will evolve and therefore so should your plan:-

- In particular, ensure you clearly explain your unique selling point (USP). Has it changed since you initially began? Is there now more than one USP addressed by the business?
- Establish and clearly define the targets which underpin your financial projections. Set out the time period over which you will achieve them.
- You should also formulate and explain a clear strategy for achieving those targets.
- Furthermore, provide clearly analysed and forecasts with reasoned supporting assumptions which underpin the targets stated above. Providing forecasts of where you expect to be month on month in pursuit of your targets will help you reflect on the issues you may face and demonstrate a consideration of any market influences you will encounter, thus evolving your strategy. It will also help you consider how you will measure your actual performance against the forecasts. You will therefore not only be able to track your success, identify areas of weakness and modify your strategy to address those weaknesses, but you will improve the accuracy of your forecasting techniques, enabling you to plan more effectively for the future.
- If available, ask an experienced business person or informed professional to review the document for you and request constructive criticism; you may learn more than you think!

Your business plan is not a dusty tomb to be written and forgotten in the back of a cupboard. It is a marketing tool. A snappy, well written Executive Summary will open doors and should be an "amuse-bouche" to whet investors' appetites. Moreover, it may indeed be a development tool in itself. Take time to write it well, keep it up to date and review it regularly.



REVIEW THE COMPANY BOOKS

Also frequently perceived to be another dusty tomb which is left at the back of a filing cabinet, on the contrary, the company's Statutory Books are the company.

We repeatedly see instances of companies having attracted finance, who end up rather red faced when their books are enthusiastically handed to the investor's lawyer during the process of due diligence who promptly reverts with a raft of questions the company is unable to answer. The most common issues arise from being unable to establish the share capital or ownership of the company from the records in front of them or from a failure to conduct the statutory affairs of the company in accordance with Company Law.

No investor will invest in a company in that condition and it often takes time to rectify the problem just at the point when you are under pressure to close the deal. Moreover, shoddy record keeping of the Statutory Registers and poor corporate governance do not reflect well on the professionalism of the company.

It is no longer a legal requirement to appoint a company secretary. However, if you have access to a professional company secretary, they may be able to save you a great deal of time and trouble as well as keeping the company compliant and the Statutory Books in good order.

A detailed review of the company's books by someone with the knowledge and experience to do so effectively should therefore be conducted before any approach to investors is made.

REVIEW THE SHARE CAPITAL, OWNERSHIP STRUCTURE AND ARTICLES

Many start-up companies are incorporated with a very simple share structure. Often they have only one share class being ordinary shares and often only two shares issued and allotted, if there are two founders, perhaps one to each founder.

If your company was incorporated by an incorporation agent, the shares may initially have been allotted to nominee shareholders with the intention that they should then be transferred to the founders at the date of incorporation. Check the Register of Members and the Register of Transfers in the Company Books to ensure this has been done or you may find you don't own the company at all!

Above and beyond this rather important detail, preparing for investment may be an appropriate point to seek advice on the most optimal share structure for your company, given your plans, the investment you are seeking and your own circumstances. It is almost certainly worth a small investment in taking both tax and legal advice in this regard. You may benefit from both tax savings and potentially a better bargaining position with your future investors.

As part of the review of your share structure in preparation for investment, your lawyer will almost certainly wish to review your Articles of Association. These are often to be found in your Company Books. If they are not there, they can be downloaded from Companies House and should be kept in your Company Books in future! Articles of Association govern the relationship amongst shareholders as well as that between shareholders and the company. Before any shares are issued to investors they should be checked to see what rules apply and need to be followed.



Investors often insist on new 'investor specific' Articles of Association to be adopted at the same time as an 'Investment Agreement' 'Shareholder Agreement' or being entered into to give the investors additional rights and protections. You will find on our website some free investment documents to download, including a Seed Investment Heads of Agreement and a Short Form Seed Investment Agreement with accompanying Standard Form Seed Investment Terms which we have developed. Please make sure you instruct a lawyer with experience in this area who can help explain these terms quickly and efficiently to you.

Please note that a properly experienced lawyer can help you ensure you have an EIS or SEIS compliant company. You should also get your tax adviser to obtain an advance clearance from HMRC to confirm that your company is EIS or SEIS qualifying. This will go a long way to catching an investor's eye on the catwalk in consequence of the significant tax advantages it offers them. Your company will therefore immediately be a much more attractive option.

REVIEW YOUR KEY CONTRACTS

During the process of due diligence by investors you will normally be asked to disclose to their lawyer details regarding key contracts. It is therefore wise to review them, or to formalise any informal arrangements before they are scrutinised.

You should consider any contracts with key suppliers, customer terms and conditions or preferred supplier agreements, employee contracts and directors' service agreements, as well as property and capital contracts such as leases and rental agreements.

Do they do what you need them to do? Could they do it better? Can you negotiate and secure the improved terms? Again, your solicitor will assist you with this.

REVIEW YOUR INTELLECTUAL PROPERTY, PATENTS AND TRADEMARKS

Some of the value of the business and its assets that will be examined by your investor or financier will be its intellectual property. You should therefore ensure that you have properly identified and protected those assets and, moreover, that they are held in the most appropriate vehicle. A specialist IP solicitor will be able to assist you with this.

DISPUTE RESOLUTION

As part of the due diligence process any investor or financier will investigate any disputes the company is involved in. If you have any current or potential claims or disputes with or against employees, suppliers, clients or any other party which impacts on the business, as far as possible, try to work to resolve them in advance of seeking finance, or at least secure a clear idea of the likely outcome and quantum.

If appropriate, you may wish to consider mediation as an alternative to litigation. Make your legal adviser aware of the fact you may be seeking funding as this could have an impact on the strategic considerations of any dispute and influence their advice.



BOOST YOUR TEAM

Your investors or financiers will be backing your team as much as your product. A second rate idea managed by a first rate team will often succeed where a first rate idea managed by a second rate team will rarely succeed.

Use the preparation for investment to review whether you have the best people on board doing what they are best at. Strengthen your team by recruiting, outsourcing or even simply training. Can they deliver your business plan? If not, what skills gaps do you need to plug and how will you do that? Could you recruit appropriate non-executive director "reputation" onto the board?

CONSIDER YOUR OPTIONS BEFORE DIVING IN

There are many, many funding options but broadly they may be classed as grant, debt or equity. It would pay to do your research and become familiar with the market before you launch your campaign for finance. We have produced several Legal Briefs on the subject, as well as a series useful of Blogs which you will also find on this website.

The Entrepreneurs section (amongst others) of the UK Business Angel Association website may also be of interest: <https://ukbaa.org.uk/entrepreneurs/>

There is a tremendous amount of literature on the subject too. One publication you may wish to add to your reading list, however, is "Angels, Dragons and Vultures" by Simon Acland.

There is also an argument for "clever contracts". Do you simply need finance or is there a deal to be done which will create an income stream but also a market for the business, not just your product. A well known Business Angel, Nelson Gray, has suggested that investors like him will be looking at not just customers of the business, (i.e. market traction) but also customers for the business, (i.e. an exit strategy). Such contracts may not seem immediately apparent but after careful thought and experienced drafting could prove a highly effective alternative for employees, founders and investors alike. Your solicitor will be a key member of the team in orchestrating such creativity to ensure you reap its full potential.

CONCLUSION

The foregoing is by no means an exhaustive checklist but serves as a useful guide to the fruitful ground work which can be done before seeking finance. It will not only reduce pressure once you identify a funding source, but will also impress the investors and financiers you target.

In short:

1. Remove as much uncertainty or risk as possible for your investor or financier. This will encourage investment and potentially reduce the "price" of the money you need to attract. The lower the perception of risk, the less return, interest, or "slice of the pie" will be demanded to offset it.
2. Employ the services of a specialist solicitor, even before you seek finance. They will prove invaluable in getting you "investor ready" and any time or cost doing so, will be saved on the deal itself. Moreover, they will be aware of and have contacts with sources of funding you may not otherwise encounter.
3. Know your business inside out, what funding you need, why you need it, what for and for how long.

For further details, please
contact:



Stuart Hendry

SENIOR PARTNER

T 0131 226 8203

E stuart.hendry@mbmcommercial.co.uk



Alexander Lamley

DIRECTOR

T 0131 226 8238

E alexander.lamley@mbmcommercial.co.uk



Ross Byford

DIRECTOR

T 0131 357 5810

E ross.byford@mbmcommercial.co.uk

While all reasonable care has been taken in the preparation of this guide, no responsibility is accepted by MBM Commercial LLP for any errors it may contain, whether caused by negligence or otherwise, or for any loss, howsoever caused, occasioned to any person by reliance on it. Individual advice should be sought before considering any of the matters detailed in this guide.