



# PRACTICAL LAW

MULTI-JURISDICTIONAL GUIDE 2012

## VENTURE CAPITAL

PRIVATE EQUITY VOL II

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# UK (England and Wales)

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## MARKET OVERVIEW

### 1. What are the main characteristics of the venture capital market in your jurisdiction?

#### Venture capital and private equity

Venture capital refers to private equity funding into companies which have a high potential for growth and are generally at an early stage of their development. Mainstream private equity is generally regarded as the equity funding for institutional buyouts, where the funder will typically leverage its investment to take a controlling interest in an established business with the potential for adding value in the short- to medium-term through growth, acquisition or reorganisation.

#### Sources of funding

Venture funding can come from a number of sources including:

- Business angels, that is, wealthy individuals who are in a position to support investments with a high risk/return profile.
- Funds which focus on university spin-outs, to allow universities to have the opportunity to monetise intellectual property developed by its academics.
- Venture funds, which are professional investors managing third party funds.
- Corporate investors, which invest into start-ups to provide them with access to new technologies and businesses that they would have difficulty developing themselves within the less entrepreneurial context of a corporate entity.

#### Types of company

Venture investment is drawn to businesses with a high potential for exponential growth. This typically lends itself to sectors receptive to market disruption such as technology, digital business, cleantech and life sciences. Areas with low growth and/or very high capital costs will generally not be suited to venture investment although there are always exceptions.

#### Market trends

Venture investment can range from tens of thousands of pounds from a business angel in a seed round to tens of millions of pounds from institutional investors in a later round. An institutional investment is typically between GB£500,000 and GB£5 million. Over the recent years, Venture Capital investment in the UK has been made into a broad range of sectors including cleantech, renewable energy, new media and life sciences. Over the past two years there has been significant interest in funding solar projects

by venture capital trusts (VCTs), which were attracted by the long-term secured income derived from feed-in tariffs. However, most businesses based on feed-in tariffs will cease to qualify for Enterprise Investment Scheme (EIS) and VCT purposes in 2012 (see *Question 3*).

### 2. Are there any recent or proposed regulatory changes affecting the venture capital industry?

Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) imposes a wide range of restrictions on venture capital fund managers based in or promoting funds into the European Economic Area and also creates a regulatory passporting regime to dispense with the requirement to obtain authorisation in each EEA jurisdiction in which the fund manager is active.

The AIFM directive will not apply to all managers but managers can choose to opt into the directive to avail of passporting rights.

The European Commission has separately (on 7 December 2011) published a proposal to regulate venture capital fund managers that fall outside the scope of the AIFM Directive. The directive would create a lighter regulatory regime than the AIFM Directive, but still allow venture capital fund managers to take advantage of a regulatory passport.

In addition, the UK is in the process of developing a new regulatory structure that will see the abolition of the Financial Services Authority and its replacement by several new bodies. Venture capital firms would generally be subject to regulation by the new Financial Conduct Authority which will ultimately be replaced at EU level by the European Securities and Markets Authority.

## TAX INCENTIVE SCHEMES

### 3. What tax incentive schemes exist to encourage investment in venture capital companies? At whom are the schemes directed? What conditions must be met?

#### EIS

EIS is designed to encourage entrepreneurship and assist small/medium-sized and start-up trading companies (TCs) raise finance by offering tax relief to investors who purchase ordinary shares.

EIS offers the following benefits on the subscription for shares in a qualifying company:

- Income tax relief of 30% of the amount subscribed (subject to a maximum subscription of GB£500,000, which will



increase to GB£1 million from 6 April 2012) provided the shares are held for at least three years.

- Capital gains tax exemption on sale of shares after three years provided that the income tax relief has not been withdrawn within those three years.

The benefits above are referred to as Investment Relief in this chapter.

In addition, EIS allows a taxpayer to defer capital gains made on the disposal of assets, by reinvesting the gain into the subscription for shares in an EIS qualifying company. The shares must be issued at any time beginning one year before and ending three years after the disposal of the asset. There is no applicable maximum limit. This is referred to as Reinvestment Relief in this chapter.

There are some significant restrictions relating to the Investment Relief and it is more likely to be available to an outside investor than to someone who works in the business.

The rules for directors are complex. Careful planning and timing is critical in this context, but it would allow a seed investor to be a director.

The following conditions must be met in relation to both Investment Relief and Reinvestment Relief:

- The shares in the TC must be eligible shares, that is, new ordinary shares.
- The shares must be issued to raise money for a qualifying activity and the money must be employed within two years of issue.
- The TC can only raise GB£2 million under EIS and VCT (*see below, VCT*) schemes in any 12-month period (provisionally to increase to GB£10 million from 6 April 2012).
- The gross assets of TC must not exceed GB£7 million before the issue of shares and GB£8 million afterwards (provisionally to increase to GB£15 million and GB£16million from 6 April 2012).
- The TC must have fewer than 50 full-time employees or part-time equivalent (provisionally to increase to 250 from 6 April 2012).

In addition, there are rules as to the extent to which the TC can own or control other companies, and to which other companies can hold shares and investments in the TC.

Certain of the conditions must be satisfied for three years after the investment, failing which the tax benefits of EIS will be withdrawn.

The Seed Enterprise Investment Scheme (SEIS) is expected to be introduced from 6 April 2012. SEIS will be similar to EIS, except that it focuses on smaller and early stage companies. Many of the rules found in relation to EIS will apply to SEIS, but particular variations are that:

- Income tax relief will be available at 50%, but the individual threshold will be limited to GB£100,000 and the company level threshold to GB£150,000. There will also be capital gains tax benefits.
- The TC must have 25 or fewer employees and assets of no more than GB£200,000.

## VCTs

VCTs are also designed to encourage investment in small/medium-sized and start-up trading companies. However, by contrast with EIS, the individual invests in the VCT and the VCT then invests in the TC.

An individual making an investment in a VCT is entitled to income tax relief of 30% of the amount subscribed (maximum subscription GB£200,000) provided the shares are held for at least five years. Dividends are exempt from income tax and any gain made on disposal is free from capital gains tax, provided the VCT continues to be approved.

The VCT must be approved by HM Revenue & Customs (HMRC) (the UK tax authority). There are a number of applicable conditions, including that it must be listed on the Official List of the London Stock Exchange or an EU Regulated Market.

There are further conditions that apply in relation to the nature of the investment:

- Investments can be made into loans and preference shares that meet qualifying conditions, but at least 10% of the total amount invested in an individual TC must be in eligible shares. Like with the EIS, there are rules that restrict those eligible shares from having certain preferential rights.
- The TC must meet the five conditions set out in relation to EIS (*see above, EIS*).
- The VCT must not invest more than GB£1 million in any one company in each 12-month period (but, with a few exceptions, this is expected to be abolished from 1 April 2012).

It is particularly important to note that the VCT cannot control the TC.

Income tax relief will be withdrawn in whole or in part if the investor disposes of the shares within five years of issue. Relief will also be lost where the VCT loses its approved status.

## FUNDING SOURCES

### 4. From what sources do venture capital funds typically receive funding?

Venture capital funds source equity from a wide range of investors, both public and private. Private investors can include:

- High net-worth individuals.
- Family offices.
- Pension and insurance funds.
- Endowments.
- Funds of funds.
- Sovereign wealth funds.
- Corporate investors.

Public investors include:

- Local and central government pension schemes.
- Charities.



- A range of quasi-governmental institutions. For example, the Business Growth Fund (BGF) was launched in early 2011. The BGF follows in a long line of public sector backed venture capital investors, including regional venture capital funds and enterprise capital funds.

At a European level, significant investment in venture capital funds is also available from a number of supra-national organisations, including the European Investment Bank (EIB) and its venture capital/private equity focused arm, the European Investment Fund (EIF).

## FUND STRUCTURING

### 5. Can the structure of the venture capital fund affect how investments are made?

The investment policy of a venture capital fund is normally set out in its constitutional documents, typically an English limited partnership (ELP) agreement (although it may take other forms depending on the type and location of investors). These documents normally specify the industry sector, investment size and geographic regions in which investments can be made. They will also often contain diversification requirements to ensure that investments are not overly reliant on a small number of similar investments. If the fund has been structured with particular tax planning in mind (such as a VCT or EIS) then the rules governing these schemes will also have an impact on how investments are made.

### 6. Do venture capital funds typically invest with other funds?

Given the desire to manage portfolio risk, as well as a recognition that early stage businesses will often need multiple rounds of investment, investors often club together in syndicates so as to be able to support a business' funding needs through to exit.

### 7. What legal structure(s) are most commonly used as vehicles for venture capital funds in your jurisdiction?

The most common legal structure for venture capital funds is an ELP formed under the Limited Partnerships Act 1907. ELPs have been used for a variety of VC/PE investment funds and are familiar to most investors. They allow significant flexibility around the commercial terms for the fund and are tax transparent. In addition, they are lightly regulated from a corporate governance perspective, are not subject to onerous publication requirements (giving investors a high level of privacy as to financial returns) and, provided investors do not involve themselves in day-to-day management, offer investors limited liability protection.

Other structures that may be used include public companies for VCT structures, private companies for club-style investments and limited liability partnerships. Where investors are located outside the UK, a number of non-UK structures are also commonly seen, even if the underlying investment company is in the UK.

## INVESTMENT OBJECTIVES

### 8. What are the most common investment objectives of venture capital funds?

Venture funds are typically looking to invest money raised in a three- to five-year investment period and to then realise the investments made before the end of the life of the fund, which is normally around ten years. While the specific objectives of the fund are set out in the investment objectives and criteria, most funds seek to generate a three times multiple on money invested. Because of the risk associated with investments of this nature (only around 20% of investments will be successful) there is significant pressure on fund managers to generate exceptional returns from the successful investments to compensate for those investments that have failed.

## FUND REGULATION AND LICENSING

### 9. Do a venture capital fund's promoter, manager and principals require licences?

A fund promoter generally must be authorised by the FSA to conduct the regulated activity of arranging deals in investments where this is conducted in the UK. Where the promoter targets retail investors, it is also common for the promoter to assume responsibility for ensuring the suitability or appropriateness of the investment for the target audience.

Subject to a few limited exceptions, fund managers must be FSA authorised and regulated because they will be carrying out one or more regulated activity in relation to the fund, such as:

- Managing the fund.
- Arranging dealing in, and safeguarding and administering, investments.
- Establishing and operating the fund vehicle.

Other related parties, including individuals and entities who are delegates of the fund manager in relation to its regulated functions, will also need to be FSA authorised and regulated.

### 10. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

Most venture capital funds are not targeted at retail clients, and are unregulated. Thus, the fund vehicle itself is not approved by the FSA, but the fund manager does need to be authorised (see *Question 9*).

If the venture capital fund is structured as a retail fund, the fund vehicle itself will be regulated. The authorisation process for the fund vehicle is different from the process that applies to active entities, such as the manager, and largely relates to the approval of the fund's constitutional and marketing materials.



A venture capital fund which is structured as a UK listed company must generally prepare an FSA-approved prospectus to be marketed to the public, although there are exceptions to this requirement.

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**11. How is the relationship between investor and fund governed? What protections do investors in the fund typically seek?**

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The relationship between the investor and fund is set out in the fund's constitutional documents, most typically an ELP agreement. This will contain a number of provisions that address the relationship between the fund manager, the fund and the investor. These include:

- The role of the fund manager, the fees paid to it and the decisions it can take. Many funds contain investment committees or advisory boards that act as check and balance on the activities of the fund manager.
- Provisions for the removal of the fund manager for cause and, in some case, without cause (no fault divorce provisions).
- Key man provisions to ensure that the key individuals responsible for the operation of the fund remain involved throughout the life of the fund.
- Exclusivity provisions to ensure that the fund manager is focused on the fund in question and not other funds in its stable.
- Provisions relating to the drawdown of investors' commitments, the investment (and potential reinvestment) of those amounts, excuse provisions and default provisions to deal with non-funding investors.
- The waterfall which deals with the allocation of profit between investors and the fund manager.
- Information, reporting and governance provisions.

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**INTERESTS IN INVESTEE COMPANIES**

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**12. What form of interest do venture capital funds take in an investee company?**

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Venture investors will typically invest by way of preferred equity. Occasionally convertible loan notes may be used as a means of deferring a valuation decision until a later stage, but the risk profile of venture investing will usually only support an equity investment.

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**VALUING AND INVESTIGATING INVESTEE COMPANIES**

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**13. How do venture capital funds value an investee company?**

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Valuation of early stage businesses is a challenge. If a business has revenues then it may be possible to form a valuation based on a multiple. However, this will often not be the case, so the valuation can be somewhat arbitrary. In reality, an investor will

not want its investment to dilute the founder equity to such an extent that they become disincentivised from growing the business. Therefore, the valuation may ultimately be implied from determining the funding needs of the business and applying that to an equity stake which will not leave founder's equity overly diluted.

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**14. What investigations do venture capital funds carry out on potential investee companies?**

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Venture capital investors normally carry out a number of investigations into the business it is investing into. These may include broad financial and legal due diligence but a bespoke approach is more likely to be taken. The investor's priority will be to ensure that:

- The business's core assets (usually intellectual property rights (IPRs)) are owned and protected.
- The management team are subject to arm's-length service agreements.
- Proper incentive arrangements are in place.

Therefore, some legal review is often required, with risk exposure being addressed through the warranties and disclosures in the subscription and shareholders agreement (see *Question 15*). In addition, for some investors (such as VCTs) it will be important to ensure that the nature of the business it is investing in is consistent with the rules which apply to its fund.

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**LEGAL DOCUMENTATION**

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**15. What are the principal legal documents used in a venture capital transaction?**

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The main documentation usually associated with a VC investment includes:

- A subscription and shareholders agreement.
- New articles of association.
- Service agreements.

See *Question 16* for further details.

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**PROTECTION OF THE FUND AS INVESTOR**

*Contractual protections*

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**16. What form of contractual protection does an investor receive on its investment in a company?**

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An investor benefits from the following protections:

- The subscription and shareholders agreement contain:
  - the terms on which the investor makes its investment, what it receives in return for its cash and how the investment will be made (for example, in a single drawdown or series of tranches);



- warranties provided by the company and founders as to the position of the company, and to a limited extent, the founders' other business interests;
  - restrictive covenants to be provided by the founders; and
  - a series of obligations as to the management and governance of the company and matters which specifically require investor consent.
- The new articles of association deal with:
- the rights attaching to shares;
  - arrangements for new share issues and transfers;
  - the operation of the board; and
  - general constitutional matters.
- Service agreements are used if the founders and/or management team do not already have robust service agreements in place.

### Forms of equity interest

#### 17. What form of equity interest does a fund commonly take?

A venture investor normally invests in preferred shares (see *Question 18*). VCT investors are often required to take at least 10% of their investment in ordinary shares.

### Preferred shares

#### 18. What rights does a fund have in its capacity as a holder of preferred shares?

The preferred shares will have the same rights as ordinary shares (and so will be regarded as "equity" unlike preference shares) but will likely have enhanced entitlements to capital and income, specific class protections and downside protection such as anti-dilution.

### Management control

#### 19. What rights are commonly used to give a fund a level of management control over the activities of an investee company?

The investment documentation normally includes undertakings on the part of the company and the management not to do various things without the consent of the investor (see *Question 15*). These will generally be non-ordinary course matters such as the acquisition or disposal of significant assets. Regular supervision will be effected through the investor's monitoring of the board, either through an investor appointed director or observer.

### Share transfer restrictions

#### 20. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation?

Share transfers are restricted to ensure that all shareholders in an investee company stand together and exit together to maximise shareholder value. The following methods are commonly used:

- **Pre-emption rights on transfer.** The articles of association will almost certainly contain pre-emption rights preventing shareholders (subject to certain exceptions) from transferring their shares to third parties, unless they have first offered those shares to existing shareholders on the same terms.
- **Tag-along rights.** In addition to pre-emption rights, articles of association often prohibit share transfers to third parties that would result in a third party holding a controlling interest in the investee company, unless that third party has offered to acquire all shareholders' shares on the same terms.
- **Co-sale.** These prevent a shareholder from transferring a proportion of his shareholding to a third party, unless all shareholders have been given the right to transfer a similar proportion of their shares to that buyer on the same terms.

#### 21. What protections do the investors, as minority shareholders, have in relation to an exit by way of sale of the company?

Shareholders in the investee company typically agree an exit plan in the investment agreement to record the respective shareholders' roles and the timing of an exit.

In addition to the restrictions on the transfer of shares in the investee company, the articles of association usually contain drag-along rights. These rights allow the holder(s) of an agreed proportion of the shares to oblige all shareholders to accept a buyer's offer. Clearly, this makes an exit much easier for investors to achieve, as not all shareholders need to consent to it.

On exit, some investors will have the right under the articles of association to have their investment repaid (sometimes with an agreed uplift or return) from the sale proceeds before other shareholders get any capital return.

### Pre-emption rights

#### 22. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

No investor would invest in any company without having the right to participate equally on any new issues of shares (so as to maintain their shareholding stake in the investee company).

In addition to this, it is very common for the investment agreement to contain a contractual restriction on the investee company in relation to issuing new shares without investor consent, except for agreed actions to satisfy employee share options.

### Consents

#### 23. What consents are required to approve the investment documentation?

The following consents are generally required:

- The board of the investee company must formally approve the terms of the funding as being in the best interests of the company, subject to contract. The investee company then usually signs the investor's term sheet or heads of terms, so that the transaction can progress.



- The investee company then obtains all necessary consents from its shareholders. Shareholder consent is often required to:
  - adopt new articles of association;
  - give the board authority to allot new shares; and
  - waive pre-emption rights on the issue of those shares.

The investee company may also need to obtain consent from other third parties (such as its bank).

## COSTS

### 24. Who covers the costs of the venture capital funds?

It is often a condition of the funding that the investee company pays the investor's reasonable costs incurred to make the investment. These costs can also cover due diligence.

## FOUNDER AND EMPLOYEE INCENTIVISATION

### 25. In what ways are founders and employees incentivised? What are the resulting tax considerations?

#### Incentives

Incentivisation can be achieved through a bonus scheme, but these are not popular with the current rates of tax (*see below, Tax*). Founders should take equity as early as possible to secure it at the lowest price possible. Where a founder is also an employee there will be income tax issues to consider.

#### Tax

If an employee acquires the shares at less than the market value, there can be an immediate charge to income tax (currently up to 50%) and national insurance contributions (a payroll tax on the employee and the employer).

Further charges may apply in the future, particularly at the point of disposal. Careful planning can mitigate the income tax risk and it is important to consider making tax elections on acquisition (known as section 431 elections).

There are a number of tax-favoured share schemes. A share option scheme is usually subject to income tax but, in the context of small- and medium-sized companies, the enterprise management incentive (EMI) is available. This is designed to allow the shares to be subject to capital gains tax alone. The company must meet qualifying conditions, in many respects quite similar to those under EIS or VCT schemes (*see Question 3*).

Individual investors usually hope that their investment will be subject to capital gains tax alone. The typical rate is 28%, but this can be reduced to 10% on the first GB£10 million of lifetime qualifying gains where entrepreneurs' relief applies.

### 26. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture?

Ensuring that founders are committed to investee companies is very important to investors, yet it is impossible to make somebody

work against their will. Accordingly, protections are designed to be punitive in nature to discourage certain behaviours. Negotiations in this area can be contentious and should be handled delicately. The methods commonly deployed are:

- Leaver provisions.
- Restrictive covenants.

#### Leaver provisions

The articles of association typically provide that if an employee shareholder leaves the business, they are automatically required to offer to sell their shares to other shareholders (or that their shares will suffer an automatic conversion into worthless shares). This has the effect of eliminating the leaver's stake in the business, which can then, if necessary, be used to incentivise that leaver's replacement.

It is common for leavers to be paid different prices for their shares, depending on why they left the business:

- Bad leavers commonly get a restricted price for their shares. Bad leavers are usually employee shareholders who leave before an agreed period of time or have done something wrong within their control (for example, a breach of their employment contract, poor performance or gross misconduct).
- Good leavers usually get fair market value for their shares. Good leavers are usually employee shareholders who leave after an agreed period of time and/or have otherwise done nothing wrong.

However, there are many variations to the above, for example:

- Allowing leavers to retain some of their shares from the outset (often used to recognise the value of an employee shareholder's contribution before the investment was made).
- Allowing leavers to retain an increasing proportion of their shares or to get more favourable pricing terms, as time passes, thereby alleviating the impact of the leaver provisions as the business grows (sometimes called vesting).
- Taking away all or some of a leaver's voting rights so that they have less influence over the investee company and, in particular, less influence on an exit.

Leaver provisions can also be found in some employee share option agreements and are used to extinguish or reduce an option holder's right to exercise share options once they have left the business.

#### Restrictive covenants

The investment agreement and a founder's employment contract almost always contain restrictive covenants from the founders to the investee company and/or the investors that:

- While engaged in the business, the founder will devote his full time and attention to the business to the exclusion of any other business opportunity.
- Should they leave the business, the founders will not work for or be involved with any competing business for an agreed period and will not try to take away any of the investee company's employees, customers, suppliers or other key business contacts.

## EXIT STRATEGIES

### 27. What forms of exit are typically used to realise a venture capital fund's investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

It is always harder for an investor (and other shareholders) to exit from an unsuccessful investee company because there is likely to be a smaller group of buyers and/or new investors prepared to execute a transaction. The usual options are therefore:

- **Sale to a specialist acquirer/investor.** There are investors and trade buyers who specialise in buying distressed assets. As this is a risky market, the purchase price will be low, often based on the underlying value of the investee company's assets rather than any earnings valuation (as this can be too uncertain).
- **Solvent (voluntary) liquidation.** The shareholders can decide to close down the business in an orderly fashion by putting the investee company into voluntary liquidation. Once the investee company has paid off its creditors, any remaining assets, which the liquidator will more than likely have converted into cash by that stage, would be distributed to shareholders.
- **Insolvent liquidation.** Sometimes shareholders do not have time to carry out a business sale or a solvent liquidation and, if the investee company becomes insolvent, the fate of the investee company is taken out of their hands. The process of distributing assets is the same as on a solvent liquidation, except that there is an increasing risk that there will not be any proceeds left to return to shareholders, as the value of the investee company's creditors' claims is likely to outweigh the value of its assets.

On an unsuccessful exit, investors will be concerned to maximise the recovery of their investment, so the best process for them will often be the one that achieves this goal most efficiently. Investors will also be concerned about their market reputation and, if they have a director on the board of the investee company, their directors' duties. The main duties relevant in this respect are to:

- Act in the best interest of the investee company and its creditors.
- Prevent the investee company from trading while insolvent, which can expose the directors to personal liability.

On exit, some investors have the right in the articles of association to have their investment repaid (sometimes with an agreed uplift or return) from the sale proceeds before other shareholders get any capital return (see *Question 22*). This has the effect of protecting the investors from the financial implications of a poor exit.

Finally, an investor may have the right under the articles of association to demand that the investee company redeem its shares at a pre-agreed valuation. However, this is only useful if the investee company has money to fund the redemption.

### 28. What forms of exit are typically used to realise a venture capital fund's investment in a successful company? What are the relative advantages and disadvantages of each?

The following are the most common forms of exit from a successful investee company:

- **Trade sale.** The main advantage of a trade sale is control, particularly if there is interest from competing buyers, as the sellers are able to take advantage of the competitive tension involved. The process also provides a fair degree of certainty of execution. The main disadvantage is that management shareholders may lose their jobs and/or influence if the investee company is being acquired by a larger company who plans to assimilate the investee company into its own business. Care must also be taken to manage critical business secrets during the process in case the transaction aborts, particularly if the buyer is a competitor, or could become so.
- **Buyout.** As well as offering the advantages of a trade sale, buyouts can also be great events for management shareholders, as they get the chance to realise some cash, retain their position within the business and reinvest into attractive equity instruments in the new company. However, there is likely to be more uncertainty around execution than on a trade sale. This is because private equity firms usually undertake a much more thorough due diligence process, particularly about the market in which the investee company operates, as private equity firms may know less about this than a trade buyer. In the current market, it is also harder to raise bank debt to support larger buyouts because of the credit crisis.
- **Initial public offering (IPO).** The main advantages of an IPO are that management shareholders are able to retain their position within the business. There is also a degree of profile raising and "feel good" factor for any business that is listed on a major stock market. However, an IPO is not really an exit at all, but is rather a partial refinancing of the shareholder base. Investors and management shareholders are often required to undertake that they will not sell their shares for an agreed period. This is called a lock-in arrangement and is used to create an orderly market in the investee company's shares, once listed. Also, in the current markets IPOs are risky to execute, depending on whether the investee company can secure sufficient interest from initial investors. This will often only become clear late in the process once the marketing phase has begun. IPOs are also expensive and are very consumptive of management time.

### 29. How can this exit strategy be built into the investment?

An agreed exit strategy will be important to all shareholders, not just investors, so it should be discussed and be built into the investment documents from the outset as part of the overall investment negotiations. Depending on what is agreed, the exit strategy will influence a number of the provisions in the investment documents, including:

- Drag-along rights, which may enable an investor to have more control on the timing of an exit by giving effect to some elements of the exit policy.
- Liquidation/sale preferences, that may give an investor a priority return protecting them from marginal exits.
- Restrictions on share transfers, designed to make it hard for shareholders to exit without all other shareholders.
- Leaver provisions, which dissuades employee shareholders from leaving the business before an exit is achieved.



Therefore, shareholders should be flexible to take advantage of exit opportunities as and when they arise. In practice, even the most successful investee companies can sometimes achieve an exit that was not foreseen at the start. For example, a buyer may

come forward who was not identified as a potential suitor (or may not have even existed) at the time of the investment. This illustrates the exciting and fast moving nature of the markets that attract venture capital investment.

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**Qualified.** England and Wales

**Areas of practice.** Venture capital; private equity; corporate M&A.

#### Recent transactions

- Advising Foresight Group on various solar investments.
- Advising investor syndicate including DFJ Esprit, Capital-E, Earlybird Ventures and Robert Bosch Venture Capital on investment in Light Blue Optics Limited.
- Advising YFM Equity Partners on partial sale of investment in Go Outdoors to 3i.

**Qualified.** England and Wales

**Areas of practice.** Venture capital; private equity; corporate M&A in the digital business and cleantech sectors.

#### Recent transactions

- Advising Imperial Innovations and Invesco Perpetual on the GB£40 million series B funding round in Nexeon. Nexeon has patented a unique silicon anode technology for the next generation of lithium-ion batteries (increasing both battery cycle life and capacity).
- Advising Adfonic on its GB£4.7 million series B funding. Adfonic is a technology company that facilitates transactions between advertisers and publishers on mobile websites and applications.
- Advising Disruptive Capital and Robeco on the GB£24 million funding of ECO Plastics (the UK's largest plastic bottle recycling centre, handling 140,000 tonnes a year).



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**Qualified.** England and Wales

**Areas of practice.** Funds.

#### Recent transactions

- Launch of Bridges Venture's healthcare fund.
- Restructuring Palmer Capital Partners' PCDF II fund.
- Launch of the AIS US consumer debt fund.
- Launch of Duet's European debt fund.
- Restructuring of Curzon Capital's UK venture capital fund.

**Qualified.** England and Wales

**Areas of practice.** Head of Financial Regulation.

#### Recent transactions

- Advising venture capital firms on becoming FSA authorised and operating outside the scope of authorisation.
- Advising companies on alternative finance structures for small businesses, including crowd funding and non-bank lending platforms.
- Reviewing fund marketing materials in the context of FSA rules, financial promotion exemptions and prospectus requirements.