DMH Stallard

# Growth in a Covid-impacted world

We have been operating in an extraordinary environment since the start of the Covid pandemic, which has presented challenges for every business, but for some there have also been opportunities to grow existing income streams or develop new ones. This guide provides an overview of some of the key issues that may be encountered as businesses seek to grow in this challenging environment.

Click below to view our interactive Growth mind map.

START

## Interactive diagram

Click on the pink sections to find out more

# Growth in a Covid-impacted world

### Acquisitions

- Structure – share purchase vs asset purchase
- Tax considerations
- How will the purchase be funded?

### People

- Recruitment of key staff
- Incentivising key staff
- Issues arising on acquisition or merger
- New working arrangements as a tool for recruitment and retention

### Obstacles to growth through acquisition

- Board member differences over direction of travel
- Disputes between current shareholders
- Third party litigation
- Inherited contractual arrangements

### Fundraising

- Considerations for listed companies
- Considerations for private companies
- Will the funder's due diligence identify legal problems?

### Premises

- Re-gearing of leases
- Negotiating a new lease
- Acquisition or disposal of a freehold property

# Acquisitions

Since the Covid pandemic took hold M&A activity involving our clients has remained strong. There are a number of reasons why a business would acquire another, rather than growing organically. Acquiring another business can provide immediate access to a market or build a market presence, the acquisition may result in economies of scale for the combined business, and in certain cases an acquisition can be a means of eliminating competition. The pandemic has given rise to opportunities to acquire businesses, including distressed businesses and also new and existing businesses which have successfully adapted to the new environment.

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Structure – share purchase vs asset purchase

Tax considerations

How will the purchase be funded?

NEXT PAGE →

← BACK TO DIAGRAM

## Structure: share purchase vs asset purchase

- A share acquisition (purchase of a target company by the acquisition of its shares) can be the most straightforward approach, as the contracts, assets and employees etc. will transfer across with the target company.
- If only part of the business owned by a company is required, or there is concern about its potential liabilities, it may be preferable to acquire only the relevant assets, contracts and employees through an asset purchase, although additional legal formalities will be required to complete the purchase.

Structuring an acquisition is a key consideration for a Buyer and a Seller

## In this section:

i click menu below to navigate

Structure – share purchase vs asset purchase

Tax considerations

How will the purchase be funded?

NEXT PAGE →

## Tax considerations

- There will be tax consequences for the Buyer and Seller depending on whether the transaction is a share purchase or asset purchase and whether any pre-acquisition restructuring is carried out.
- A Seller should obtain tax advice in advance of a sale, to identify whether tax relief such as Entrepreneurs' Relief will be available and whether any advance tax clearances should be obtained.

## How will the acquisition be funded?

- If the Buyer doesn't have sufficient cash, it may need to obtain bank or other financing, possibly using the assets of the business being acquired to secure the debt, subject to the lender carrying out legal and financial due diligence.
- A Buyer which is a company may be able to offer its shares as consideration to a Seller of a business, but this may not be attractive to the Seller if the Buyer company is not listed.

Tax and the costs of funding will both be relevant to a commercial assessment of a proposed acquisition

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

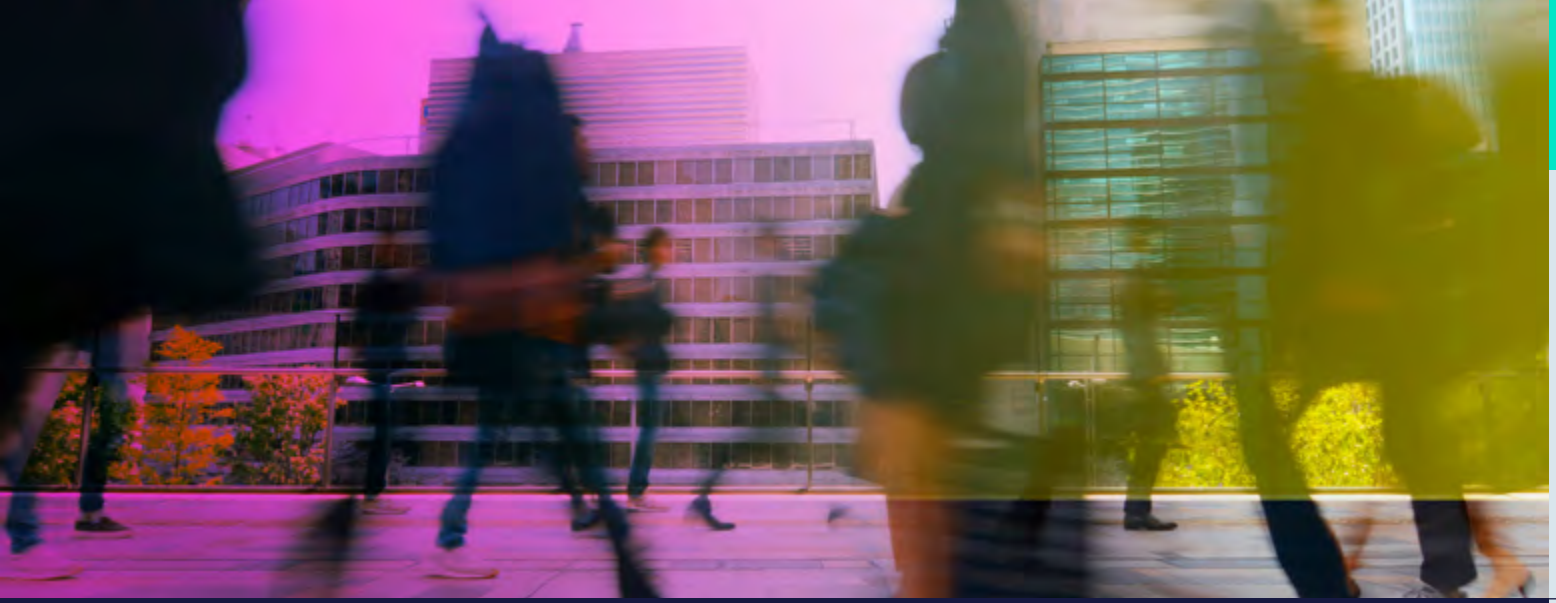
Structure – share purchase vs asset purchase

Tax considerations

How will the purchase be funded?

NEXT SECTION →

MAKE AN ENQUIRY →



← BACK TO DIAGRAM

# People

People are a crucial asset for most businesses, so recruitment and retention remain high on the list of priorities. Retaining the right people, without incurring undue cost is an important issue on acquisition or merger. However, changes to working practices in the light of the Covid pandemic have impacted most industries, and employees have higher expectations as to flexibility and other benefits than previously. Modern working arrangements for a hybrid or dispersed workforce may give a competitive advantage in the context of recruitment and retention.

## In this section:

i click menu below to navigate

Recruitment of key staff

Incentivising key staff

Issues arising on acquisition or merger

New working arrangements as a tool for recruitment and retention

NEXT PAGE →

← BACK TO DIAGRAM

## Recruitment of key staff

- Why are you recruiting – is it a new skill set, is it to improve resilience, is it to solve a particular operational problem or issue amongst the existing team?
- What are you looking for – is it a temporary appointment (may be to re-set behaviours or expectations), is the issue that current (performance) management of a team or an area has failed, or is it someone who will be in the organisation for the longer term (may be as part of succession planning?)
- Should you look at some sort of consultancy process initially to help refine what you are looking for? That may also help to demonstrate internally that change is needed/coming.

> In recruitment as much as anywhere, the old adage of 'fail to prepare, prepare to fail' holds good

## In this section:

i click menu below to navigate

Recruitment of key staff
Incentivising key staff
Issues arising on acquisition or merger
New working arrangements as a tool for recruitment and retention

NEXT PAGE →

← BACK TO DIAGRAM

## What methods do you use to find candidates?

- Using headhunters for senior roles remain very popular, but you should be clear as to the scope of the 'due diligence'/verification that the headhunter will carry out on a candidate.
- LinkedIn is the search tool for the digital age – it may help find 'a needle in a haystack', and provide some visibility of the company the candidate keeps.
- Specialist recruitment agencies can provide some current market knowledge and intelligence and are arguably closest to the coalface.
- Direct approach is relatively unusual, but can of course be very effective (like headhunting it can play to the target's vanity).
- Word of mouth is unfashionable in most areas as it risks contravening good HR policies and fair recruitment processes, but personal recommendation/introduction can be both compelling and reassuring.

## In this section:

i click menu below to navigate

Recruitment of key staff

Incentivising key staff

Issues arising on acquisition or merger

New working arrangements as a tool for recruitment and retention

NEXT PAGE →

← BACK TO DIAGRAM

## Incentivising key staff

- A key aspect will be the purpose, focus and expected duration of the appointment. The terms offered need both to reflect those points, and any mechanisms (whether the carrot of a bonus or equity stake, or the stick of a clawback or other penalty provision) need to be consistent as well.
- Salary - While it is well recognised that base pay is not the only reason why quality candidates will be motivated to perform, it is always a 'hygiene' factor. It is important to have up-to-date, reliable data on comparable roles in similar sectors.
- Pension contributions – with the advent of tapering provisions, many high earners and those with substantial pension pots are less interested by pension terms offered by new employers. They will often look at other forms of deferred pay – whether through bonus, incentive plans or stock options.
- In terms of granting equity, business owners should take care to ensure that they don't grant or promise equity in a hurry, and then regret this over time. Consideration of a phantom or shadow equity scheme may be more appropriate.
- As to cash bonuses, there needs to be clarity around objectives, triggers, payment terms and conditions. There is a still a misguided preference amongst many employers for 'wholly discretionary' bonuses. Such arrangements are often more problematic than they are worth and they are ripe for challenge either on the basis of unreasonable or discriminatory exercise.

## In this section:

i click menu below to navigate

Recruitment of key staff
Incentivising key staff
Issues arising on acquisition or merger
New working arrangements as a tool for recruitment and retention

NEXT PAGE →

- In terms of insured benefits (such as life cover, private medical and dental care, permanent health cover) it is critical that the documentation is worded so that the extent of the employer's obligation is to pay the premium, rather than provide the benefit. Equally, the employer should ensure that the benefit terms can be varied, or in extreme cases withdrawn, so that the extent of its obligations to the employee do not exceed the cover actually provided.

Pay and benefits are often described at hygiene factors, but get them wrong and the available talent pool will reduce considerably

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Recruitment of key staff

Incentivising key staff

Issues arising on acquisition or merger

New working arrangements as a tool for recruitment and retention

NEXT PAGE →

← BACK TO DIAGRAM

## Issues arising on acquisition or merger

- When acquiring a business, there will usually be a careful process of 'due diligence' checking and verifying the businesses financial liabilities.
- Will the acquisition trigger a payment to certain staff, or will they be entitled to leave altogether? In the context of staff it is important to consider whether the acquisition will trigger payments to some existing staff, or indeed whether it will give them 'permission' to leave the business once acquired.
- There will also likely be considerations regarding TUPE, which is likely in turn to limit the ability of the acquirer to change terms and conditions of employment.
- Recent case law has highlighted the practice of a seller inflating the pay and benefits of its senior staff shortly before the transfer. which inflates the cost of those new staff. It may be possible to challenge such behaviour by the seller.
- What is often missed are the acquirer's consultation obligations in respect of its own current staff.
- Equally, it may well be necessary that following an acquisition redundancies will be necessary. It is likely that such redundancies will need to be managed from the combined pool of staff (drawn from those of both the pre-existing as well as the acquired business).
- On the other hand, an acquirer will often want to 'lock in' key staff, so as to ensure that certain customer and supplier contacts and other trade connections are secured.
- Acquirers may want staff to sign up to new terms and conditions, including strengthened protections in relation to trade secrets, customer lists and financial models.
- Longer notice periods and medium term bonus arrangements are likely to be appropriate as the acquirer tries to ensure that the anticipated value is realised.

## In this section:

i click menu below to navigate

Recruitment of key staff

Incentivising key staff

Issues arising on acquisition or merger

New working arrangements as a tool for recruitment and retention

NEXT PAGE →

# New working arrangements as a tool for recruitment and retention

- Covid has changed the ways in which many people can (and want to) work in the short and medium term at least.
- These revised working arrangements present challenges for most businesses. Gaining feedback, responding and providing effective support for managers in new ways of working are all critical in ensuring that businesses maximise this new opportunity.

> The working environment in many sectors is undergoing massive transformation. Now more than ever, senior and line managers need support in managing through such uncertainty

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Recruitment of key staff
Incentivising key staff
Issues arising on acquisition or merger
New working arrangements as a tool for recruitment and retention

NEXT SECTION →
MAKE AN ENQUIRY →

# Obstacles to growth through acquisition

Acquiring another business can be an arduous process for a Buyer, both in terms of cost and time expended. A Buyer should according make sure its own management is in agreement before seeking to make an acquisition and carry out legal and financial due diligence on the target business to identify any problems in advance.

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Board member differences over direction of travel

Disputes between current shareholders

Third party litigation

Inherited contractual arrangements

NEXT PAGE →

← BACK TO DIAGRAM

## Board member differences over direction of travel

- Are there any members of the Buyer company's board of directors who are resistant to a proposed acquisition?
- It would be unwise to incur costs and expend time on a potential acquisition, if it is ultimately voted down by the Board.
- Are there any directors in the target company who the Buyer does not wish to retain after the acquisition is completed? Should their exit be part of the negotiations? Or do they need to be kept on under renegotiated terms, for the short term at least, because their expertise is required - perhaps with a bonus or earn out arrangement?

It is important for the success of an acquisition that the Buyer's management fully supports it

## In this section:

i click menu below to navigate

Board member differences over direction of travel

Disputes between current shareholders

Third party litigation

Inherited contractual arrangements

NEXT PAGE →

← BACK TO DIAGRAM

## Disputes between current shareholders

- Is there a risk of a dispute between the current shareholders of the Buyer company as a result of the intention to proceed with a particular acquisition?
- Assuming a majority of the shareholders wish to proceed, will the presence of dissenting shareholders cause problems for the management of the Buyer following the acquisition?
- Can the dissenting shareholders legally prevent the Board from pursuing the acquisition? If they don't have the majority required to remove and appoint directors, do they have the right to veto the acquisition under a Shareholders' Agreement?

It is likely to be counterproductive to undertake an acquisition, if it would trigger a shareholder dispute

## In this section:

i click menu below to navigate

Board member differences over direction of travel

Disputes between current shareholders

Third party litigation

Inherited contractual arrangements

NEXT PAGE →

← BACK TO DIAGRAM

## Third party litigation

- When considering an acquisition, a Buyer's legal due diligence exercise will seek to identify any litigation that the target business is involved in.
- If it is significant, an assessment will need to be made of the prospects of a successful outcome, the likely further legal fees, the demands on management time and the potential cost to the target business if the litigation is unsuccessful.
- If the potential liability arising from the litigation is significant, it may be a deal breaker, either because the commercial risk for the target business is too great and the financial exposure cannot be satisfactorily covered by an indemnity from the Seller or a potential funder is unwilling to provide finance because of it.
- Strategies for dealing with the litigation include reaching a pre-trial settlement, finding an third party prepared to take a stake in the litigation and fund a claim in return for a percentage share of a successful outcome and sourcing "after the event" (ATE) insurance to buy off the risk of having to pay an opponent's legal fees in the event of defeat in the litigation.

It is important to consider whether a target business is involved in litigation that presents a significant commercial risk

## In this section:

i click menu below to navigate

Board member differences over direction of travel

Disputes between current shareholders

Third party litigation

Inherited contractual arrangements

NEXT PAGE →

## Inherited contractual arrangements

- A Buyer's legal due diligence exercise will also consider the target business' existing contracts, which in some cases may be unnecessary following the merger or prohibitively expensive.
- The Buyer will need to assess whether the terms of these agreements provide for them to be terminated: what are the notice provisions and what is the cost penalty (if any) of giving notice?
- If the terms of an agreement do not provide for its termination, a Buyer should consider alternative means: how likely is it that a supplier will bring a breach of contract claim against a Buyer that walks away from a contract, is there scope for negotiating more favourable terms or an early exit, possibly with a financial inducement for the other party?

> A thorough legal due diligence review of the target business is key in identifying potential problems in advance

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Board member differences over direction of travel

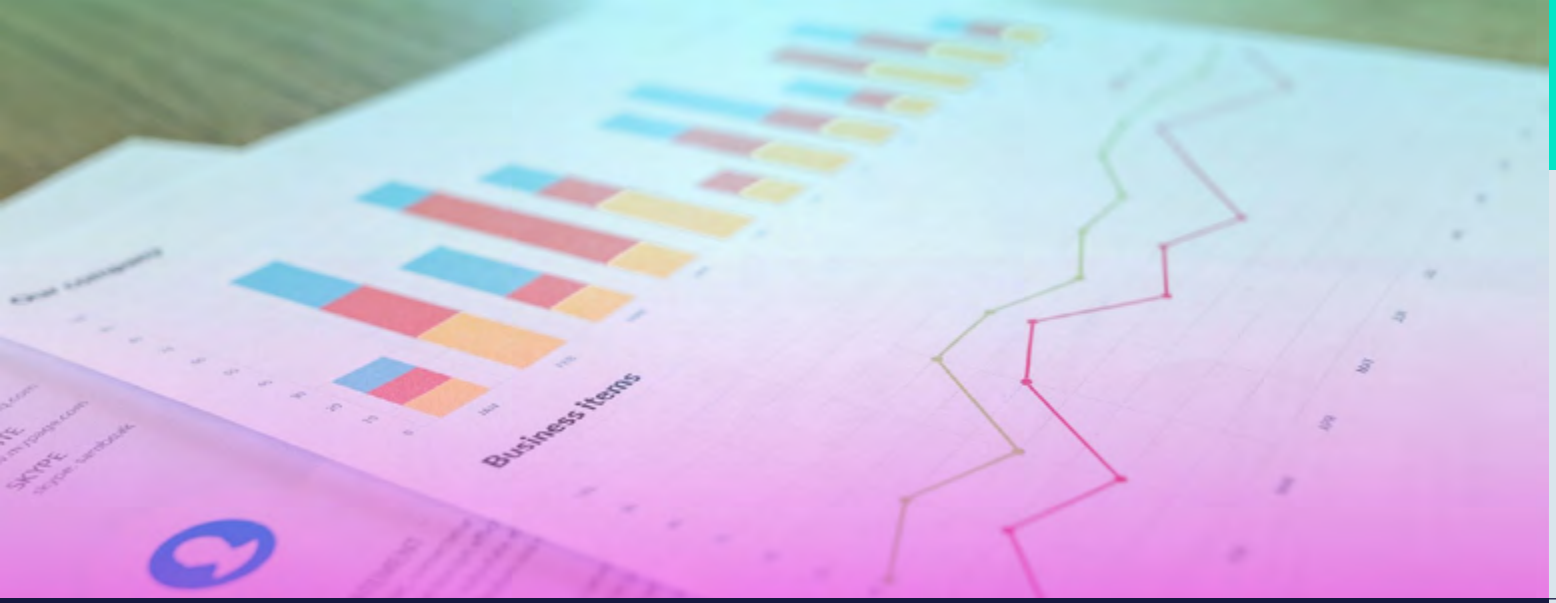
Disputes between current shareholders

Third party litigation

Inherited contractual arrangements

NEXT SECTION →

MAKE AN ENQUIRY →




# Fundraising

Some Buyers have sufficient cash to fund fully a business acquisition, either by a single payment to the Seller on completion of the acquisition, or by deferring part of the cash payment, the amount of which is often dependant on the future profitability of the acquired business (known as an earn out). The Seller may wish to have a continuing interest in the business sold, in which case they may accept payment by way of the issue of shares (equity) in a Buyer company.

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Considerations for listed companies

Considerations for private companies

Will the funder's due diligence identify legal problems?

NEXT PAGE →

← BACK TO DIAGRAM

## Considerations for listed companies

- Listed companies can raise money on the capital markets by issuing shares or debt instruments depending on market conditions.
- They can also offer new shares to the Seller as consideration.
- It may be necessary for the listed Buyer to convene a shareholders' meeting to authorise the issue of shares or the acquisition itself which will affect the timetable.

Listed companies can use their shares to raise funds or as consideration for a Buyer, but will be subject to greater public scrutiny than a private company

## In this section:

i click menu below to navigate

Considerations for listed companies

Considerations for private companies

Will the funder's due diligence identify legal problems?

NEXT PAGE →

← BACK TO DIAGRAM

## Considerations for private companies

- The Seller is unlikely to accept new shares in the Buyer as consideration, if the Buyer is a private company.
- If financing is obtained, it can be costly and the funder will require security (debenture, fixed charges etc.) which may be problematic, if existing security is already in place, and may require complicated priority or subordination arrangements.
- Private equity finance is likely to involve the Buyer surrendering a significant part of its equity and allowing the provider significant influence over the management of its business.

Private companies are more likely to require debt financing than listed companies

## In this section:

i click menu below to navigate

Considerations for listed companies

Considerations for private companies

Will the funder's due diligence identify legal problems?

NEXT PAGE →

## Will the funder's due diligence identify legal problems?

- A funder may wish to carry out financial and legal due diligence on the Buyer before providing finance to it.
- A provider of equity investment will require significant warranties in addition.
- A Buyer would be advised to carry out its own due diligence in advance to make sure there will be no legal or financial issues that would deter a funder.

The Buyer should anticipate a funder carrying out legal and financial due diligence on it and identify any potential problems in advance

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

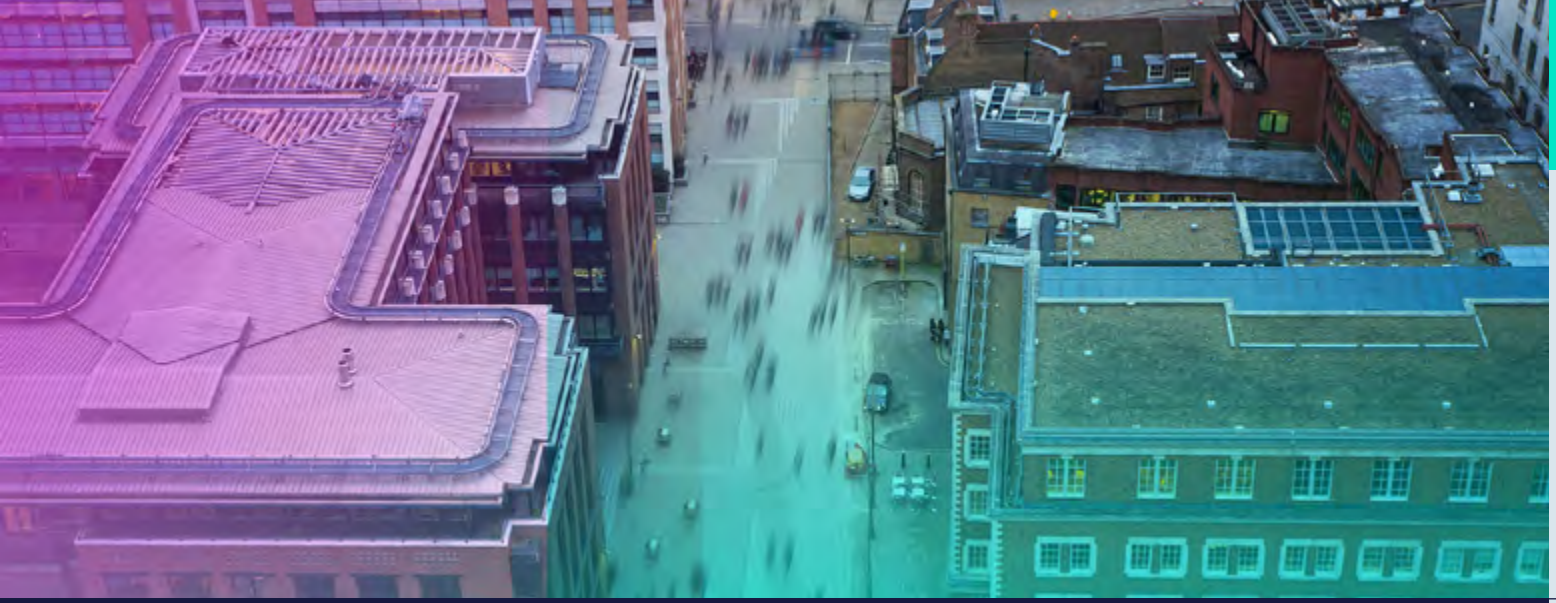
Considerations for listed companies

Considerations for private companies

Will the funder's due diligence identify legal problems?

NEXT SECTION →

MAKE AN ENQUIRY →



# Premises

The Covid pandemic has changed the way that most businesses think of their property usage and commitments. Nevertheless, nearly all businesses will want to continue to maintain a physical presence; the key is ensuring that is fit for purpose going forward.

← BACK TO DIAGRAM

## In this section:

i click menu below to navigate

Re-gearing of existing leases

Negotiating a new lease

Acquisition or disposal of a freehold property

NEXT PAGE →

← BACK TO DIAGRAM

## Re-gearing of existing leases

- Following an acquisition, a Buyer may be inheriting current leasehold obligations and may therefore wish to restructure their property commitments to make them more suitable for the needs of the newly expanded business.
- A Buyer could therefore look to negotiate a surrender. While in the current climate some landlords will be unwilling to engage, others may have development plans (or another tenant lined up) which would make them more amenable to surrender discussions.
- Depending on a Buyers' relative bargaining position, as the tenant, they may have to pay a premium to their landlord to "encourage" them to accept a surrender. A surrender will normally give a clean break from the premises.
- A Buyer may have a break right in a lease in the near future and will need to review their lease to see how much notice needs to be given (usually at least 6 months) and what conditions may be attached to exercising the break. We always recommend getting a solicitor to draft any break notice as this removes the risk of the break not being exercised properly and the lease inadvertently continuing beyond the break date.
- Another possibility is to let a lease expire. A Buyer will need to review the obligations in the lease around repairing, decorating and removing any alterations they have carried out. Particular care needs to be given to a potential liability for "dilapidations", in the event that the Buyer vacates the premises without carrying out their repair obligations. Dilapidations liabilities can run into hundred of thousands of pounds.
- If a Buyer wants to stay beyond the expiry of their lease term, we can advise on the implications of "holding over". This will in part turn on whether the lease is "inside" or "outside" the security of tenure provisions of the Landlord and Tenant Act 1954.
- Another possibility is to assign or underlet your premises.

## In this section:

i click menu below to navigate

Re-gearing of existing leases

Negotiating a new lease

Acquisition or disposal of a freehold property

NEXT PAGE →

← BACK TO DIAGRAM

## Negotiating a new lease

- As part of a Buyers' growth strategy, they may be considering taking on new premises. There are tactical considerations here and in the current climate, there will be possibilities to "drive a hard bargain" with a prospective landlord.
- If there is surplus of similar space on the market, a Buyer may be able to hold out for a shorter lease term, depending on their requirements. Or they may be able to insist on more favourable break provisions as a trade off for accepting a longer term than they would otherwise require.
- Alternatively a Buyer could insist on the landlord being unable to break the lease. That ensures they remain in control of their destiny.
- There will be other possibilities such as insisting on the lease having the protection of the Landlord and Tenant Act, which is not a "given". This means that at the expiry of the lease, the Act kicks in and there will be a degree of protection from eviction.
- A Buyer could also look to drive a hard bargain over "traditional" elements in lease negotiations such as rent holidays, not having to provide personal guarantees or imposing a "schedule of condition" in order to cut down on potential future dilapidations liabilities.
- Another consideration could be to demand an alternative rental arrangement. Some landlords may be prepared to contemplate a turnover rent as opposed to a market rent. Consideration will need to be given as to whether this could work favourably for the new expanded business.

> The major shift in the balance of negotiation power between most landlords and tenants are giving rise to some new and innovative approaches to lease arrangements

## In this section:

i click menu below to navigate

Re-gearing of existing leases

Negotiating a new lease

Acquisition or disposal of a freehold property

NEXT PAGE →

← BACK TO DIAGRAM

## Acquisition or disposal of a freehold property

- Of course it will not necessarily be the case that a Buyer will want to source further leasehold property. It may suit their purpose to acquire freehold property. While many of the negotiating points in relation to leases (see above) will (obviously) not apply, the weak bargaining position of some owners sitting on large portfolios will still give rise to opportunities for purchasers.
- Conversely, any restructuring of property commitments post acquisition may involve disposing of freehold property. If so consideration may need to be given to the tax implications of any disposal. Even if not going down the leasehold route, we will still be in a position to assist with freehold transactions.

Property liabilities remain a key issue for most businesses; now may be the time to review holdings

## In this section:

i click menu below to navigate

Re-gearing of existing leases

Negotiating a new lease

Acquisition or disposal of a freehold property

GET IN TOUCH →

# Contact

Every business has been faced with numerous challenges throughout the Covid pandemic, but opportunities for growth have also emerged. We would be happy to discuss how the issues highlighted within this document may impact your business, and we can assist you with implementing measures to support your future plans, maximise business performance and effectively navigate any obstacles that pose a risk to your growth.

For more information or to make an enquiry, please contact Nick Williams, Partner, by clicking the link below.

GET IN TOUCH

DMH Stallard

Brighton Gatwick Guildford Horsham London

DMH Stallard
Helping to shape your future

dmhstallard.com