DMH Stallard

Corporate Commentary

For any sale transaction, you will need legal and tax support, with many deals involving corporate finance

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EQUITY OR DEBT?

When the cost of borrowing is high (as now), growing businesses will look to equity investment, in order to finance working capital/growth. What should businesses consider, when looking at an equity fund raise?

'Crowd funding' was popular a few years ago, particularly for businesses with a strong image/link to consumers (drinks companies are the obvious example). The challenge is how to manage a large number of equity (share) investors. This requires a planned communications strategy, and a well-prepared, plain English investor pack. There are now some corporate "crowd finance" funds, which pool private money, and offer more structured facilities. Some of these also offer loans, and asset finance.

At the other end of the spectrum is the single/selected high net worth investor. Often these individuals bring experience and skills as well as money. Typically, this will be an experienced investor, who requires an investment agreement/ articles of association, to protect their interest. A non-executive board role is often included. While agencies can make introductions, it is advisable to have a personal connection.

As a general rule, debt or asset finance should always be considered before equity. Diluting equity means sharing future growth, generated through the entrepreneurial efforts of the founders. If an investor can accelerate growth, through industry, or other connections, equity should again be considered.

Before sharing equity, it is important to recognise and manage shareholder rights. Founders are no longer as free to make investment/decisions, or to pay themselves what they choose. The business has to be professional; no longer being able to operate as a 'lifestyle' business.

- If a founder wants to sell the business, can the investor refuse to sell, or renegotiate? A 'drag' right has to be added to the articles or shareholders agreement, to ensure control for the founder.

- Can the shares be recovered if an investor leaves the business? (non-executive director [NED], or employee).

Share options for staff are a popular way of offering a form of equity ownership, without issuing shares. The options can trigger/vest, on a qualifying event – often a sale of the business. A well drafted option will be cancelled if an employee leaves the business.

Equity investment can bring great benefits to businesses, but it should not be regarded as a simple, or risk-free option.

If you would like to discuss any of these themes further, please get in touch

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