Ashtons LEGAL

Guide To Scaling Up Your Emerging Business

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Introduction

We have produced this guide to give founders a high-level overview of the legal issues they might face when looking to scale up their business. It takes our cumulative experience of advising entrepreneurs and innovative businesses, whether just starting out or further down the line, and looks to simplify the complex, competing demands into the following topics:

Although we have aimed this guide at tech companies and those who operate in the digital space, it could equally apply to any high-growth business.

Our guide is linear but each stage is fluid and the life cycle of each business' journey will be different. We hope this helps steer you through some of the issues you are going to face.

Founders

Founders don't work alone. Most start-ups are usually collaborations of some kind, whether the founders contribute the ideas, money, or facilities for the business.

But with the best will in the world, conflict happens and we spend lots of time resolving disagreements between business founders.

Although some of these disputes can't be foreseen, you can go a long way to avoiding them by having these kinds of discussions with your business partners when you set up your new venture together in order help achieve maximum success in the future:

- **Agree an initial strategy** – it's essential that founders understand their roles in the business and agree in broad terms about the direction of intended travel. This is the time to fully set out your vision for the company otherwise you risk working together under false pretences and disagreeing when the business is up and running, which is harder to deal with.

- **Appoint advisors** – successful businesses tend to share a few key characteristics, one being that they value input from their trusted advisors. Find lawyers and accountants who understand the sector you work in and have experience of the issues you are likely to encounter.

- **Have agreements** – once you understand your roles and contributions, write it down. Each business will need different documents, but most will usually need something to cover IP, equity, decision making and breaking deadlocks, directors service contracts and employee contracts. Although lots of start ups can be put off by the perceived cost of committing these agreements to writing, in our experience they are crucial, not least of all because at some point you will want to be able to enforce your rights, and you won't be able to if you don't have them clearly set out; think of these agreements as an investment that will pay dividends down the line when you inevitably need to fall back on them.

Incentives

Good staff can be hard to find, so they say, meaning that attracting and keeping the best talent can be a real challenge for founders especially in the hyper-competitive world of tech.

As a rule of thumb, salaries in tech jobs are usually higher than in other industries, and that can be hard to keep up with particularly when cash is tight in the beginning. For these reasons cash-poor start-ups often provide their staff with some kind of further incentive, usually participation in a share scheme of some kind, although the nature and complexity of the incentive can vary massively depending on the founders' plans.

Any incentive will undoubtedly help the founders attract staff in the first place, but well thought-out plans will go further and help retain and motivate key staff when their continued commitment is crucial to the growth of the business. Other reasons to implement a share scheme could be to reduce employment costs through valuable tax reliefs or plan for an exit or succession.

Each business needs to carefully consider which type of incentive is right for them, but some of the most common examples of incentives that we see and advise founders about are:

- **Enterprise management incentives** – generally EMI schemes are very flexible and the terms of an EMI scheme can be drafted to meet the company's individual needs and objectives. The company and the employee will benefit from tax relief on the grant and exercise of the option.
- **Growth shares** – growth shares, also known as value or hurdle shares, are special, restricted shares that let employees participate in post-acquisition increases in the value of the company. The employee subscribes for their shares at the outset, meaning they will pay CGT on the growth in value rather than income tax and NICs on the exercise of a normal option. Although they are usually designed to be tax-efficient, growth shares are not currently governed by statute and their tax treatment may be open to challenge or different tax rates in the future.
- **Unapproved share option schemes** – if the company is not eligible for EMI or one of the other approved schemes but still wants to grant some options for its employees, unapproved options are a way to do so. Because they are unapproved, there are no rules about how they must be structured and so they can be completely flexible and very attractive if the founders and the staff accept that there is no tax advantage.

Investment

Congratulations! You've launched your product or its MVP and you're now generating interest from investors who are all keen to give you some of their money ...

Depending on your long-term plans, taking some external investment can be a very useful way to get substantial working capital into the business and really start scaling up. Investment opportunities can present themselves more or less at any time, and reasons for accepting or declining them will change with time as well.

Some founders take the decision to bootstrap their start-up and while that can sometimes mean it is harder to achieve explosive growth, particularly in the short term, it also means that they will retain full control over the company so it's a good and valid option for some people.

There's more than one type of investor to fundraise from. Below are some of the types that we normally see, and some of their key characteristics:

- **Friends and family** – lots of founders approach their close friends and family first of all, because they are often best placed to put in some initial pre-seed money. Although everyone is typically more relaxed in this kind of investment, we would always recommend some form of investment agreement or documentation, not least of all because you may need to formally deal with them in the future.

- **Angel investors** – high net worth individuals are a valuable source of investment, knowledge, and new connections. They are usually willing to get involved before venture capital or private equity, but you need to be mindful of letting one or two people leverage significant control over your business.

- **Accelerators & incubators** – these are programmes and working spaces that can give founders money, advice, knowledge or a combination of all of them, usually in return for some equity. Founders can cultivate their ideas and usually get the opportunity to pitch to other investors as well.

- **Crowd funding** – peer to peer lending is increasingly popular, largely because the main providers market their platforms as stand-alone, remote services with legal and regulatory taken care of. Our view is that while that may be partially true, advice should be taken alongside the platform's standard approach to make sure the round fits in with the company's other rounds and future plans.

- **Venture capital & private equity** – these investors usually arrive once the business is well established and has a good share of its current market; the money they put in is significant and normally helps to reach new markets. However, the conditions are usually the toughest sought by any of the investors, they will want substantial equity in return for their money, and they have to be paid back before anyone else.

Expansion

You might also have to think about whether scaling up is right for you and your business, and if it is, how you go about it.

The aim of most founders is to scale up and expand at some point. Buoyed by the success of tech companies who have rapidly expanded in the public glare, there are plenty of others who want to emulate them and grow as quickly as possible. In our experience, that's a luxury for just a handful of very high profile companies where their products are completely ubiquitous, and the real most important aspect to think about is identifying the right opportunity to expand.

As well as the commercial and legal issues behind expanding, it is critical that founders also think about their personal goals and what they want to achieve, and whether these will be met by expanding.

Organic v spontaneous growth

- **Organic, planned growth:** where possible, growth would be planned and easily accommodated. Your products, systems and brands would all be capable of moving to the next level of your market or to a brand new market altogether. For example you would have considered your differentiating factors and how they feed into product development for the new market; your employees and whether they will be retained for the next level; your supply chain, infrastructure and capacity to take on more clients, or whether you need to outsource some functions.

- **Spontaneous, unplanned growth:** when growth is more opportunistic, it can lead to the same possibilities but can also cause you problems with its uncontrolled nature. Is your business capable of withstanding fluctuations? Does it have the cash to safely expand without compromising pre-existing trade? Do you have the necessary licences, permits and authority to operate in a new market? If not, how can you quickly fix this?

Exits

You have managed to successfully steer through launching your business, expanding its markets, transitioning from doing every role in the company to managing and delegating to other people, dealing with (or removing) your seed investors, and bending over backwards to satisfy your VC investors. It might be time for a well-earned break.

Selling your business can be seen in many ways as the culmination of all your efforts, the end of your journey, and when you get to take out the value you have put in during your journey. Sometimes an exit is part of a well thought out and executed business plan, but a lot of the time exits are have a degree of spontaneity and clients aren't always geared up to deal with the exit process. These are our tips to avoid missing out on an exit because of lack of preparation.

- **Have exits on the agenda.** This doesn't necessarily mean actively marketing your business from the first day, but you should at least be aware of the possibilities and how you can position your business to prepare for an exit. As we said at the start, "Agree an initial strategy," including how and when you might want to exit.

- **What do buyers want to see?** Put yourself in a buyer's shoes – what are they going to look for in your business during due diligence? It's crucial to make sure that your business has all of its ducks in a row, because any defects can be used to chip away at the price you think you had negotiated, or in the worst case where there is a fundamental problem with key assets like your IP, the buyer may want to pull out. It's usually incredibly hard and expensive to address these problems in the middle of due diligence, so you need to be proactive and continually review and secure ownership of your assets.

- **The exit may not be the end.** Data shows that in a majority of sales, the outgoing founders stay involved in the business in some capacity because buyers want to understand all of the unspecific know-how that can't be written down or easily disseminated. It is also quite normal for a buyer to want an element of deferred payments or earn-out, meaning that you might need to prepare to stay on in some capacity during that time.

How Can We Help?

Please get in touch with one of our technology and information law experts if you have any questions about your business or your role in it – see the team overleaf.

Ashtons is a top ranked technology and information law firm who act for businesses in East Anglia, nationally, and internationally. We have the legal and commercial experience to guide you and help make your technology business a success, whether you are a start-up developing your first product or service or incentivising your staff, a tech-enabled business buying solutions to improve efficiency, or a founder planning your exit.

We are recognised as leading experts in the IT and Telecoms and Corporate and Commercial sectors by the Legal 500, the independent legal industry commentator.

Our clients are innovative and entrepreneurial. Our aim is to be their valued advisor – we want to know you and your business. We focus closely on clients' objectives and establish ongoing and close relationships that add value to their businesses.

We provide the full range of advice that clients in the tech sector need, and you can find examples of some of our recent work and client testimonials on our dedicated technology website page at

https://www.ashtonslegal.co.uk/sectors/technology/

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Client Testimonials

"The Ashtons Legal practice is one of the few exceptions, in my experience, with their partner James Tarling leading a team that specialises in helping innovative companies such as ours to grow and safely manage the many legal questions that inevitably arise"

Will Temple, CEO, Medical Management Systems

"Ashtons have the most amazing ability to listen, clarify where required and understand complex requirements. They can then take this information and craft appropriate and readable legal documentation that satisfies both ubisend and our enterprise clients"

Dean Withey, CEO, ubisend

"I can't recommend Ashtons enough. The process was new to me, and James, David and Jessica have not only provided all the robust legal advice I needed to protect my position, but have also always been available at the end of the phone or email to answer my questions or concerns"

Joe Fogel, founder of Vaiopak

Our Team

Our business law group is made up of lawyers specialising in commercial legal issues, employment law, disputes and litigation, corporate deals and investments, and estate planning for founders.

Get in touch with our main technology contacts, below, so that they can point you in the right direction to the expert advice you need.

Key technology contacts

James Tarling (Partner)

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James helps innovative technology companies grow and develop their businesses. He has a wealth of experience in leading corporate transactions and investments for such clients and guiding businesses through complex intellectual property, data protection and privacy issues. Clients value James' ability to find practical solutions to complex legal issues. James and his team assist businesses from early stage start ups through to established international technology businesses in particular those working in the US.

David Sloman (Associate)

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David specialises in advising businesses on technology and information law. He works closely with businesses over long periods to help structure and manage their commercial relationships to achieve their objectives. In particular he helps businesses to licence, use, buy and sell technology and steers them through regulatory frameworks such data protection laws. He has particular interest in advising innovative, high-growth start-ups get going and scale up through creating the right business structure, exploiting their technology, taking on investment, and growing organically.

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